

Chapter 7: Can Advertising Revenues Support the Net?

Although not originally envisioned, there has been a movement away from subscription revenues and toward pure advertising as the basis for supporting many Internet web sites. This business model, mimicking over-the-air television, has many flaws that will become apparent as this market matures. Subscriptions are going to come back and will be required for most sites to support their content.

The online world was originally a subscription-based world. Users of the leading online services, CompuServe, Genie, and AOL, did not encounter advertising to any real extent. Users paid their fixed monthly fee, which usually included 5 or so hours of use, any additional charges brought about by usage of the system which exceeded the 5 hour limit, and sometimes additional fees for using a portion of the service that was considered a *premium* area, such as getting old newspaper stories. This was how online services generated their revenues. There was very little advertising.

The exception to this story was Prodigy. This service, jointly owned by Sears and IBM, was ahead of its time. Unlike the others, it charged a flat monthly rate for unlimited connection time during the early and mid 1990s. Prodigy also had notoriously ugly graphical advertisements scattered throughout its site. The advertisements and the other aspects of the site were the object of scorn among more knowledgeable computer users who often mocked the novice users attracted to Prodigy. Nevertheless, thanks to its flat fee structure, Prodigy became the leading online service in the mid 1990s.

By including advertising and removing hourly fees, two trends that were later adopted by all the online services Prodigy showed itself to be ahead of its time. But it was too far ahead.. But although Prodigy achieved the highest market share, it was not profitable. Therefore its owners decided to switch to a price scheme similar to its competitors.

With its pricing advantage gone, consumers rapidly shifted their allegiances, and the primary winner was the online service that had been winning the majority of independent reviews—AOL.⁵² A few years later all the major online services, led by AOL, began charging a flat monthly fee for unlimited usage, and also began putting more advertising on their sites.

With the advent of the Internet, many web sites tried to emulate the early model used by the online services—a subscription-based model. The

⁵² For a history of these online services, including product reviews, see WLM, chapter X.

Wall Street Journal, Slate Magazine, ESPN Sports, and others attempted to charge users for accessing the material in their site. This was not to last, however.

Perhaps wishing to keep information from feeling bad or claustrophobic, since pundits such as Kevin Kelly argued that information *wanted* to be free, many Internet sites decided to forgo subscription revenues.

Apparently succumbing to the will of freedom hungry information, the route that these Internet sites took was one that is quite familiar to anyone who has watched broadcast television, which is just about everyone. That route is one that tries to maximize audience size so as to maximize advertising revenues.

Currently, the market appears to have rejected subscription fees, since many content providers that had tried subscription fees (Slate, TheStreet, Microsoft Investor) have reverted to covering their costs through advertising revenues alone. The co-founder of TheStreet, a stock market site, is quoted as saying "Going free for news is a must if we are to compete world-wide for readers."⁵³

Yahoo lead the way in giving away information to maximize audience and advertising revenues. A consumer going to its web site could get free news, including sports and business news. That is something that had previously cost money. Yahoo was paying for this service, but giving it away. A consumer going to its site could also get free stock market quotes and stock market research tools. These also had previously cost consumers money. Consumers could get free email. Free instant messaging. Free online communities. Free maps.

Yahoo, following this pure advertising model, became one of the great success stories. Its market capitalization grew like Jack's Beanstalk, reaching just north of \$200 billion in January of 2000. As a comparison, Viacom purchased CBS Inc for \$35 billion in the fall of 1999 and Walt Disney, a firm that has much more than its ownership of ABC, had a market capitalization of \$70 billion at that time.⁵⁴ So in principle, Yahoo could have purchased all three television networks and had change left over. As crazy as this value for Yahoo was, these values were based entirely on an advertising based model. I lost a lot of money betting that Yahoo was overpriced during the large runup in its price. Although its later decline was a victory of sense over nonsense, it

⁵³ For example see: *Online Publisher TheStreet.com Plans to Drop Fees for Main Site*, An Interactive Journal News Roundup January 10, 2000.

⁵⁴ See http://204.202.137.115/sections/business/DailyNews/cbs_viacom_chronology_990907.html

provided me with little more than some small satisfaction that in no way balanced my losses incurred as the stock rode upward.⁵⁵

Many other firms adopted the Yahoo model and gave away lots of services for free. Free web hosting. Free backup space. Free message boards. Free income tax software. Even free Internet access and free computers.⁵⁶ Open an online brokerage account and you got paid \$400 (Etrade). Information must have been very happy with all this freedom.⁵⁷ In fact, many web sites charged *negative* prices, meaning that they were paying consumers to come to their web sites, through promotions and giveaways.⁵⁸

But an advertising based model never made sense, and never was going to generate sufficient value for all the Internet sites that intended to use it as their sole source of revenues. alone is a good economic model and can support numerous Internet sites is **myth number 4**.

A. The inadequacy of the television model

Neither the pure subscription nor pure advertising model makes as much sense as a hybrid model combining both subscriptions and advertising. Migrating the television model to the Internet seemed to make sense since both were expected to be mass mediums attracting large numbers of eyeballs.

But the mistake that was made was the opposite of the problem that sellers of online groceries made. Online grocers had too *little* regard for the habits and customs that had evolved slowly over time in competitive marketplace. In the case of using advertising as sole support of content, the television model was accorded too *much* respect.

The television-advertising model is not one that had survived brutal competition with competitive alternatives. No doubt, television advertising was and is big business. At one time, ownership of a television station was considered tantamount to being given the ability to print money, which is a testament to how profitable television was. But the profitability did not come from the superiority of its revenue model. Instead, it came from the fact that television was an industry with limited entry. Creation and ownership of television stations was restricted by the government and the limitations in

⁵⁵ As I write this, Yahoo has a market capitalization of approximately \$10 billion, which still seems rather lofty to me.

⁵⁶ Juno, among others, gave away free Internet service. Xx gave away free computers. TurboTax provided free software if you used its web site instead of putting the software on your personal computer.

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⁵⁸ See for example, "The great Net giveaway gimmick: Call it promotion. Call it bribery. Increasingly, Web sites are using sweepstakes to attract an audience. Is the tactic working?" Jennifer Mack, ZDNet News, October 24, 1999 2:21 PM PT.

the available television frequency spectrum. The result was that the number of licenses granted was far less than the level that might have reduced the profitability of television stations to a more normal level.⁵⁹

More importantly, television stations did not have the option of using other models of revenue generation. Over-the-air broadcasts were available to anyone with an antenna and a television, making it impossible for television broadcasters to charge viewers, even if the broadcasters had wanted to use a subscription based revenue model.⁶⁰

Advertising based television, although a successful business, could not credit its success to its revenue generation model. There was no Darwinian selection of the fittest. At least not until cable television entered the scene. Cable television, which is a hybrid of advertising and subscription, provides a degree of competition between different revenue models. And cable is at a disadvantage because not as many homes are passed by cable as are passed by some broadcast signals. The current competition allows television viewers and the market to choose between different models. I do not believe that the final verdict is in, although I have elsewhere predicted that broadcast television would eventually lose its lead over cable due to cable's superior revenue generation possibilities.⁶¹ I still believe that over-the-air broadcasters are doomed to eventually showing little more than old reruns, something of a role-reversal from the traditional relationship between cable and over-the-air broadcasters, because of over-the-air broadcasters' reliance on an inferior revenue model.

****advertising revenues per capita??****

⁵⁹ This is a very well accepted view of economists who have looked at the sale of television licenses. In general, a piece of paper, otherwise known as a license, will not have a positive price if it merely allows the owner to participate in a market that is fully competitive. That is because a competitive market is one such that potential entrants are deterred from entering because the likely return on their investment in the industry is no higher than the return they can get in other investment activities. Think of it this way. Assume that all the banks in your city were paying interest of 5% on checking accounts. A new bank opens up and requires that you pay a yearly license fee to join the bank and earn the right get 5% on your checking account. No consumers would pay the yearly fee. If the bank, on the other hand, were to pay 8%, 3% above market, then it could charge a license fee that consumers would be willing to pay.

⁶⁰ If the government had altered the laws somewhat this might not have been so. In England, potential viewers were not allowed to view television programs without paying yearly license fee. This was awkwardly enforced by using trucks with electronic eavesdropping devices that attempted to ferret out users who were watching television and not paying their license fees.

⁶¹ In a report conducted for CBS in 1990, I predicted that cable networks would overtake over-the-air broadcasters in terms of quality of programming, due to their superior revenue generating ability. Specifically, I argued that over-the-air broadcasters would eventually show old reruns and the quality original programming would appear on cable networks, the reverse of what was then the standard. We have come a long way toward that prediction, with more and more first run programming appearing on cable (e.g., the Sopranos) and over-the-air broadcasters losing more and more market share.

A somewhat different market which has allowed various revenue-generation models to compete in a Darwinian fashion is the magazine and newspaper market. Magazines could be entirely subscription based, or entirely advertising based, or a hybrid of the two. Any casual examination of this market clearly reveals that it is the hybrid model that dominates in this market.

A combination of subscription and advertising revenues seems likely to replace pure advertising as the revenue model on the Internet because a dual revenue system has many advantages. Except for the television market, which is constrained, it is hard to find any other markets choose to survive entirely on advertising alone. And as I have stated before, the past provides important information about the future. Always.

B. Advertising effectiveness on the Internet.

It is also unlikely that advertising revenues could be sufficient to support all the sites counting on it. First, the audience (measured in total viewing-hours) is not large compared to television, nor is it likely to be terribly large until television migrates to the net. Current estimates of time spent on the web averages 30 minutes per day for the average user compared to 4 hours for television viewing, and many more individuals watch television than use the Internet.

Second, Internet advertising will remain less effective than television advertising as long as it remains so easy to avoid. If it becomes intrusive, in other words, not allowing the Internet user to move forward until the advertisement is viewed, there will likely be a backlash from users. But this intrusiveness is required to make the advertising more effective for those users who remain to encounter it.

Third, advertising budgets are not terribly malleable, and Internet advertising will have to come largely at the expense of other media. Taking away share from other media will become increasingly difficult. Although Internet advertising is very good at segmenting the population according to tastes, these 'narrowcast' messages will be insufficient to support mainstream content.

Let's take these points one at a time.

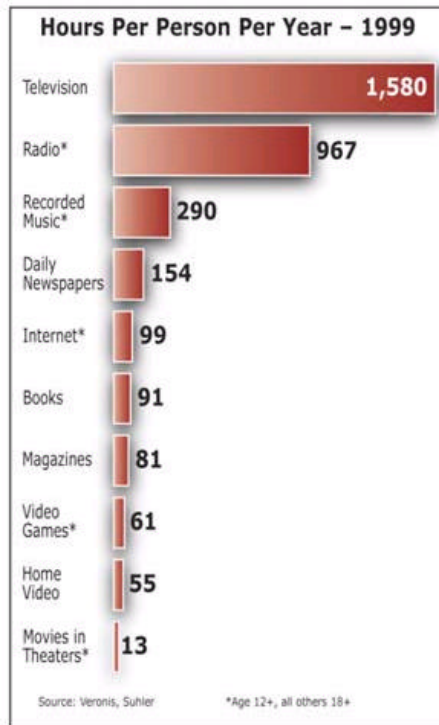
i. Size of Audience

Television is a passive form of entertainment and is by the far the leading recreational activity among Americans. The typical household spends over 7 hours a day watching television and adults watch approximately 4.5

hours each in front of the set.⁶² Televisions are virtually ubiquitous in the United States, with households more likely to have televisions than telephones. Another leading recreational activity is listening to music, often on the radio, and this too is a passive activity.

The Internet has been very successful in drawing many users into more activities that are not passive, or are at least far less passive. It is unclear that these activities will permeate society the way television viewing has. Further, many households and individuals do not own computers, and are unlikely to find a computer a particularly compelling purchase. Non-computer Internet devices have been duds in the market, and are likely to remain so until and unless streaming video and music are able to replace television and radio. This is not about to happen anytime soon.

The average time spent by Americans on various activities is represented in the following chart.



Clearly, the Internet has a long way to go before it can be considered in the same league as radio or television. The only non-passive activities on the list are video games and the Internet. Recorded music and home video at

⁶² The number in 2000 was 7 hours and 35 minutes. See Nielsen media research, found on the TVB web site: www.TVB.org

least require that the user chooses the CDs or tapes, but this is hardly more active than changing a channel with a remote control device.

Now it is true that other non-passive leisure activities, such as sports participation are not listed here, but these activities would also be dwarfed by television viewing.

ii. Advertising Effectiveness on the Net

One of the reasons that television advertising has been effective is that it is very difficult to avoid. Television advertisements are strategically placed to maximize the likelihood that viewers are engrossed in the programming and will thus be most likely to see the advertisement. These advertisements are often placed just before an important point in the program. Viewers who change channels or leave the room do so at their peril, for they may misjudge the time and miss the denouement of the program they have been watching for the last 50 minutes.

Television viewers are used to these intrusions and understand that they are a necessary evil to see the free programming. Internet users are not used to it and it is unclear what they would do if advertisements on the Internet were to mimic their television brethren. Understand what that would mean. To effectively mimic the television does it, Internet advertisements would take over the entire screen for a minute or two and prevent the user from doing anything else on the Internet (computer). It is unclear whether this is even technologically feasible. There are some programs that require that an advertisement is always present, but this is not the same as prevent other uses of the computer. (it is hard to imagine how a program could take over the entire computer and I am not sure if there is any way to control the browser to keep the user from moving forward.

A more recent style of advertisement that has generated a great deal of press are 'pop-under' advertisements, with the most well-known being the little X-10 hidden camera, that, if you can believe the innuendo in the advertising, would allow the purchaser to take pictures of naked young women in the shower if only he can find a shower so populated. This advertisement appears in a new window that pops up behind the main browser window. There are mixed opinions about the effectiveness of these advertisements, with some claiming that the level of annoyance is such that it will be harmful to the advertiser.⁶³ In fact, this more intrusive level of advertising is more like television.

⁶³ "Pop-Under Web Ads May Backfire, Says Jupiter" Reuters, Jul 26, 2001 at: <http://www.thestandard.com/article/0,1902,28294,00.html>

Pop-under advertising is still far less intrusive than pop-over, or multiple pop-overs. Anyone who has accidentally encountered an Internet porn or warez site (and who reading this book would admit to going intentionally?) has seen a form of advertising that is extremely difficult to get rid of. Numerous windows open up all over the screen, each advertising a different site. Attempts to close these Windows often lead to new Windows popping up on the page. You practically have to fight with your PC to get control over the screen. This very annoying advertising is an example of what Internet advertisers could do if they really wanted to make sure the user was unable to avoid the advertisements. Porn advertisers apparently believe that such advertising provide more benefit than harm. I suspect other advertisers will follow their lead, without being quite so aggressive.

Currently, however, advertisements on most web sites are still largely of the fixed banner advertisement variety. Click-through rates, the general form of measurement have been falling fairly steadily over the last few years, evidence that banner advertising is not very effective at driving traffic to web sites.⁶⁴ Click-throughs are measured as the percentage of individuals who actually click on a banner advertisement when visiting a web page containing a banner ad.

Clicks Are Not Clicking

The declining trend of click through rates, despite a slight increase in June, shows the diminishing popularity of Web ads with many consumers.



* Impressions are the total number of times a banner has been served to the Web population.

Source: Nielsen//NetRatings

The Internet Advertising Bureau has argued, contrary to what I have suggested above, that banner advertisements are indeed very effective at altering consumer perceptions and increasing sales, and that click-through rates are irrelevant. These results are contained in a study performed in 1997

⁶⁴ The decline in click-through rates is well documented. See for example the “Reality Bytes” column in the July 23, 2001 Wall Street Journal from which the chart is taken.

(jointly with Millward Brown Interactive) that appears scientifically rigorous.⁶⁵

I just do not believe its results. They report that web surfers enjoyed banner advertising, with 26% of respondents stating that it was “great.” They also report that web surfers formed a more favorable opinion of a company if it advertised on the web than if it didn’t. Why would they have this opinion, except if they thought of web advertisers as partners helping to make their surfing possible and providing the funds for the low prices and giveaways that was the characteristic of early of Internet commerce.

I think it is difficult to imagine television viewers harboring similar views of television advertisers, because viewers have no doubt about the survival of the medium. In 1997 when web advertising was still in its infancy, and the future of the web was unclear, web surfers might have been protective of its future, but I have trouble believing that most Internet users these days believe the advertising on the web says very much about the firm doing it, or that it is “great” to have. Additionally, I believe there is a flaw in the experimental design that plays to this early audience’s interest in trying to promote advertising on the web.

In the main experimental component of the study, surfers were exposed to a single banner advertisement, while the web users were supposedly unaware that there was anything unusual about this one experimental banner advertisement. These users were then asked a series of questions about the advertisement at differing time periods up to a week after the exposure. Respondents reported considerable awareness from this one exposure with little change in their extra awareness even a week later. I find this just too incredible to believe. What is not known from the experimental design is whether web users were on extra alert when the experimental web banner was served to them.

Little details are crucial in this experimental design. When users at particular sites clicked on a banner for ‘celebrity news’ some users were randomly selected and asked to fill out a demographic survey. Were there any hints in the survey that an experiment having to do with advertising might be taking place? The report doesn’t make it clear, although it would be useful to know. After completing the survey, users were then fed the celebrity information page they had requested, and this page contained either a control banner advertisement or an experimental banner advertisement.

⁶⁵ See their 1997 Online Advertising Effectiveness Study which argues that banner advertising is just the cat’s meow. It can be found at: <http://www.mbinteractive.com/site/iab/study.html>

It would have been a better design to ask the respondents to fill out the survey *after* they had seen the page with experimental or control banner ads. That way their behavior toward the ads could not have been possibly tainted by the survey. This problem may well be responsible for the surveys findings, which I find very counter-intuitive.

Even so, the study's authors conclude that Internet advertisements are slightly more effective than television advertising (20%) although somewhat less effective than printed media. The Internet-TV differential is small enough that my later assumption that the two mediums are the same may not be inconsistent with their findings.⁶⁶

iii. Advertising budgets

Advertising effectiveness has long been one of the mysteries of business. It is quite clear that advertisers do not have a very good idea of how effective their advertising is in creating additional sales. This was forcefully driven home several years ago when 'people-meters' were first introduced.

People-meters are devices that can measure how many individuals are watching a program and for how long without any input on the part of the user. The typical audience measuring device had been surveys that random viewers were sent. When the results of people-meters and surveys were compared, it was determined that people-meters registered a smaller audience than did surveys.

The major television networks objected to the use of people-meters, fearful that the smaller measured audience would lead to a decline in advertising revenues. And major advertisers indicated that if the television audience were smaller than they had previously thought, they would lower their advertising expenditures on television.⁶⁷

Even if there was unanimity that people-meters correctly indicated that television audiences were smaller than previously thought, however, it would be irrelevant for advertising expenditures *if advertisers had some good idea of how effective their advertising was*. The logic is simple and compelling.

Assume an advertiser plans to purchase a 1 minute television spot on a program such as ER. How much should he pay? The answer is that he should

⁶⁶ Of course, they are comparing a single banner advertisement to a single television advertisement, whereas I suggest comparing a man-hour of usage on each media. This makes it very difficult to compare the two metrics.

⁶⁷ April 21, 1991, The Newsday Magazine; Pg. 8, "Trouble in Nielsenland; TV shows live or die by their Nielsen ratings, but television executives dispute their accuracy. At stake: billions of dollars in ad revenues" Adam Snyder.

determine the extra profits that are generated by the additional sales brought about by the advertising and this should be the maximum amount that should be paid.⁶⁸ If advertisers were aware of the actual impact of their advertising, the size of the audience would be irrelevant.

The people-meter doesn't change the size of the *real* audience, only the size of the *measured* audience. If advertising expenditures were based upon the known effectiveness of advertising, switching to people-meters would be irrelevant. Even if advertising budgets were based upon rules-of-thumb having to do with measured audience size, all the rules would still hold based on the old measurements that were used to derive those rules, and the switch to people-meters would have merely required revising the rules, not the advertising budgets. Therefore, the brouhaha over the introduction of people meters is itself evidence that advertising budgets are not based on actual effectiveness.

Advertisers, therefore, operate largely in the dark with little in the way of hard data about how effective their advertising is.

C. Positive aspects of Internet advertising

One area where Internet advertising will shine is classified advertising, a very large advertising market of approximately \$18 billion.⁶⁹ As discussed in Chapter 4: The (Non) Ubiquity of E-tailing? C.ii, classified advertising has large network effects and is a perfect form of advertising for the Internet. Ebay can be thought of as the mother of these sites but other specialized sites such as Hotjobs.com or Monster.com work the same way.⁷⁰

Of course, whether consumers find the electronic version of classifieds easier to use is a function of their connection speed and the website setup. Also, local classified ads tend, at the moment, to favor print newspapers since the large number of non-Internet users tend to give newspaper classifieds greater network effects than online classifieds might have. National classifieds (e.g., high end employment possibilities) are likely to migrate before local classifieds.

⁶⁸ Somewhat more precisely, the advertiser should compare extra revenues net of variable costs, what economists call 'quasi-rents'. This would be approximated by EBID, earnings before interest and depreciation.

⁶⁹ Newspaper advertising revenue is in the vicinity of \$50 billion and classified advertisements are estimated to be 33-40% of revenues.

⁷⁰ Nevertheless, it is claimed that so far there is no diminution in newspaper classified revenues. In two studies, newspapers reported that their classified web sites did not reduce their off-line classified advertising revenues. This ignores the impact of outside sites, however. This was reported in *Newspapers and Technology*, June 2001, "Are newspapers losing revenue to online sites? Not yet," by Peter Zollman. See http://www.newsandtech.com/issues/2001/06-01/ot/06-01_zollman.htm

Internet advertising, of the banner variety, does have some other advantages over other mediums such as television, radio or magazines. One very important advantage, which Internet advertising sellers are now trying to downplay is the immediate feedback of advertising effectiveness through the measurement of 'click-through' rates. Unlike other advertisements, banner advertisements don't just sit there. They are not completely passive. Banner advertisements actually do something when you click on them. This allows advertisers to gauge whether the audience is interested enough to actually follow through and try to get additional information. This is a very useful tool for advertisers.

The Internet Advertising Bureau, however, argues that click-through rates are unimportant. They argued this in 1997 when click through rates were still high. They and others argue it even more forcefully now, since click-through rates have fallen from above 5% in 1995 to under .5% now.⁷¹

Another advantage of Internet advertising is its fine slicing and dicing of the audience, allowing great segmentation and placement of ads catering to very narrow, specifically targeted groups. Magazines have a similar sort of targeting, since they too appeal to very specific audiences. Television, radio, and newspapers, however, are not well suited to targeted advertising. The Internet is probably more finely subdivided than even magazines, since web pages are far more numerous than are magazines, so that in principle, the Internet is the king of targeting. The only problem is that these very small, very focused sites are not likely to have sophisticated advertising personnel, and advertisers may not find it as simple to place ads where they want as is true for other, more professional, media. This is a problem that plagued cable television networks for years.

D. Advertising Revenues on the Internet

It is difficult to know with any precision what the advertising revenues on the Internet are going to be. Nevertheless, given how effective one believes that Internet advertising is going to be versus, say, television, it is possible to put some benchmark estimates in place.⁷²

Let's start with the television market. According to the Television Bureau of Advertising, total advertising revenue for cable and broadcast

⁷¹ In "Are Click-Through Rates Really Declining?" Jim Meskauskas claims that the rates were about 5% in 1997 and have fallen to about .5% recently. See Internet.com, January 16, 2001, at: <http://clickz.com/cgi-bin/gt/article.html?article=3179> Also, "Three years on: ad and click-through rates decline" Online publishing news, February 24, 2000. See <http://www.onlinepublishingnews.com/htm/n20000224a.htm>

⁷² Note that these are advertisements by typical advertisers, not classified advertisements which I expect the Internet to dominate at some point.

television was approximately \$50 billion in 1999. What kind of comparisons can be made between television and the Internet?

First, we can examine the cost to an advertiser of an hour of the putative viewer's time. This is a somewhat unusual metric for comparing media, but one that I think can be informative.

	Cost Per Hour of Activity	
	Television	Internet
1. Hours Viewing Media per Day	4	0.5
2. Size of Audience	265,000,000	132,500,000.0
3. Viewer-Hours per Day	1,060,000,000	66,250,000
4. Viewer-Hours per Year	#####	24,181,250,000
5. Advertising Revenue	#####	\$3,110,000,000
6. Price per Viewer-Hour	\$0.129	\$0.129

The first row of the table lists the average viewing time per user of the medium, about 4 hours for television and half an hour for Internet use. The second column provides data for television and the third column provides data for the Internet. All the numbers for television are actual current values. Some of the later numbers in the Internet column are hypotheticals intended to make a point.

The second row provides the number of users, which is just about everyone for television, and about half the population for the Internet.⁷³ By multiplying the number of users by the number of hours per user we arrive at the number of man-hours per day, in row 3. Row 4 multiplies this by 365 to get the yearly number of man-hours spent using each medium. Row 5 list the advertising revenues for television, but not the actual revenues for the internet.⁷⁴

The real question is whether the advertising value of an hour's contact with an Internet user is worth more or less than the value an hour's contact with a television viewer. Television viewers are normally exposed to 12 to 15 minutes of commercials in an hour. Internet users are exposed to any number of banner advertisements in an hour, depending on how many pages they view and how many advertisements are on those pages.

⁷³ There are supposedly 123 million Americans with Internet access according to "Wow! Facts, 2001" although I am somewhat loathe to report facts from any publication with an exclamation point in the title. See <http://www.ewofacts.com/wowfacts/chap47.html> . Nielsen/NetRatings puts the number of American web users at 167 million in August of 2001. See http://www.nielsen-netratings.com/hot_of_the_net_i.htm

⁷⁴ Advertising revenues for television is for American broadcast and cable stations.

Given that television advertisements are more difficult to avoid, and given their greater audio-visual power, I very much doubt that advertisers would find the contact with an Internet user to be as valuable as the same duration of contact with a television viewer. Of course, Internet boosters would dispute this, and I have to admit that my view is not much more than a gut level reaction, although an informed gut level reaction.

If we assume, for the moment, that in fact the mediums are equally effective at influencing consumers given an hours use of the mediums, we could arrive at an estimate of Internet revenues that would put it at parity with television. From the table above, that would be \$3.1 billion.

So if it were the case that Internet use doesn't change dramatically from its current level, and if it were the case that the effectiveness of Internet advertising renders an hour of viewing as no more valuable to advertisers than an hour of television viewing, then the three billion dollar figure above is about the maximum that could be expected. Even if Internet use were to double or triple, advertising revenues would seem unlikely to surpass the \$10 billion level.

What are current Internet advertising revenues?

Although they are in a slump as I write this book, they appeared to be in the vicinity of \$8 billion in 2000.⁷⁵ Estimates for 2001, based on part year results, indicate that advertising revenues have fallen, perhaps into the range of \$6 billion.⁷⁶ Some of this is classified advertising (5-10%), which I believe will do very well on the Internet.⁷⁷ Still, the advertising revenues generated would seem already to be on the high side. Some estimates are

⁷⁵ See "Net Ads Continue to Feel Signs of Economic Slowdown" dated April 23 2001. The article reports that the Internet Advertising Bureau logged \$8.2 billion for US Internet advertng in 2000. It can be found at <http://www.net-ads.com/articles/advertising/apr2001/003.html> . These data were for the US only and banner advertising had dropped to 40%. In "First Quarter Internet Ad Revs Soar" found in the August 8, 2000 issue of InternetNews. Josh Schonwald reported that advertising revenues in the US in the first quarter of 2000 were approximately \$2 billion. This is before the Internet meltdown and we know that much of this revenue came from advertisements placed by other Internet companies that later went belly-up. The article is at: http://www.internetnews.com/IAR/article/0,,12_432421,00.html A later article on ITP news by Mark Sutton, published on December 23, 2000, "Online advertising revenue slips for the first time" also claimed that despite a slowdown, 2000 was likely to hit \$8 billion. This latter article said that only half of the revenue was from banner advertising, however. See <http://www.itp.net/news/97756714361841.htm>

⁷⁶ July 10, 2001 "Weak Spending, Poor Ad Market To Hurt Results at Top Net Firms," Peter Loftus Dow Jones Newswires. However, a different projection, by investment firm Veronis Suhler projects 2001 revenues at \$7.5 billion and 2005 revenues at only \$9.9 billion in 2005. See <http://www.msnbc.com/news/610170.asp>

⁷⁷ Other pundits have made similar projections. See for example "Journalism in a Digital Age" by Christopher Harper, who puts newspaper classified advertising at 40% of total newspaper advertising. See: <http://media-in-transition.mit.edu/articles/harper.html>.

that revenues will double to \$16 billion by 2005 although others see a more modest \$10 billion.⁷⁸

The \$16 billion estimate is over four times the revenues that seem reasonable on the chart above. This would be the equivalent of having television viewers seeing four times as many ads, assuming that there is no drop off in the value of an advertising contact.⁷⁹ Since television advertising is near 15 minutes an hour, that would be the equivalent of watching nothing but ads.

Ignoring the question of why anyone would watch nothing but advertising, one needs to ask whether a viewer spending an hour watching one television ad after another is more or less valuable than a surfer exposed to current Internet pages. How much impact can advertising have in an hour, and is television such an inefficient medium that full-time television ad viewing is of less value to advertisers than part-time ad viewing on the Internet?

How could television, with its sound and moving pictures, be such an inferior medium? If current television advertising was so bad, would not television advertisers perhaps do better taking the lead from the Internet? Perhaps they should put fixed banner ads on the television screen, with some primitive animation and no sound? Perhaps these banner ads should run for only a few seconds, and perhaps they should take up only part of the screen? This logic seems inescapable.

Obviously, I do not find this possibility plausible, and thus conclude that current Internet advertising revenues seem to be too high relative to television advertising. And this differential is apparently expected to grow over time. I think that Internet advertising will have trouble meeting these projections.

Of course, the astute reader might have noticed that I am assuming here that Internet advertising revenues will reflect the actual advertising values, whereas I earlier explained that advertisers do not know how effective their ads are. My assumption that advertising revenues are related to real world values seems contradictory to my claim that advertising revenues have a life of their own, independent of economic logic. The reality is that at some point, I expect advertisers to catch on to the fact that they are

⁷⁸ This projection was made for 2005 by Jupiter Communications, according to Internet.com in an article entitled "Internet Advertising in 2000 and Beyond", Dec 18, 2000 by Nancy Whiteman and Janet Ryan. See: <http://www.clickz.com/article/cz.2994.html>.

⁷⁹ There is usually a very slight drop off, but it is very close to linear. See S. J. Liebowitz, *Canadian Journal of Economics*, "The Impacts Of Cable Retransmission On Television Broadcasters," August 1982, Pp. 503-524 for a discussion.

getting less bang for the buck in some mediums than in others, and that there is some relationship between payback and advertising expense.

It should also be noted that in year 2000 some advertising revenues were still coming from other websites whose business models have been discredited as they ran out of money because of excessive expenditures on items like advertising. That is a major reason that the 2001 advertising revenues are falling below the year 2000 levels.

Declining click-through rates are also likely harbingers of slow advertising growth to come. Declining click-through rates are obviously due to both the clutter of multiple banners on a single page and the surfer's ability to screen them out while working. Doubling the number of advertisements should not double the revenues because each ad will be less effective than would have been the case with fewer advertisements.

Nor is the population of Internet users likely to grow rapidly. Most users with computers are already online. Those users without computers really are not likely to have much interest in Internet type of activities, as revealed by their lack of computer in the first place. As hard as it is for Internet devotees to believe, some people just don't care for interactive experiences. I suspect it is quite a large proportion of the population, including most elderly citizens. That is why Internet devices, or web appliances as they are more formally called, have been such failures. This will change, of course, when television is carried on the Internet.

The only serious route for advertising growth, then, would seem to be in the number of hours spent online. There is certainly room to grow from the current 30-45 minutes per day.⁸⁰

Without some major new activity, however, some sort of killer app, it is hard to know what will lead surfers to spend more time online. One hope that has been put forward is that the new generation of cell phones will push consumers to use the Internet. But this seems like another case of wishful thinking. The devices are too small to read, there is no keyboard, and there are few activities where a phone is anywhere near as good a medium as is a computer. Phones are used by drivers, often, except in Connecticut, to the chagrin of others. Drivers, we can fervently hope, will not be using the Internet.

It is also difficult to know where this extra time will come from. The typical adult spends 4 hours a day with television, 2 hours with radio, sleeps 8 hours, works 8 hours, spends an hour with newspapers and magazines and

⁸⁰ 45 minutes according to the TVB website. <http://www.tvb.org/tvfacts/index.html>

presumably spends some time on other leisure activities, such as eating dinner.

The bottom line? Internet advertising revenues are not likely to grow dramatically. For web sites having difficulty making ends meet, their salvation is not likely to come from additional advertising revenues. Instead, they should test the water with small subscription fees and see if that can sustain them. Subscription fees are where the great revenue increases are likely to come from in the future.