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## GUEST ARTICLE

# NEW TARGETING TECHNOLOGY SETS STAGE FOR INTERNET ADVERTISING BOOM



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“The broad adoption of behavioral targeting, continued expansion of lead generation companies and the introduction of vertical ad networks will increase revenue and CPMs for the second-tier sites that have attracted loyal audiences.”

**A**merica’s growing addiction to blogs, social networks, entertainment sites and niche content sites is one of the most significant changes on the Internet in the past few years. However, despite the widespread attraction to this new class of content sites (collectively called “second-tier” sites), Internet advertising revenue and premium CPMs (high advertising fees) have remained remarkably concentrated in top-tier sites.

The vast majority of second-tier sites are poorly monetized because they either lack the technical ability to target their audiences or lack an audience large enough to attract advertising directly. However, new technology and business models are emerging that will improve targeting of second-tier sites and generate significant value for Internet advertisers. Behavioral targeting technology, lead generation companies and vertical ad networks will dramatically increase revenue in this mounting second-tier.

### Advertising abhors a vacuum

Virtually all content sites aspire to directly court brand advertisers willing to pay premium CPMs. But, the economic reality is that it is only profitable for a very small number of publishers to directly sell advertising due to the high sales, account management and advertising oper-

ation costs. Generally speaking, publishers need to have enormous traffic, generate professional content, and be among the premier sites in an attractive market to sell directly to leading brand advertisers and agencies.

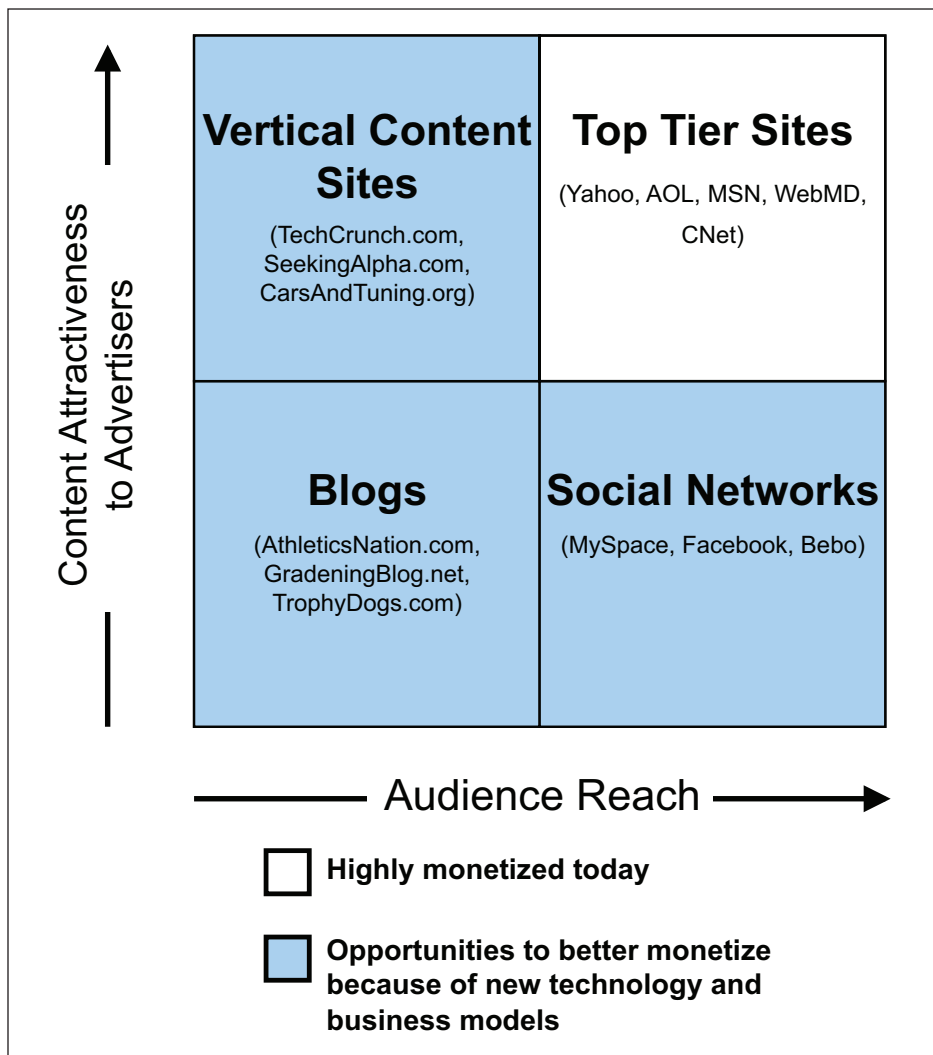
That model works well for top-tier sites—such as portals **AOL**, **MSN** and **Yahoo**, as well as leading content sites such as **CNet** and **WebMD**. These sites can command CPMs of \$50 or more for their valuable online page-views.

However, Americans are spending an increasing amount of time on second-tier sites—blogs, niche content sites, social networks, user-generated content sites and entertainment sites—that either don’t have the audience scale or targeted content sought by large advertisers. In 2002, the aforementioned three portals represented 23% of time online. In 2007, they only represented 13%.

There are now over 70 million blogs that collectively generate over 1.5 million posts per day. **MySpace**, **Facebook** and **YouTube** now comprise 16% of all time spent online. Online game sites **Pogo** and **Runescape** and children’s site **Neopets** have become top 25 sites within the last year.

Without the ability to directly attract advertisers, most of the second-tier sites rely on **Google** AdSense or horizontal ad networks to generate revenue, resulting in very low CPMs (frequently under \$1) and

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large quantities of unused inventory. However, by the end of 2008, we believe the combination of behavioral targeting technology, lead-generation companies and vertical ad networks will deliver breakthrough monetization for these second-tier sites.

### Behavioral targeting

“Behavioral targeting” (BT) stumbled into the advertising spotlight in the fall of 2007 with Facebook’s controversial Beacon platform, which broadcast its users’ surfing habits to their Facebook “friends.” While Beacon caused an uproar, handled correctly, BT can securely and in a non-invasive manner provide relevant advertising to individual Web users without divulging their behavior to others. On second-tier sites without well-defined content, BT can serve ads to consumers based on their aggregate Web usage from prior sites they’ve visited, the frequency of those

visits and what they’ve looked for on search engines.

BT is essential to monetizing second-tier sites because the contextual targeting techniques that work so well in the top-tier deteriorate rapidly when applied to sites with smaller audiences and less cohesive or specific content.

**Bill Gossman**, CEO of BT company **Revenue Science**, refers to these sites as the “contextual desert.” The context of the page is so diverse and varied on these sites that it is no longer useful for targeting, rendering Google AdSense and ad networks ineffective and resulting in strikingly poor monetization. Rather than focus on the content on the page, BT relies on the user’s previous online viewing experience to inform the system about what ads would be most effective. By focusing on a user’s interests rather than the content on the page, BT techniques deliver far more relevant and effective ads, transforming this barren “contextual desert” into a fertile oasis.

For example, if you recently visited a prominent auto site such as **Kellybluebook.com**, BT networks would ensure that you see an ad for a new car when you’re visiting a baseball blog or music site. While BT has been around for many years, it is just now making its way out of experimentation and into mainstream media plans. AOL’s acquisition of **Tacoda** and Yahoo’s acquisition of **Blue Lithium** demonstrate the growing level of interest.

Since BT becomes more effective as advertisers gain a more comprehensive picture of users’ online behavior, a second generation of BT companies is emerging that cultivates partnerships with ISPs to gain the broadest possible purview. **NebuAd**, **FrontPorch** and **Phorm** are pioneers in this promising field.

### Lead generation

The tailored targeting of BT is well aligned with the business strategies of lead generation companies, which have been among the most prolific advertisers on the Internet, using both search and display advertising to garner traffic. Top lead generation companies such as **Lending Tree** (owned by **IAC**), **WebClients** (**ValueClick**), **Vantage Media**, and **Reply!com** (the last two are **Scale Venture Partners** portfolio companies) are sophisticated in employing

advanced targeting, tracking and testing techniques to spend profitably across a diverse set of online media.

An ongoing challenge in the lead generation business is the rising cost of keywords in search engines, particularly Google. As the cost per click (CPC) in paid search has increased over the last several quarters, these firms are shifting their expenditures to advertising on second-tier sites. Accelerating this trend is the use of behavioral targeting by lead generation companies.

Despite all of their sophistication, even the best companies in lead generation pay for a lot of clicks that ultimately result in no revenue. That's because less than 5% of users who visit a given landing page actually fill out the lead form. Thus, 95% of their traffic does not convert into a qualified lead.

BT enables lead generation companies to "re-target" those non-converting visitors who initially expressed interest, but for whatever reason abandoned the landing page without completing the form. These re-targeted visitors typically have much higher conversion rates, thereby enabling second-tier sites to increase their CPMs while still delivering the performance required by the lead generation companies.

#### **Vertical ad networks**

The final factor in improving the monetization of second-tier sites is the emergence of vertical ad networks. Historically, horizontal ad networks have effectively expanded reach, but were rarely viewed as "premium" or "highly targeted" media buys. On the other hand, vertical networks connect with specific target audiences that have a clear affinity for a particular area of interest.

Some vertical ad networks such as **Jumpstart** and **Active Athlete Media** aggregate a large number of sites on a particular topic without generating their own content and traffic. Other vertical ad networks emerge from leading content sites that attract large audiences and have established relationships with advertisers. For example, **Waterfront Media** (a Scale portfolio company) has parlayed its success

with **EverydayHealth.com** and other "owned and operated" health content sites into a vertical network comprised of smaller health-oriented sites.

Vertical ad networks enable advertisers to appeal to a large, concentrated audience with a simplified media buy. Brand advertisers are particularly attracted to this model because they're assured their impressions will be surrounded by professional, relevant content and the vertical networks provide certainty about which sites the ads appear on. From a publisher's perspective, these vertical ad networks generate higher CPMs for niche content sites than their other alternatives.

In summary, Internet advertising revenue has been disproportionately generated by a small number of top-tier portal sites. The broader adoption of behavioral targeting, continued expansion of lead generation companies and the introduction of vertical ad networks will increase revenue and CPMs for the second-tier sites that have attracted loyal audiences, but lack the audience scale or targeting to sell directly to advertisers.

Companies that play a pivotal role in this transformation will create enormous value over the next few years. We expect there will be a flurry of venture activity this year in these emerging Internet advertising categories, given the frothy acquisitions in this sector (Google/**DoubleClick**, **Microsoft/Quantive**, **Yahoo/Right Media**), the disparity in monetization between top-tier and second-tier sites and the sheer size of the Internet advertising market (\$20 billion in U.S. alone, growing at 25%). We're about to enter a new era of Internet advertising that reflects how we actually spend time online.

*Sharon Wienbar is a Managing Director with Scale Venture Partners. She invests in mobile, Internet and enterprise software companies and sits on the boards of Bellamax, Biz360, Facetime Communications, Glu Mobile, MerchantCircle, PlayPhone, Reply.com and Waterfront Media. Chad Kinzelberg is a Director with Scale Venture Partners. He focuses on Internet and enterprise software investments.*



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