YAHOO'S BRILLIANT SOLUTION

By figuring out how to make brand advertising work online, **Terry Semel** is on the verge of creating the 21st century's first media giant.

BY FRED VOGELSTEIN

Julie Roehm has more than $2 billion to spend this year, and the way she's been spending it worries executives at News Corp., the Washington Post Co., and virtually every other media company on the planet. As Chrysler's director of marketing communications, Roehm, 34, oversees a budget *that Advertising Age* ranks as the sixth-largest pool of ad dollars in the nation. She decides how many minutes of the carmaker's commercials appear on networks and cable channels nationwide and how many pages of its ads turn up in magazines like this one and newspapers such as *USA Today*.

Here's the scary part: Roehm rarely misses a chance to talk about how delighted she is with online advertising. Last year she spent 10% of the budget online; this year she is allotting closer to 18%; next year, she says, she will allocate more than 20%. Do the math: In 2006 roughly $400 million of Chrysler's money that used to go into TV, newspaper, and magazine ads will be spent on the Internet. Says Roehm: "I hate to sound like such a marketing geek, but we like to fish where the fish are."

No wonder media executives are concerned. One of their headaches is Googlemania—Google effectively reinvented online advertising with the targeted, classified-like text links that you now see everywhere. Soaring profits from selling those ads have helped drive Google's stock market capitalization to some $85 billion, making Google the most highly prized media company in the world. But while the old guard is keeping a watchful eye on Google, the company it really fears—and the one advertisers like Roehm increasingly love—is Yahoo.

It's been easy for most people to overlook the media and advertising juggernaut that Terry Semel, Yahoo's CEO, has assembled since he arrived from Hollywood four years ago. That's partly because Semel makes himself easy to overlook. He's not a showman like Apple's Steve Jobs or a high-tech rock star like Google's Larry Page or Sergey Brin. In fact, he seems to work hard at being bland. Listen to him theorize about the online revolution: "The

HINT: IT'S SIMPLE For all the Internet's high-tech trappings, Semel knows that success in attracting consumers and ads hinges on an old-media formula.

PHOTOGRAPHS BY HENRY LEUTWYLER

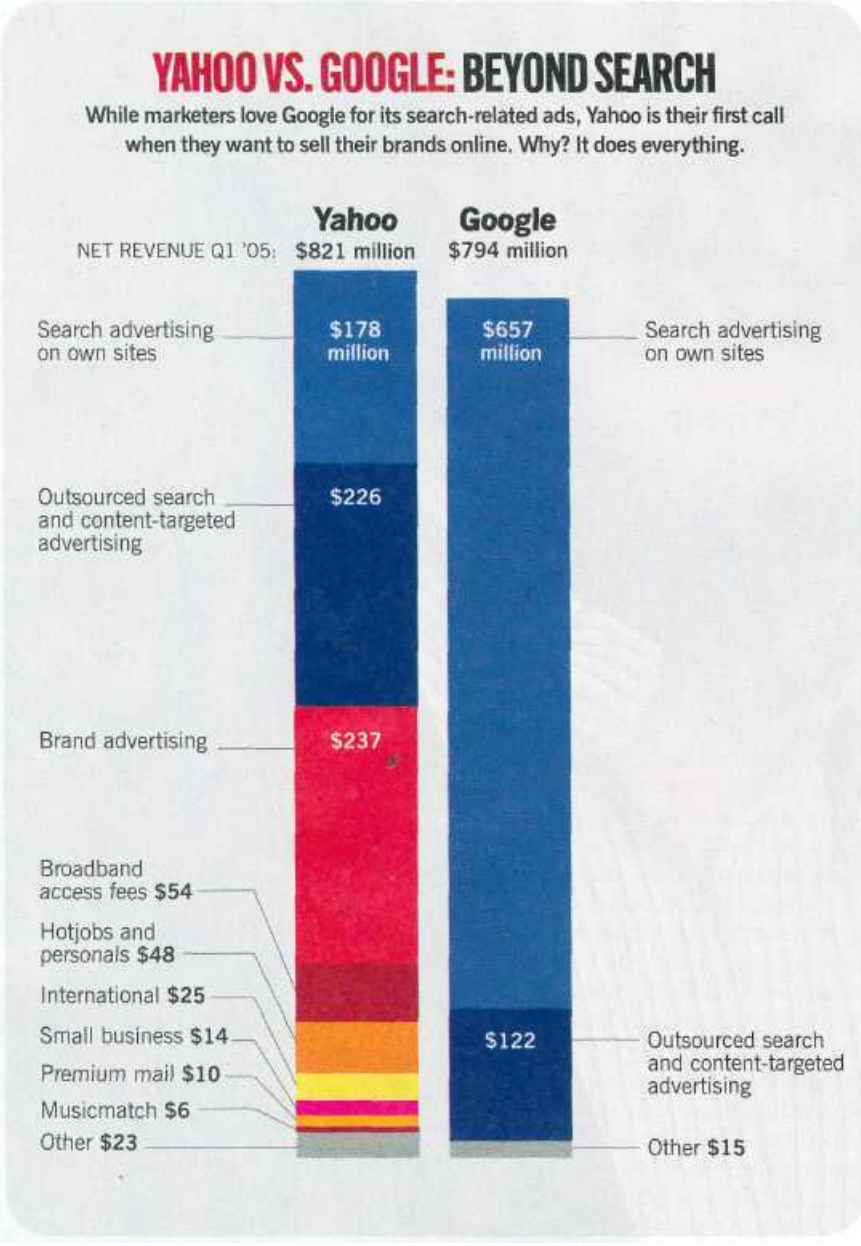
great part about the Internet of all the existing mediums from before is that it's the first one that is truly global, and its impact is massive." Caffeine, anyone? Semel doesn't care if he's boring. Like many good negotiators, he knows that the more he says publicly, the less he's likely to win. Twenty years of doing movie deals as co-CEO of Warner Bros, taught him that. At 62, Semel's a behind-the-scenes guy, a strategist with a bold master plan: to transform Yahoo into the 21st century's first media titan. He has surrounded himself not with nerdy brainiacs but with veteran advertising and media executives adept at building bridges to the powerful businesses that feel the most threatened by the Internet.

So far, Semel has put together one of the web's hottest winning streaks. When he took over in 2001, the Sunnyvale, Calif., portal—founded in 1994 by Jerry Yang and David Filo—was a mess. The dot-corn bubble had burst, revenues had fallen by half, and red ink flooded the bottom line. As the founders took a back seat (today Yang acts as the resident visionary, and Filo works in IT), Semel and his enforcer, COO Dan Rosenzweig, set about diversifying sales beyond the banner ads Yahoo had lived off. He added search advertising, online classifieds, and a host of commission-generating businesses such as selling SBC and Verizon broadband subscriptions. The moves transformed a money loser into a $3-billion-a-year company that this year will post operating income in excess of $1 billion—a near-Microsoftian operating margin of some 30%. (By comparison, Google is about the same size, but its margins are almost double.) Today Yahoo arguably offers the online world's broadest array of information and entertainment for users, married to the web's most sophisticated collection of offerings for advertisers. Each month more than 430 million people worldwide typically visit one of its myriad sites.

Until recently Semel's grand plan was missing a crucial strand: widespread use of online advertising by big marketers like Chrysler. Burned or disillusioned by the bubble, they questioned whether online advertising would ever match the effectiveness of commercials or print ads. Sure, Google's text ads work, because you throw them in front of users just as they are looking to buy or research something online—like a smart, aggressive yellow pages. (MSN and Yahoo's search ads work the same way.) But using the Internet to sell "that Pepsi feeling"—creating and fostering an emotional attachment to a brand—was a challenge of an entirely different order. Most marketers doubted that it could be done.

But lately decision-makers like Roehm are seeing the Internet in a new light. Their conversion can be explained in one word: broadband. Roughly a third of U.S. households now have high-speed Internet connections, which has done two things that advertisers like. It has caused the average time Americans spend online to grow 50% since 2001, according to Knowledge Networks, a Menlo Park, Calif., research firm. Surfing the Internet now takes up 15% of the time Americans spend with all media, it says. (That's conservative, say Forrester Research and many advertisers, who believe the number is double that.) Second, instead of handcuffing advertisers to the banner ads of the bubble years, broadband has freed them to fashion creative messages that are more like TV commercials.

In a May report Forrester surveyed 99 major advertisers and 20 ad agencies and found that nearly 85% of them planned to expand their online ad budgets this year. More significant, it reported a radical shift from the belief that brand building and the Internet don't mix. Sixty-three percent of those surveyed said that online advertising was a brand-building tool "equal to or better than" advertising on TV or in print.



FORTUNE CHART / SOURCE: MORGAN STANLEY

CRAZY FOR ONLINE Julie Roehm spends Chrysler's ad dollars where she knows they'll make an impact—and increasingly that's online.

Anecdotal evidence supports that. Not a week goes by, it seems, without a big advertiser—P&G, Pepsi, and Georgia Pacific are recent examples—announcing plans to expand promotion of its products online. The trend means that a huge volume of brand advertising will flow into the online world—$8 billion to $12 billion a year by 2010, depending on whom you ask, up from less than $5 billion now, about 3.5% of total U.S. spending on brand advertising.

For Semel and Yahoo, that is the best possible news. Although Google leads the pack in the $5-billion-a-year market for search-related ads, Yahoo is increasingly competitive there. And in the scrum for online brand advertising—almost as large a market—Yahoo is poised to grab the biggest share. Its 181 million active registered users are probably the largest online clientele, which means Yahoo can tell advertisers it knows the habits of more users than any other portal—or any traditional media company. In contrast, Google never trained its users to register and has only recently started to ask them to sign up for services like e-mail orblogging. What's more, measured by page views—the indicator that brand advertisers watch most—Yahoo users are the most engaged. Yahoo generated nearly twice as many page views —178 million worldwide in May—as its nearest competitor, MSN. (MSN generated 96 million page views in May, Google 68 million, and AOL [which, like FORTUNE, is owned by Time Warner] 39 million, according to Comscore Media Metrix.) Says Brian McAndrews, CEO of Aquantive, one of the largest advertising firms specializing in Internet distribution: "Yahoo's opportunity is massive." And while its online rivals are ramping up to attract brand advertising too, Morgan Stanley Internet analyst Mary Meeker says the advantage right now is Yahoo's: "If you're new to online advertising (and a lot of big advertisers are), Yahoo is your first call because they do everything."

The woman Semel has hired to go after brand-advertising dollars is no one you would expect to find at a tech company. Wenda Millard, Yahoo's 50-year-old head of ad sales, looks and acts like the publisher of a fashion magazine. She talks about the importance of "engaging" and "delighting" users, about "relationships" and "building trust" with advertisers. And she does it in an even, mellifluous purr that is both reassuring and utterly persuasive.

No wonder: Before jumping in 1996 to DoubleClick, the once-powerful Internet ad-processing company, and then to Yahoo in 2001, Millard spent 20 years in the magazine business. She started out selling ads for *Ladies' Home Journal* and *New York* magazine. By 38 she was publisher *of Family Circle,* making her one of the industry's youngest publishers and the first woman to run a major women's magazine. Though she works for Yahoo, she is based in New York City, and is unapologetic about her

REPORTER ASSOCIATE *Kate Bonamici*

old-media ways. Indeed, she—and many others—thinks they are her greatest asset. "When you're asking a major marketer to spend hundreds of millions of dollars on a new medium, they want to trust you," she says. "If I didn't have a relationship with the presidents of all these FORTUNE 1,000 companies or the heads of all these agencies, why would they trust me?"

Remember, during the bubble the Internet portals, including Yahoo, thought their sites would forever be in such demand that they could cut ad agencies out of the loop and take orders directly from advertisers by e-mail. They viewed media's traditional lunching and golfing with advertisers and their agencies as a waste of time. That arrogance backfired when the bubble burst, and portals became *persona non grata* on Madison Avenue.

Millard was the first to make peace. Because of her background, she recognized the importance of agencies as gatekeepers for big advertisers and reinstated them as partners. McAndrews of Aquantive says that earned her lasting credibility with him and other middlemen.

By 2003, advertisers and agencies were starting to respond to Yahoo's broad reach, diverse ad offerings, and deep knowledge of its users. Today Yahoo is where Dave Burwick, chief marketing officer at Pepsi-Cola North America, spends the biggest chunk of the nearly $20 million that he has allocated to online advertising (about 5% of his total budget). He's so enamored of Yahoo's "progressive view of where its medium is going and willingness to experiment" that last month he decided to shift his company's two-year-old Pepsi Smash music video series from the WB television network to Yahoo. The Internet brings Pepsi a larger audience of teenagers, he says, enabling them to watch its videos when they want and to interact with one another and with Pepsi via instant messaging.

Roehm too spends the biggest chunk of her online dollars on Yahoo. She says that Yahoo gives her the most information about how the advertising performs, allowing her to slice and dice the effectiveness of every dollar she spends. "We marketers are much more obligated to tell our shareholders and our management what the real return on our spending is. Online provides us the opportunity to give a real answer to that question," Roehm says. "It's measurable. It allows you to have a one-on-one, two-way dialogue with your customers." She knows that almost every dollar she spends online generates $1.50 or more in sales for Chrysler. Although she doesn't have a comparable figure for her spending on TV or in print, her gut, says Roehm, tells her online is a lot better.

FRIEND AND FOE Tom Curley views Yahoo as a customer, but the AP's owners see it as a rival too.

Not only can Yahoo provide Roehm with extremely detailed demographic information about the people who click on her ads, it can also predict the probable response rate to the ads on each segment of the portal. It can predict what time of day the ads are likely to be most effective. And increasingly, by analyzing "click streams" on its network, Yahoo can spot potential buyers at various stages of the consideration process. In other words, by looking at the billions of user clicks that flow through its servers every day, Yahoo is getting better and better at figuring out that a given pattern—say, a user who's looked up football on Yahoo Sports, checked out adventure movies on Yahoo Entertainment, and compared truck prices on Yahoo Autos—means the browser is interested in buying a Jeep and is just beginning to think about a purchase. Another pattern might mean a user is interested in minivans and is just a few days from buying. Such information is hugely valuable, says Roehm: Once Yahoo knows where a potential customer is in the car-buying process, it can serve up the appropriate Chrysler ad.

As advertisers flock to Yahoo, media companies that supply it with content are increasingly upset. Indeed, if anything threatens Semel's vision of the 21st century's first media giant, it's the growing irritation of the giants of the 20th century. That's because Yahoo produces relatively little content of its own—it's an aggregator vulnerable to being cut off if old media become angry enough.

Old media's worries are legitimate. While declines in TV ratings and newspaper circulation accelerated last year, Yahoo's traffic, as measured in unique users, grew 24%. The fear that Yahoo will wreck their business model is especially acute among newspaper and TV-news executives. Yahoo's success "has become a red-meat issue," says Tom Curley, CEO and president of the Associated Press. "If

> Yahoo's success "has become a red-meat issue. **If there were an enemies list,** it would be front and center."

there were an enemies list, [Yahoo] would be front and center." Donald Graham, chairman and CEO of the Washington Post Co., was probably the first to see Yahoo as a rival, says Curley, but now he hears it regularly from publishers who sit on his board of directors.

It's easy to see why. Just look at Yahoo News, the company's second-most-visited page after Yahoo.com. Yahoo News attracts 4.6 million visitors a day on average, according to Cornscore, about the same number of people who read the *New York Times* every day. *USA Today*, the nation's largest newspaper, says its readership is 5.6 million. Add in all the people who get their news via Yahoo's myyahoo pages—which users program for themselves, mixing and matching from a seemingly limitless array of news, weather, finance, and entertainment feeds—and the number is double that.

Here's what News Corp. CEO Rupert Murdoch had to say on the subject of Internet news in an address to editors last spring in Washington, D.C.: "Unless we awaken to these changes, we will, as an industry, be relegated to the status of also-rans. We need to realize that the next generation of people accessing news and information have a different set of expectations about the kind of news they will get, including when and how they will get it, where they will get it from, and who they will get it from."

Convincing old media that they will gain rather than lose from doing business with Yahoo is a big reason Semel hired Lloyd Braun nine months ago; Semel is hoping that just as Millard's roots in magazine publishing make her a soothing presence on Madison Avenue, Braun's roots in Hollywood will reassure old media.

The 46-year-old Braun certainly has the charisma to bring anxious media execs to the table. In his capacious Santa Monica, Calif., office, whose terrace is the size of many New York City apartments, he ranges around like a pent-up teenager. Dressed with the studied schlumpiness—untucked shirt, spotless shoes—that is the uniform of Hollywood creative executives, he fiddles with a golf ball and putter, a chair, and a Magic Marker; he plays Michael Jackson's "Bad" from his Yahoo music collection. "Right after the trial I downloaded it and started blasting it, and everyone has been loving it," he screams over the King of Pop's familiar sound blaring from the speakers.

Braun is charged with keeping Yahoo's hundreds of millions of users coming back day after day. Don't mistake his enthusiasm for flightiness: He is one of Hollywood's toughest, most connected operators. A former entertainment lawyer and talent agent, he has created hit TV shows for more than a decade. At Brillstein Grey Entertainment he helped develop *The Sopranos*, and at ABC he was one of the brains behind *Desperate Housewives*, *Lost*, and *Grey's Anatomy*.

LUNCH ANYONE? Yahoo ad sales chief Wenda Millard knows it takes more than e-mail to woo advertisers.

Though he has been been at Yahoo less than a year, Braun has already shaken things up—to the consternation of some of Yahoo's old guard. Before he came, Yahoo's various sites, like finance, news, and entertainment, were semiautonomous units largely run as fiefdoms by powerful general managers. That caused problems. The sites didn't cooperate well, so lots of work was duplicated, and Yahoo had difficulty dealing coherently with content suppliers. Semel says, "Even though sports, news, and entertainment were licensing things and doing partnerships with the same companies, we did it through five different voices and five different people."

Braun is fusing the fiefdoms into a single unit in the Colorado Center in Santa Monica and requiring everyone to relocate. Yahoo Finance, which is based in New York City, is moving; so are Yahoo News and Yahoo Sports, both currently in Sunnyvale, Calif. Braun has also imposed a new layer of centralized management. He hired Scott Moore from Microsoft's MSN to oversee news and finance, David Katz from CBS to run sports and entertainment, Shawn Hardin from AOL to run games, and Ira Kurgan from Fox to focus entirely on making deals for more content. They'll join Dave Goldberg, who has been running music at Yahoo since it acquired Launch, the music company he cofounded, four years ago. (Three of the eight old-guard general managers have quit, and three have shifted to other jobs.)

With the new team largely in place, Braun is ready to apply principles of programming from the TV business to enrich users' Internet experience. The tricky part is doing it so that Yahoo users will still feel as though they control what they do and see instead of feeling as if they are watching, say, ABC television. In fact, before Semel approached him about coming to Yahoo, Braun probably would have said it couldn't be done. "I remember during the bubble when I was hearing about all these different deals for television shows on the web and wondering why anybody would want to watch [them] when they could watch *The Simpsons* on television. The TV industry has 50 years' experience doing television, and most of it isn't good enough. How is this business going to all of a sudden do this?"

The arrival of broadband has expanded the universe of what's possible online, however, like video and music, enabling Braun to rethink how Yahoo presents content. Asked to detail his strategy, Braun alternates between coy and expansive (see box), but he is clear about his mission. Yahoo must create a venue that attracts so many viewers and creates so much buzz

that no matter how disconcerted old media become over Yahoo's growing popularity, the money and attention it delivers to content suppliers will be too great to resist. "Aren't they going to want to be at the place where hopefully you're going to find all these other unique, exclusive, engaging things going on? I think they are," he says.

If only it were that easy. Reassuring traditional media companies that he's not out to eat their lunch is still a big part of Braun's job, and old media have made dozens of moves to assert themselves online. Two years ago the *New York Times* pulled its content off Yahoo; it wants readers to visit nytimes.com directly. Last year Reuters, after 154 years as a wholesaler of news to newspapers, television, and radio, set up its own news site and put customers, including Yahoo, on notice that it will soon charge more for its content. More recently, in March, newspaper companies Tribune, Knight Ridder, and Gannett bought 75% of Topix, an online rival of Yahoo News. "There's no question that a lot of the other media companies out there are nervous about [us and wondering], Okay, are they friend or foe?" says Braun. The problem isn't that they hate Yahoo, he adds; it's that "everybody now is feeling this out. There are a lot that we're talking to about working together. They far outnumber the ones that are saying, 'We want to go it alone.' "

Braun is willing to resort to old-fashioned incentives to keep his suppliers onboard—like sharing ad revenues, paying a license fee, or cutting them in on one of the premium services that Yahoo users pay for, like Yahoo Music. "Or there could simply be some promotional value that they're getting, which, by the way, is a great value," he says. "If we're sending a zillion eyeballs, 18- to 34-year-old eyeballs, let's say, to an older-skewing network, I know how valuable that would have been to me" when I was at ABC.

Watching Terry Semel surf the broadband wave should be quite a show. He has rescued Yahoo, true, but nowhere is success more likely to draw a crowd than online. Microsoft, AOL, and even Google are adjusting their business strategies to better compete. AOL last month said it's moving away from its subscription-based model and making more of its content available for free. It wants to recapture users who defected to portals like Yahoo—and the ad revenues that followed them. MSN is building its own search-advertising business in hope of someday not needing to outsource it to Yahoo as it does now. It is also working hard to cut ad clut-

WATCH MY YAHOO

Lloyd Braun is flexing his Hollywood programming muscle to make the portal a must destination for web surfers.

Lloyd Braun's arrival at Yahoo last November inspired lots of gossip. Why would Yahoo hire a TV programmer unless it planned to make video content? In an interview with FORTUNE, Braun explained that Yahoo will make video content, but only in tiny amounts. The company's not even thinking about making entire shows or building a full-scale news-gathering operation. It costs too much, Braun says; besides, videos in the conventional sense are not what users are asking for. "If we try to re-create TV on the Internet, we're going to fail. The last thing I want to do is watch a half-hour sitcom on my PC or phone. I wouldn't last ten minutes."

Instead, Braun aims to take what he calls "linear and static" web content and make it more personal and interactive. Yahoo Music is an example. The subscription service offers unlimited downloads from a catalog of one million songs for $60 a year; it connects to Yahoo's instant messaging so that you can see what your friends are listening to; and it keeps track of what you download so that, as Amazon does with music and books, it can suggest other music that might interest you. Braun hints that Yahoo will offer an analogous service for TV shows. Do you hate it when you miss an episode of a hot series? "I'm going to fix that issue for you," he says.

He does believe Yahoo must come up with new "must see" content. Rather than try to concoct that in-house, he is deep in talks with Hollywood about developing Yahoo-exclusive "shows." Expect them to be shorter than conventional TV fare. (Braun might not last ten minutes in front of his PC screen, but ask if he'd last five, and he grins.) He's also looking to buy exclusive content, as in a deal he and Semel cut last year to show never-before-seen footage from *The Apprentice* on Yahoo.

Yahoo News, meanwhile, is slated for a makeover. "Right now you can click on eight different links but end up reading the same story. That is not my definition of programming," says Braun. News also needs context to make it more valuable, he says. For example, when terrorists blew up three subway cars and a bus in London last month, Yahoo News viewers sucked up stories, video, and photographs of the disaster. Add similar details of the 2003 bombings in Madrid and perhaps a historical perspective on terrorism, and viewers might stay on the site longer. Says Braun: "We can put [news and information] in front of eyeballs at moments when they're going to want to click on it, and that's a very, very valuable thing for our partners."

CUBICLES ARE FOR NERDS Braun's L.A. office even has a deck.

ter on its pages and broaden its brand-advertising offering, which is increasingly competitive with Yahoo's. Google, having built a mammoth franchise on the principle that old-fashioned cost-per-1,000 advertising—banner ads—has no place online, is now letting advertisers pay for ads that way. Why? Google insiders believe that as the $150-billion-a-year brand-advertising business moves online, it would be stupid not to compete.

Yahoo's rivals could also leapfrog it by innovating more fiercely. Though it spends as heavily on product development and R&D as Google and Microsoft (between 11% and 14% of revenues), both competitors define themselves as technology companies foremost, while Yahoo does not. Yet for Yahoo, falling behind in this arms race would spell big trouble.

Perhaps the biggest risk Yahoo faces is living up to the high expectations set by investors. They're not as stratospheric as those for Google, but by awarding Yahoo a $50 billion market cap and a future P/E of about 50, investors have priced in 30% revenue growth—that's doable given all the new money heading Yahoo's way, but it doesn't leave much room for error. For example, although Yahoo reported second-quarter growth of 39% in the U.S. and 59% abroad, its earnings were a hair below expectations and its stock immediately fell 10%.

Negotiating in intensely competitive environments, though, is Semel's greatest skill. In Hollywood he was known as the man who could make even the most intractable deal work. In Silicon Valley he looked like an odd duck. Just a few years shy of collecting Social Security, he barely knew how to use a computer when he arrived at Yahoo four years ago. But so what? Yahoo may have started out as a high-tech company, but it's a media company now.

It turns out that the riddle of how to succeed online isn't so tough after all. Semel is taking everything he learned in his analog past and marrying it to what he can see in the digital future. After all, he was in Hollywood when studios worried that VCRs would ruin their business and again when DVDs arrived on the scene. In each case, the studios' revenues grew, because, says Semel, new distribution options "help them reach a much larger audience—and make more money." He's betting that can happen again, but (remember the quote we said required caffeine?) this time on a scale as immense as the Internet itself. F

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