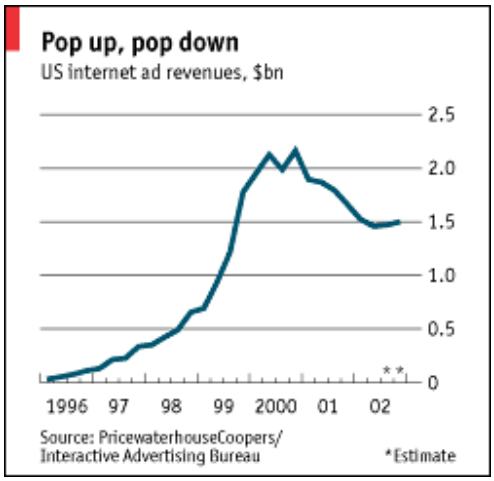
Prime clicking time

At last, internet advertising that works but does not annoy



SURFING the web, like the waters, is supposed to be a smooth and speedy experience. But these days, it is more a case of dodging obstacles: advertising windows pop up all over the screen. In reaction, many computer users have installed programs to block the ads. AOL, the leading online service, is distributing software that lets its 35m subscribers suppress pesky pop-ups (except its own, of course).

Fortunately, this irritating online marketing could be the last gasp of a doomed attempt to advertise on the web in basically the same way as print. A less annoying alternative has been found that is more effective than banner ads, which are now mostly ignored by surfers. These are simple, text-based ads that are directly linked to what people are doing online.

This kind of advertising is expected to generate $2 billion this year, almost a quarter of all online advertising sales. Some analysts predict that this will rise to $7 billion by 2007. A race for dominance in this promising market is already under way between Google, a popular web-search service, and Overture, another search firm.

Search firms pioneered the new form of advertising, variously known as “search-related” or “pay-per-performance”. The idea is to use search terms as a proxy for a surfer's consumption interests—and dish up text-based commercial listings related to the search terms, along with the search results. In most cases, these are separate lists along the right side of the screen, with the ads labelled as such.

Advertisers pay only if people actually click on such “sponsored” links. How much they pay per click, at least in the basic version of the ad programs, depends on how high firms want their listings to rank and how popular is their associated search term (or “keyword”). These are auctioned off, with the top spots going to the highest bidders. To be the first sponsored link in America when somebody searches for “The Economist”, say, an advertiser must bid around $2.50 per click. “Journalism” costs only 30 cents.

Overture invented the concept, which was initially derided as another bizarre dotcom business model that would never take off. But the firm, which went public in June 1999 as GoTo.com, made it work by syndicating its ads to popular websites, such as Yahoo! and MSN, and sharing the revenues. It is now a fast-growing, profitable internet start-up. Last month, it reported first-quarter revenues of $225m—up by 57% from the same period last year.

The main reason for this unexpected triumph was the end of the internet boom, according to Gary Stein, an analyst with Jupiter Research, a market-research firm. With capital no longer free, advertisers were no longer willing to waste their money on often-ignored banner ads and were looking instead for more efficient forms of advertisement. Yet consumers also like the new ads: they are not intrusive and, even better, they are often relevant.

How they are made relevant is the main difference between Overture and Google, which introduced its own pay-per-performance program early last year. Overture ranks ads according to how much advertisers bid. Google also ranks ads by how popular they are, measured by the click-through rate. This pushes advertisers to make their links more relevant.

Google, which is being sued by Overture for patent infringement, has also innovated in the way it auctions keywords—although Overture now offers this format as well. The highest bidders still get the top spots, but only pay the amount offered by the next-highest bidder, plus one cent. This is meant to encourage advertisers to bid the highest amount they are willing to pay, without having to second-guess what the next best bid will be.

Google, which may go public late this year or early next, claims it is now ahead of its rival, with 100,000 advertisers to Overture's 88,000. Overture's shares have tumbled since Google entered the fray, from more than $42 to $15, although they have recovered a bit recently.

The critical battle between the two firms will probably be over "content-targeted" advertising—which links ads not to selected keywords, but to the content of web pages. This is done by using software to boil text down to a handful of keywords and to serve up related ads next to it. Just as with search-based advertising, the idea is that surfers are more likely to click on ads relevant to a web page's content than on a scattershot banner ad.

This time, Google was first. Since March, its ads have also been appearing on the pages of such websites as HowStuffWorks.com and Slashdot.org. Content targeting also explains why the firm recently acquired two start-ups, Applied Semantics and Pyra Labs. The first is a developer of content-targeting software; the second sells software to create personal web pages called "web logs", or "blogs", which could make excellent homes for Google's ads.

Overture appears to have expected such moves. Earlier this year, it bought AltaVista, a rival to Google, and the search division of FAST, a Norwegian firm. These acquisitions should help it to be more like its rival: it can now also offer high-end search services to its partner sites. Later this year, the firm will also start offering content-targeted advertising.

There is more to come. Expect both firms to use the huge amounts of data gathered through their search services to make their ads even more relevant to surfers. In a way, says Hal Varian, an economist at the University of California at Berkeley, who helped Google to set up its advertising auctions, marketing is at the same turning-point as financial services were 30 years ago: at last, the data is available to put all the fancy theories into practice. Long live the internet advertising dream.

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