SELLING ON THE WEB: REVENUE MODELS AND BUILDING A WEB PRESENCE

LEARNING OBJECTIVES
In this chapter, you will learn about:
• Revenue models
• How some companies move from one revenue model to another to achieve success
• Revenue strategy issues that companies face when selling on the Web
• Creating an effective business presence on the Web
• Web site usability
• Communicating effectively with customers on the Web

INTRODUCTION
In the 1980s, Progressive was a relatively small auto insurance company that specialized in writing policies for people who could not qualify for regular policies with other insurers. Progressive was able to charge higher premiums for these policies, which the insurance industry calls substandard policies. Often, other insurers who could not write standard policies for customers would refer those customers to Progressive. The combination of high premiums and the lower cost of a smaller sales force allowed Progressive to earn good profits on the substandard business. Eventually, other insurers noticed Progressive’s success and began to offer their own substandard policies. To respond to the increased competition, Progressive improved its claim service and was one of the first insurance companies to offer 24/7 service every day of the year. Through the 1990s, Progressive developed a full line of auto insurance products for all types of drivers and worked hard to make sure that it offered the lowest prices in every market. Like most other companies selling auto insurance, Progressive offers policy quotes and service on its Web site. Progressive’s marketing mentions the quality of its service, but it always emphasizes its low prices. In 2002, Progressive began comparing its prices to those of other insurers on its Web site. Progressive’s Web site offers quotes that include its price along with prices of similar policies offered by its competitors, even when one or more of the competitors offers a lower price. People shopping for auto insurance often visit the Web sites of various insurers. By offering to provide quotes from other companies in addition to its own price, Progressive hopes to convince shoppers to include its site in their list of Web sites to visit. By offering several quotes, Progressive can save shoppers time. The practice of displaying competitors’ quotes also creates an impression of openness and honesty. Progressive believes that people prefer to buy insurance from honest companies who offer the best prices. In recent years, Progressive has used television advertising that emphasizes the price comparison feature of its Web site. The comparison shopping feature on its Web site is an important element in Progressive’s overall marketing efforts to convince potential customers that the company is both honest and able to offer the lowest prices on auto insurance.

REVENUE MODELS
As you learned in Chapter 1, a useful way to think about electronic commerce implementations is to consider how they can generate revenue. Not all electronic commerce initiatives have the goal of providing revenue; some are undertaken to reduce costs or improve customer service. You will learn about those types of initiatives in Chapter 5. In this chapter, you will learn about various models that online businesses currently use to generate revenue, including Web catalog, digital content, advertising-supported, advertising-subscription mixed, and fee-based models. These approaches can work for both business-to-consumer (B2C) and business-to-business (B2B) electronic commerce. Many companies create one Web site to handle both B2C and B2B sales. Even when companies create separate sites (or separate pages within one site), they often use the same revenue model for both types of sales.

Web Catalog Revenue Models
Many companies sell goods and services on the Web using an adaptation of a mail-order
catalog revenue model that is more than 100 years old. In 1872, a traveling salesman named Aaron Montgomery Ward started selling dry goods to farmers through a one-page list. Richard Sears and Alvah Roebuck began mailing catalogs to farmers and small-town residents in 1895. Both Montgomery Ward (which closed in 2001) and Sears, Roebuck & Company grew to become dominant retailers in the United States by the 1950s, with retail stores serving urban markets in addition to the catalog business that served their rural and small-town markets.

In this traditional catalog-based retail revenue model, the seller establishes a brand image, and then uses the strength of that image to sell through printed information mailed to prospective buyers. Buyers place orders by mail or by calling the seller’s toll-free telephone number. This revenue model, which is often called the mail-order or catalog model, has proven to be successful for a wide variety of consumer items, including apparel, computers, electronics, housewares, and gifts.

Companies can take this catalog model online by replacing or supplementing their print catalogs with information on their Web sites. When the catalog model is expanded this way, it is often called the Web catalog revenue model. Customers can place orders through the Web site or by telephone. This flexibility is important because many consumers are still reluctant to buy on the Web. In the first few years of consumer electronic commerce, most shoppers used the Web to obtain information about products and compare prices and features, but then made their purchases by telephone. These shoppers found early Web sites hard to use and were often afraid to send their credit card numbers over the Internet. Although these fears are less prevalent today, most companies that use the Web catalog revenue model successfully do give customers a way to complete the payment part of the transaction by telephone or by mail.

Many of the most successful Web catalog sales businesses are firms that were already operating in the mail-order business and simply expanded their operations to the Web. Other companies that use the Web catalog revenue model adopted it after realizing that the products they sold in their physical stores could also be sold on the Web. This additional sales outlet did not require them to build additional stores, yet provided access to customers throughout the world. Types of businesses using the Web catalog revenue model include sellers of computers and consumer electronics; books, music, and videos; luxury goods; clothing; flowers and gifts; and general discount merchandise. In the next sections, you will learn how these types of businesses have applied the Web catalog revenue model to their operations.

Computers and Consumer Electronics

The leading computer manufacturers, including Apple, Dell, Gateway, Hewlett-Packard, and Sun Microsystems, have had great success selling on the Web. All of these companies sell a full range of products—from small notebook computers to large server computers—to individuals, businesses, and other organizations through their Web sites.

Dell has been a leader in allowing customers to specify exactly the configuration of computers they order on the Web. Dell created value by designing its entire business around offering this high degree of configuration flexibility to its customers. Other personal computer manufacturers that sell directly to customers on the Web have followed Dell’s lead by offering visitors different ways to access product information. These sites often offer links to specific products and pages designed for specific categories of customers, such as home, small business, education, or government users.

Retailers of consumer electronics products have also been active in undertaking electronic commerce using the Web catalog revenue model. Companies such as Crutchfield expanded their successful mail-order catalog operations to include Web sites. Other companies that had strong retail presences in their physical stores, such as Best Buy, J&R Music World, and Radio Shack, also created Web sites to sell the same products that they had been selling in their stores.

Having more than one way to reach customers is often a good idea for companies. Each different pathway to customers is called a marketing channel. Companies find that having several marketing channels lets them reach more customers at less cost. For example, it is expensive to stock a large number of different items in a physical store, so a company such as Best Buy will stock the most popular items in its stores but will sell a wider variety of items (including those that are not in high demand at every one of its retail locations) on its Web site. Customers who want to have physical contact with a product (putting fingers on a laptop computer’s keyboard, for example) before buying can visit the retail location. A customer who wants a high-end and expensive home theater system can find it on the Web site. By having two marketing channels (retail store and Web site), Best Buy reaches more customers and offers more products than it could using either channel alone.
Some types of products are difficult to sell online. This is particularly true for expensive Luxury Goods, as described later in this chapter. With their physical stores shuttered, traditional music retailers such as Camelot, Musicland, Sam Goody, and Tower Records, which had been selling music in their retail stores for decades, to create Web sites that could compete online. These traditional retailers struggled for years, gradually closing most or all of their retail stores, as they tried to compete against online CD retailers (and against online sellers of downloadable music, described later in this chapter). With their physical stores shuttered, and having gone through a series of buyouts and mergers, these traditional music retailers exist online today as the f.y.e. and Tower Records Web sites.

Luxury Goods
Some types of products are difficult to sell online. This is particularly true for expensive...
luxury goods and high-fashion clothing items that customers generally want to see in person or touch. The Web sites of couturiers Vera Wang and Versace, for example, were not constructed to generate revenue directly, but to provide information to shoppers who would visit the physical stores to examine items they had seen on the sites. Such sites tend to make heavy use of graphics and animation. Evian, the purveyor of premium-priced bottled water, created a Web site that presents information about its product and company in what it hopes is a visually stunning way. This presentation is intended to convey a feeling of exclusivity to those who choose to drink the water.

**Clothing Retailers**
A number of apparel sellers have adapted their catalog sales model to the Web, including bebe, Gap, Lands’ End, L.L. Bean, Talbots, and Wet Seal. Unlike sellers in the high-fashion clothing category previously discussed, these Web stores display photos of casual and business clothing categorized by style and described with prices, sizes, colors, and tailoring details. Their intent is to have customers examine the clothing and place orders through the Web site. Lands’ End pioneered the idea of online Web shopping assistance with its Lands’ End Live feature in 1999. A Web customer with a question can initiate a text chat with a customer service representative or click a button on the Web page to have the representative call. In addition to answering questions, the representative can offer suggestions by pushing Web pages to the customer’s browser.

Lands’ End also has personal shopper and virtual model features on its site. The personal shopper is an intelligent agent program that learns the customer’s preferences and makes suggestions. The virtual model is a graphic image built from customer measurements and descriptions on which customers can try clothes. About 15 percent of visitors to the site use the virtual model and, on average, dress the model 40 times during a visit. Lands’ End has found that the dollar amount of orders placed by customers who use the virtual model is about 10 percent higher than other orders. The Canadian company that developed this Web site feature, My Virtual Model, has sold the technology to a number of other clothing retailers. The My Virtual Model Web site stores an individual’s virtual model details and makes that information available through any other clothing retailer site that offers the service. Other online general apparel retailers have added online chat, personal shopper, and virtual model features to their sites. Some of these sites include a feature that lets two shoppers browse the Web site together from different computers. Only one of the shoppers can purchase items, but either shopper can select items to view. The selected items appear in both Web browsers. Web sites can buy this technology from vendors such as DecisionStep (its product is called ShopTogether).

In the fast-changing clothing business, retailers have always had to deal with the problem of overstocks—products that did not sell as well as hoped. Many retailers use outlet stores to sell their overstocks. Lands’ End found that its overstocks Web page worked so well that it has closed some of its physical outlet stores. An online overstocks store works well because it reaches more people than a physical store and can be updated more frequently than a printed overstocks catalog. Overstocks and clearance sale pages have become a standard element of clothing retailers’ Web sites.

In addition to general apparel retailers, a number of specialty retailers opened stores on the Web. For example, women’s shoe retailers such as Steve Madden and Nine West use the Web catalog model to sell directly to consumers online.

One problem that the Web presents for clothing retailers of all types is that the color settings on computer monitors vary widely. It is difficult for customers to get an accurate idea of what the product’s color will look like when it arrives. Most online clothing stores will send a fabric swatch on request. The swatch also gives the customer a sense of the fabric’s texture—an added benefit not provided by catalogs. Most Web catalog retailers also have generous return policies that allow customers to return unused merchandise for any reason.

**Flowers and Gifts**
Gift retailers also use the Web catalog revenue model. The florist 1-800-Flowers created an online extension to its highly successful telephone order business to compete with online-only florists such as Proflowers.com. Chocolatier Godiva offers business gift plans on its site. For gift shoppers who want a familiar brand name, shopping mall mainstays Hickory Farms and Mrs. Fields Cookies both have Web catalog sites. When Harry and David, famous for its trademarked “Fruit-of-the-Month” club, opened an informational Web site to promote its catalog business, they were surprised by the volume of sales that the site generated and quickly added online ordering features.
General Discounters
A number of companies began their first retail operations online. Some of these businesses, such as Buy.com and Overstock.com, operate as Web-based deep discounters. Borrowing a concept from the physical world’s Wal-Marts and discount club stores, these discounters sell merchandise such as computer equipment, software, consumer electronics, books, and sports equipment at extremely low prices.

Traditional discount retailers, such as Costco, Kmart, Target, and Wal-Mart, were slow to implement online sales on their Web sites, which were originally used for general information distribution. They had huge investments in their physical stores, were making large amounts of sales in those stores, and did not really understand the world of online retailing. However, after some false starts and learning challenges, all of these major retailers now use the Web catalog revenue model in their successful online sales operations.

WALMART.COM
Wal-Mart is the world’s largest retailer, with more than 7000 stores and annual sales exceeding $400 billion. Founded in 1962 by retailing legend Sam Walton, the company has won numerous awards for business innovation. However, Wal-Mart’s move into online retailing was troubled, to say the least.

Wal-Mart launched its first Web site in July 1996. Like most company sites of that time, it contained some information about the company, but did not offer any products for sale. Wal-Mart did little to develop the Web site over the next three years, but it did add a Web store—just in time to participate in the disastrous 1999 holiday shopping season.

Wal-Mart was not the only Web retailer to have trouble in 1999. Many companies found that they were ill-prepared for the large number of customers who decided to try electronic commerce in that year’s holiday season. Lost orders, unfilled orders, and shipments that failed to arrive until January 2000 were common for many Web retailers that year. Wal-Mart was noted as an industry leader in shipping and logistics management; however, the announcement on its Web site that it could not promise Christmas delivery for items ordered after December 14 was particularly embarrassing.

To make matters worse, Wal-Mart was in the middle of developing a new Web site that it had hoped to launch before the holiday season. The project, which industry analysts estimate cost more than $100 million, ran months late and did not operate until January 2000.

After eight months of operating the new Web site, Wal-Mart found itself with low levels of customer traffic (well below those of its major rivals J.C. Penney, Sears, Kmart, and Target) and high levels of criticism from Web site design experts who found the site slow, difficult to use, and lacking customer service features.

In October 2000, Wal-Mart closed the site completely for four weeks. Earlier in the year, it had created Walmart.com, a joint venture with Accel Partners to develop a new Web site, but the new site was not ready to launch until November. Industry analysts widely criticized Wal-Mart’s decision to completely shut down its Web operations for such a long time period at the beginning of the holiday shopping season.

The new Web site is a vast improvement over the old site. It is much better organized and offers improved browsing and search functions. The new site offers about the same number of items as the old site did (about 500,000—several times more than what the physical stores carry); however, the new site has more offerings of consumer electronics, toys, photo services, and sporting goods, and fewer offerings of consumable products. Behind the scenes is a new distribution center that serves Walmart.com exclusively.

Wal-Mart’s experience is a testament to how difficult it can be to get Web retailing right. Success eluded the largest retailer in the world for years. Wal-Mart is estimated to have spent more than $150 million on its various Web implementations over five years before it was able to present a truly usable site to its customers.

Digital Content Subscription Revenue Models
Firms that own written information (words or numbers) or rights to that information have embraced the Web as a highly efficient distribution mechanism. Most of these companies use a digital content revenue model; that is, they sell subscriptions for access to the information they own. Although many types of information are now sold by subscription online, most of these digital content providers specialize in legal, academic research, business, or technical material.

Legal Content
LexisNexis began as a legal research tool, and it has been available as an online product for years. Today, LexisNexis offers a variety of information services, including legal information, corporate information, government information, news, and resources for academic
libraries. The original legal information product exists on the Web today as Lexis.com and provides full-text search of court cases, laws, patent databases, and tax regulations. In the past, law firms had to subscribe to and install expensive dedicated computer systems to obtain access to this information, but the Web has given LexisNexis customers much more flexibility in how they purchase information. Through the Lexis.com Web site, law firms can subscribe to several versions of the service, which are customized for different firm sizes and usage patterns. The Web site even offers a credit card charge option for infrequent users who do not want a subscription. LexisNexis has used the Web to improve the delivery and variety of its existing product line and has been able to devise new products that take advantage of the Web’s features.

**Academic Research Content**

ProQuest, a Web site that sells digital copies of published documents, has its roots in two businesses: the former Bell and Howell learning materials business and University Microfilms International (UMI). These firms acquired reproduction rights to a variety of published and unpublished materials. For example, UMI had contracts with most North American universities to publish all doctoral dissertations and masters theses on demand. ProQuest offers digital versions of these documents for sale, along with a number of newspapers, journals, and other specialized academic publications. Many schools and libraries have subscriptions to ProQuest. Ovid and EBSCO Information Services also sell subscriptions to digital versions of journals to corporate and university libraries. These companies sell access to bibliographic databases and electronic journals to schools, companies, and libraries as well.

**Business Content**

Dow Jones, a business-focused publisher of newspapers such as The Wall Street Journal and Barron’s, was one of the first publishers to create a Web site for selling subscriptions to digitized newspaper, magazine, and journal content. The Dow Jones Interactive site offered a customized digital clipping service that provided subscribers with a daily e-mail message of news on topics of interest to them. In 2002, Dow Jones launched an online content management and integration service called Factiva. Today, Factiva gives companies the ability to manage internal information and integrate it with external information to track company and industry news, perform analysis of acquisition candidates, and manage the company’s risk in a dynamic business environment.

**Technical Content**

One of the first academic organizations to make the transition to electronic distribution on the Web was (not surprisingly) the Association for Computer Machinery (ACM). The ACM Digital Library offers subscriptions to electronic versions of its journals to its members and to library and institutional subscribers. Academic publishing has always been a difficult business in which to make a profit because the base of potential subscribers is so small. Even the most highly regarded academic journals often have fewer than 2000 subscribers. To break even, academic journals must often charge each subscriber hundreds or even thousands of dollars per year. Electronic publishing eliminates the high costs of paper, printing, and delivery, and makes dissemination of research results less expensive and more timely.

**Advertising-Supported Revenue Models**

The advertising-supported revenue model is the one used by broadcast network television in the United States. Broadcasters provide free programming to an audience along with advertising messages. The advertising revenue is sufficient to support the operations of the network and the creation or purchase of the programs. Web advertising grew from essentially zero in 1994 to $2 billion in 1998. However, Web advertising was flat or declining in the years 2000 to 2002. Since then, Web advertising has once again resumed its growth and, as you will learn in Chapter 4, is well established as an important component of the advertising mix for businesses of all types.

Online advertising has been challenged by two major problems. First, no consensus has emerged on how to measure and charge for site visitor views. Because Web sites can take multiple measurements, such as number of visitors, number of unique visitors, number of click-throughs, and can measure other attributes of visitor behavior, Web advertisers have struggled to develop a standard for advertising charges. In addition to the number of visitors or page views, stickiness is a critical element in creating a presence that attracts advertisers. The stickiness of a Web site is its ability to keep visitors at the site and attract repeat
visitors. People spend more time at a sticky Web site and are thus exposed to more advertising.

The second problem is that very few Web sites have sufficient numbers of visitors to interest large advertisers. Although a few Web sites have succeeded by appealing to a large general audience that advertisers want to reach, most successful advertising on the Web is targeted at specific groups. The set of characteristics that marketers use to group visitors is called demographic information, which includes things such as address, age, gender, income level, type of job held, hobbies, and religion. It can be difficult to determine whether a given Web site is attracting a specific market segment unless that site collects demographic information from its visitors—information that visitors often are reluctant to provide because of privacy concerns.

One solution to this second problem has been found by an increasing number of specialized information Web sites. These sites are successful in using an advertising-supported revenue model because they draw a specialized audience that certain advertisers want to reach. These sites do not need to gather demographic information from their visitors because anyone drawn to the site will have the specific set of interests that makes them a prized target for certain advertisers. In most cases, advertisers will pay high enough rates to support the operation of the site and in some cases, the advertising revenue is large enough to make these sites quite profitable.

Two examples of successful advertising-supported sites that appeal to audiences with specific interests are The Huffington Post and the Drudge Report. Each of these Web sites appeals to people who are interested in politics (liberal and conservative, respectively). Advertisers that want to target an audience with a specific political interest are willing to pay rates that are high enough to make these sites profitable enterprises. Online news sites that focus their coverage on a particular town or metropolitan area can use the advertising-supported revenue model successfully. Companies that want to reach potential customers in that area would find such sites to be useful for targeted marketing, since the Web sites would draw visitors with a specific interest in the geographic area. Similarly, HowStuffWorks is a Web site that explains, as the name suggests, how things work. Each set of Web pages in the site attracts visitors with highly focused interests. For example, a visitor looking for an explanation of how heating stoves work would be a good prospect for advertisers that sell heating stoves. HowStuffWorks does not need to obtain any specific information from its visitors; the fact that visitors are viewing the heating stoves information page is enough justification for charging heating stove companies a higher rate for ads on those pages. HowStuffWorks is an attractive online advertising option for a wide variety of companies because the site has pages on a large range of very specific products and processes.

These three strategies—general interest, specific interest, and collection of specific interests—for implementing an advertising-supported revenue model are summarized in Figure 3-2.

Web Portals
Some companies have been successful using the general interest strategy shown in Figure 3-2 by operating a Web portal. A portal or Web portal is a site that people use as a launching point to enter the Web (the word "portal" means "doorway"). A portal almost always includes a Web directory or search engine, but it also includes other features that help visitors find what they are looking for on the Web and thus make the Web more useful. Most portals include features such as shopping directories, white pages and yellow pages searchable databases, free e-mail, chat rooms, file storage services, games, and personal and group calendar tools.

FIGURE 3-2 Three strategies for an advertising-supported revenue model

One of the leading Web portal sites is Yahoo!, which was one of the first Web directories. A Web directory is a listing of hyperlinks to Web pages. Because the Yahoo! portal’s search engine presents visitors’ search results on separate pages, it can include advertising on each results page that is triggered by the terms in the search. For example, when the Yahoo! search engine detects that a visitor has searched on the term new car deals, it can place a Ford ad at the top of the search results page. Ford is willing to pay more for this ad because it is directed only at visitors who have expressed interest in new cars.
Other employment ad sites, such as CareerBuilder.com, have had more difficulty attracting advertisers than the larger sites. Not all portals use a general interest strategy, however. Some portals are designed to help visitors find information within a specific knowledge domain. The technology portal C-Net is an example of this type of site. C-Net uses the collection of specific interest strategy. The entire site is devoted to technology products and the site includes many reviews of specific technologies and related products. Advertisers pay more to have their ad appear near a discussion of a technology related to their product or on a page that reviews the product.

Travel portals such as Kayak have also been successful as advertising-supported online businesses. The Kayak site allows visitors to specify travel dates and destinations, and then searches multiple sites to find the best airfares, car rentals, and hotel rooms. It searches provider sites such as those of the airlines, hotels, and car rental companies, but it also searches sites that consolidate travel products and sell them at reduced prices. Kayak benefits its visitors by saving them the trouble of visiting multiple sites to find the best travel deals. And it sells targeted advertising space to companies that want to reach travelers with near-term travel plans.

**Newspaper and Magazine Publishers**

Many newspapers and magazines publish all or part of their print content on the Web. They sell advertising to cover the costs of converting their print content to an online format and operating the Web site. The Internet Public Library Newspapers Collection page includes links to hundreds of newspaper sites around the world. Some publications, such as local shopping news and alternative press newspapers, have always been fully supported by advertising revenues and are distributed at retail locations and newsstands without charge. Many of these publications have made an easy transition to an advertising-supported revenue model. Most newspapers and magazines, however, have relied on subscription and newsstand revenue to supplement their advertising revenue. These publications have had a more difficult time in making their online editions generate sufficient revenue.

It remains unclear whether an online presence helps or hurts the business operations of these publishers. Although a Web site can provide greater exposure for the publication’s name and a larger audience for advertising that it carries, an online edition can also divert sales from the print edition. Like retailers or distributors whose online sales lead to the loss of their brick-and-mortar sales, publishers also experience sales losses as a result of online distribution. Newspapers and other publishers worry about these sales losses because they are very difficult to measure.

In addition to the concern about lost sales of print editions, most newspaper and magazine publishers have found that the cost of operating their Web sites cannot be covered by the revenue they generate from selling advertising on the sites. Many publishers continue to experiment with various other ways of generating revenue from their Web sites. You will learn about these other revenue models later in this chapter.

**Targeted Classified Advertising Sites**

In the past, newspapers generated a significant percentage of their revenue from their classified advertising pages. You have already learned that targeted advertising can command higher rates than general advertising. Newspaper classified advertising was the original version of targeted advertising. Each ad is placed in a specific classification and only readers interested in that type of ad will read that classification. For example, a person looking for an apartment to rent would look in the Rentals classification. The growth of classified advertising Web sites has been very bad for newspapers. Sites such as Craigslist now carry many free classified ads that would once have produced substantial classified advertising revenue for local newspapers. Craigslist and similar sites run most ads for free, only charging for a small proportion of the ads they carry (Craigslist charges for job ads, brokered rental ads in New York City, and a few other categories). Craigslist generates enough revenue to continue operating, but many other classified advertising sites generate substantial revenue, replacing newspapers’ historical role as the primary carrier of classified ads. The most successful targeted classified advertising category has been Web employment sites. Companies such as CareerBuilder.com offer international distribution of employment ads. These sites offer advertisers access to targeted markets. When a visitor specifies an interest in, for example, engineering jobs in Dallas, the results page can include a targeted ad for which an advertiser will pay more because it is directed at a specific market segment. Other employment ad sites, such as The Ladders and Guru.com, charge both job seekers
and employers for ads and access to those ads.
Employment ad sites such as Monster.com also target specific categories of job seekers by including short articles on topics of interest. These articles increase the site’s stickiness and attract people who are not necessarily looking for a job. This is a good tactic because people who are not looking for a job are often the candidates most highly sought by employers.

Another type of online classified advertising business is the used vehicle site. Trader Publishing has printed advertising newspapers for many years and now operates the AutoTrader.com site. CycleTrader.com and BoatTrader.com are similar sites that accept paid advertising from individuals and companies that want to sell cars, motorcycles, and boats. If the product has a dedicated following, this type of site can be successful by catering to small audiences. For example, the VetteFinders site sells classified ads for Corvette automobiles only.

Any product that is likely to be useful after the original buyer uses it provides the potential for a classified advertising site. People who want to sell used musical instruments can place ads on the Musicians Buy-Line site. Comic book collectors will find classified ads directed to them at ComicLink.com. Golfers who have given up the game or moved on to better clubs can place classified ads for their old equipment on The Golf Classifieds.

**Advertising-Subscription Mixed Revenue Models**

In an advertising-subscription mixed revenue model, which has been used for many years by traditional print newspapers and magazines, subscribers pay a fee, but also accept some level of advertising. On Web sites that use the advertising-subscription revenue model, subscribers are typically subjected to much less advertising than they are on sites supported completely by advertising. Firms have had varying levels of success in applying this mixed revenue model and a number of companies have moved to or from this model as they try to find the best way to generate revenue online.

Two of the world’s most distinguished newspapers, The New York Times and The Wall Street Journal, have each used a mixed advertising-subscription model since they first took their publications online. The New York Times Web site today derives the bulk of its revenue from advertising, but the newspaper has experimented in recent years with charging fees for access to various parts of its site. In 2005, The New York Times began charging a fee for access to its Op Ed and news columns. By 2007, the newspaper decided that it could earn more advertising revenue by providing free access to those pages than it was earning in subscription fees, so it went back to relying on an advertising-supported revenue stream. Today, the newspaper charges only for access to its premium crossword puzzle pages and for older articles retrieved from its archives. The Wall Street Journal’s mixed model is weighted more heavily to subscription revenue. The site allows nonsubscriber visitors to view the classified ads and certain stories from the newspaper, but most of the content is reserved for subscribers who pay an annual fee for access to the site. Visitors who already subscribe to the print edition are offered a reduced rate on subscriptions to the online edition.

Most newspapers and magazines that use the mixed advertising-subscription revenue model for their online publications follow The New York Times approach of making most content available online, but a number of them do limit free content as The Wall Street Journal does. Figure 3-3 shows the revenue models used by a number of newspapers and magazines, including the advertising-supported model, the mixed advertising-subscription model with most content freely available, and the mixed advertising-subscription model with most content available only to subscribers.

Sports fans visit the ESPN site for all types of sports-related information. Leveraging its brand name from its cable television businesses, ESPN is one of the most-visited sports sites on the Web. It sells advertising and offers a vast amount of free information, but die-hard fans can subscribe to its Insider service to obtain access to even more sports information. Thus, ESPN uses a mixed model that includes advertising and subscription revenue, but it only collects the subscription revenue from Insider subscribers, who make up a small portion of site visitors.

Consumers Union, the publisher of product evaluations and ratings monthly magazine Consumer Reports, operates a Web site, ConsumerReports.org, that relies exclusively on subscriptions (that is, it is a purely subscription-supported site). Consumers Union is a not-for-profit organization that does not accept advertising as a matter of policy because it might appear to influence its research results. Thus, the site is supported by a combination
of subscriptions and a small amount of charitable donations. The Web site does offer some free information as a way to attract subscribers and fulfill its organizational mission of encouraging improvements in product safety.

**Advertising-Supported**

**FIGURE 3-3 Revenue models used by online editions of newspapers and magazines**

**Fee-for-Transaction Revenue Models**

In the fee-for-transaction revenue model, businesses offer services for which they charge a fee that is based on the number or size of transactions they process. Some of these services lend themselves well to operating on the Web. To the extent that companies can offer Web site visitors the information they need about the transaction, companies can offer much of the personal service formerly provided by human agents. If customers are willing to enter transaction information into Web site forms, these sites can provide options and execute transactions much less expensively than traditional transaction service providers. The removal of an intermediary, such as a human agent, from a value chain is called disintermediation. The introduction of a new intermediary, such as a fee-for-transaction Web site, into a value chain is called reintermediation.

**Travel**

Travel agents earn commissions on each airplane ticket, hotel reservation, auto rental, or vacation that they book. These commissions are paid to the travel agent by the transportation or lodging provider. The travel agency revenue model involves receiving a fee for facilitating a transaction. The value added by a travel agent is that of information consolidation and filtering. A good travel agent knows many things about the traveler’s destination and knows enough about the traveler to select the information elements that are useful and valuable to the traveler. Computers, particularly computers networked to large databases, are very good at information consolidation and filtering. In fact, travel agents have used networked computers, such as the Sabre Travel Network, for many years to make reservations for their customers.

When the Internet emerged as a new way to network computers and then became available to commercial users, a number of online travel agencies began doing business on the Web. Existing travel agencies did not, in general, rush to the new medium. They believed that the key value they added, personal customer service, could not be replaced with a Web site. Therefore, the first Web-based travel agencies were new entrants. One of these sites, Travelocity, is based on the same Sabre system that traditional travel agents use. (Travelocity is also owned by Sabre.) Microsoft was an early participant in the online travel agency business with its Expedia subsidiary. Travelocity, Expedia, Hotels.com, and Hotel Discount Reservations are regularly listed among the top electronic commerce sites in surveys and industry analyst rankings. All four are profitable. In 2001, a consortium of five major U.S. airlines (American, Continental, Delta, Northwest, and United) launched Orbitz, which quickly became one of the most visited travel sites on the Web. The Orbitz home page appears in Figure 3-4. In addition to earning commissions from the transportation and lodging providers, these sites generate advertising revenue from ads placed on travel information pages. These ads are similar to those on search engine results pages because advertisers can target them without obtaining demographic details about the site visitor. For example, if you are booking a flight to Chicago, the page that lists airline ticket options may also carry a banner ad for a hotel in Chicago or a car rental company that is running a promotion in the Chicago area. Many traditional travel agents were squeezed out of the business as larger online operations took their most lucrative business. Airlines reduced or eliminated the commissions they once paid to travel agents on each ticket. Many travel agents (including the online travel sites) now charge their customers a flat fee for processing an airline ticket, and most passengers today buy their own tickets from online travel sites or from the airlines’ Web sites directly.

**FIGURE 3-4 Orbitz home page**

The smaller travel agencies that have survived often specialize in cruise vacations. Cruise lines still view travel agents as an important part of their selling strategy and continue to pay reasonable commissions to travel agents on the sales that they make. Web sites that make discounted cruise packages easy to search, such as VacationsToGo.com, or that provide detailed information about cruises, such as Cruise Specialists, have been successful in this travel industry niche.
Other small travel agencies have been successful by following a reintermediation strategy with a focus on specific groups of travelers. These travel agents identify a group of travelers with specific needs and create travel packages designed for that group. For example, surf vacations have become increasingly popular. The stereotypical surfer of years gone by (a young unemployed male) has been replaced by a much broader demographic. Today’s surfers often have significant financial resources and enjoy surfing in exotic locations. Web sites such as WaveHunters.com have followed a reintermediation strategy and cater to this highly specialized market in ways that generalist travel agents have not. Travel agencies that specialize in unusual or exotic destinations, such as Antarctica, have also been successful as intermediaries if they have particular expertise, knowledge, or local contacts that help them create custom itineraries.

Automobile Sales

Auto dealers buy cars from the manufacturer and sell them to consumers. They provide showrooms and salespeople to help customers learn about product features, arrange financing, and make a purchase decision. Most auto dealers negotiate the prices at which they sell their cars; thus, the salesperson’s job also includes extracting the highest possible price from the consumer. Many people do not like negotiating car prices, especially if they have taken the time to learn about car features, arrange financing, and are ready to purchase a car without further assistance from a salesperson. Autobytel and similar firms, such as MSN Autos and CarsDirect.com, provide an information service to car buyers. Each of these firms implements the fee-for-transaction revenue model in a slightly different way. For example, CarsDirect.com offers customers the ability to select a specific car (model, color, options) at a price it determines. CarsDirect.com then finds a local dealer that has such a car and is willing to sell it for the CarsDirect.com price. Alternatively, Autoweb.com and Autobytel locate dealers in the buyer’s area that are willing to sell the car specified by the buyer (including make, model, options, and color) for a small premium over the dealer’s nominal cost. The buyer can purchase the car from the dealer without negotiating with a salesperson. Autobytel and Autoweb.com charge participating dealers a fee for this service. In effect, firms such as Autobytel, Autoweb.com, CarsDirect.com, and MSN Autos are taking the salesperson out of the value chain. To the extent that the salesperson provides little or no value to the consumer, these firms are reducing the transaction costs in the process. The car salesperson is disintermediated and the Web site becomes the new intermediary in the transaction, which is an example of reintermediation.

Stockbrokers

Stock brokerage firms also use a fee-for-transaction model. They charge their customers a commission for each trade executed. In the past, stockbrokers offered investment advice and made specific buy and sell recommendations to customers in addition to their transaction execution services. They did not charge for this advice, but they did charge relatively high commissions on the trades they executed. After the U.S. government deregulated the securities trading business in the early 1970s, a number of discount brokers opened. These discount brokers distinguished themselves from the established “full-line” brokerage houses by not offering any investment advice and charging very low commissions. Because the full-line brokers had failed to provide value to some of their customers (those who had no need for investment advice or buy/sell recommendations), those customers were very happy to move their business to the discount brokers who provided nothing more than fast, inexpensive trade execution.

The Web made it possible for firms such as E*TRADE and Datek (later purchased by TD Ameritrade) to offer investment advice (posted on Web pages or sent in e-mailed newsletters) similar to that offered by a full-line broker, without incurring many of the costs of distributing the advice (such as stockbroker salaries, overhead, and the costs of printing and mailing newsletters). Web-based brokerage firms could also offer fast execution of trades that customers entered into Web page forms. Thus, in the 1990s, discount brokers who had taken business away from full-line brokers for 15 years faced new competition from online firms. Of course, the full-line brokers found that they were losing business to both the discount brokers and the online brokers. In response, both discount brokers (such as Charles Schwab and TD Ameritrade) and full-line brokers (such as Merrill Lynch and Morgan Stanley Smith Barney) opened new stock trading and information Web sites. Online brokers offer customers the same kind of transaction cost reductions as the online auto-buying sites offer car shoppers. Traditional stockbrokers were disintermediated just as car salespeople were. And the financial crisis of 2008 took its toll on the remaining full-service brokerage firms. Today, most individuals who buy and sell stocks regularly use
Online brokers.

Insurance Brokers
Other sales agency businesses are moving to the Web. Although insurance companies themselves were slow to offer policies and investments for sale on the Web, a number of intermediaries that sell insurance policies from a variety of companies have been online since the early days of the Web. Quotesmith, which began business in 1984 as a policy-quoting service for independent insurance brokers, decided in 1996 to offer its policy price quotes directly to the public over the Internet. By quoting policies and accepting applications directly, Quotesmith is disintermediating the independent insurance agents with whom it formerly worked.

Other Web sites that offer insurance policy information, comparisons, and sales include InsWeb, Answer Financial, and insurance.com. As you learned in the case at the beginning of this chapter, Progressive provides quotes on its Web site for both its insurance products and for its competitors’ products. The General (General Automobile Insurance Services) uses its Web site to reach auto insurance buyers who might have had trouble getting insurance from other companies. It advertises its online insurance quotes as being “fast and anonymous.” By offering a comfortable environment to potential customers who have been rejected by other companies because of credit problems or a record with traffic tickets, The General has been successful in this specific niche of the insurance market. Today, many major insurance companies, such as Allstate, GEICO, and State Farm Insurance, offer information and policies for sale on their Web sites.

Event Tickets
Before the Web made online sales possible, obtaining tickets for concerts, shows, and sporting events could be a challenge. Some venues only offered tickets for sale at their own box offices, and others sold tickets through ticket agencies that were difficult for patrons to find or impossible to reach by telephone. The Web gave event promoters the ability to sell tickets from one virtual location to customers practically anywhere in the world.

Established ticket agencies such as Ticketmaster were early participants in online ticket sales. Other companies, such as Tickets.com and TicketWeb, also offer a wide variety of tickets for events in many different locations. These ticket brokers earn a fee on every ticket they sell.

In addition to the original sale of tickets, the Web created opportunities for those who deal in secondary market tickets (tickets that have already been sold by the event’s producer and that are being offered for resale to other persons). Companies such as StubHub and TicketsNow operate as brokers to connect owners of tickets with buyers in this market. These ticket resellers earn fees on tickets they resell for others, but they can also profit by buying blocks of tickets and reselling them at a higher price. Both ticket brokers and ticket resellers reduce transaction costs for both buyers and sellers of tickets by creating a central marketplace that is easy to find and that facilitates buyer-seller negotiation.

Real Estate and Mortgage Loans
Other fee-for-transaction businesses are also starting to open electronic commerce Web sites, including real estate brokers and mortgage loan brokers. Online real estate brokers provide all of the services that a traditional broker might provide—except that online brokers provide these services through their Web sites. Most traditional real estate brokers have created Web sites, such as Coldwell Banker and Prudential. The industry’s trade association, the National Association of Realtors, sponsors a Web site, Realtor.com, that carries ads for houses listed by its member firms.

Although the financial crisis of 2008 dramatically reduced the number of mortgage brokers in business, a number of them continue to do business online. Both Ditech and E-LOAN still provide information and take mortgage loan applications online.

Online Banking and Financial Services
Because financial services do not involve a physical product, they are easy to offer on the Web. The greatest concerns that most people have when they consider moving their financial transactions to the Web are security and the reliability of the financial institution—the same concerns that exist in the physical world. However, on the Web, it is much more difficult for a firm to establish its reputation for security and trust than it is in the physical world, where massive buildings and clearly visible room-sized safes can help create the necessary image. Many people who are willing to buy products and services online are unwilling to trust a Web site for their banking services, but the number who do is growing. Researchers estimate that more than 25 percent of all people who have made a purchase
online also conduct their banking business online. In Chapter 11, you will learn more about how online payments and other financial transactions are processed.

Most banks that entered the Web banking business did so by opening online “branches” that carried the identification and reputation of the bank’s brand as it existed in the physical world. Other firms started online banks that were not affiliated with an existing bank (such as the First Internet Bank of Indiana). Bank One opened an online bank under the name Wingspan in 1999. Bank One decided to present Wingspan as a new and separate entity, in the spirit of the dot-com boom that was then under way. After operating Wingspan separately for about two years, Bank One decided to close Wingspan and merge it with its main Web site (Bank One has since been acquired by Chase). Today, most banks understand that their online operations can benefit from using their established name and reputation to provide customers with a sense of trustworthiness.

Online banking operations handle only a small portion of the world’s financial transactions today, but more customers accept them every year as a good way to conduct their banking business. Banks benefit from serving their customers online because it costs the bank less to provide services online than to provide those same services through personal interactions with bank employees in a branch office.

In addition to customers’ concerns about trust and security online, two other significant barriers are preventing a more rapid rate of growth in the online banking business: a lack of bill presentment features and a lack of account aggregation tools. Although online banks let customers pay their bills electronically, most customers still receive their bills in the mail. Unfortunately, most people must visit a different Web site to view each online bill. As online banks add bill presentment services that allow their customers to view all of their bills on the bank’s Web site (and pay each of them with a single click), those banks will find more customers willing to do their banking on the Web. A bill presentment service provides an electronic version of an invoice or billing statement (such as a credit card bill or a mobile phone services statement) with all of the details that would appear in the printed document.

Another important feature that few online banks currently offer is account aggregation, which is the ability to obtain bank, investment, loan, and other financial account information from multiple Web sites and display it all in one location at the bank’s Web site. Many of a bank’s best customers have credit card, loan, investment, and brokerage accounts with several different financial institutions. Having all of this information aggregated in one place is very useful for these customers. Although some banks have created their own account aggregation and bill presentment software, companies such as Yodlee sell these services to banks and other financial institutions. The number of banks that offer aggregation is growing rapidly. Industry analysts expect that most banks (online and traditional) will offer aggregation services by 2012.

Online Music

The recording industry was slow to embrace online distribution of music because audio files are digital products that can be easily copied once purchased. The digital copies are perfect and thus can seriously impair future sales of the original audio file. Music files are in great demand and are easily copied, which is why in the early days of online music, many otherwise law-abiding persons illegally copied and shared music files. As you will learn in Chapter 7, recording companies fought this illegal sharing of music files by suing some of the people who shared files and the Web sites that facilitated their sharing activity. Although the recording companies still file lawsuits, they have also finally decided that they should capture some of the market for music files by selling their audio tracks online.

The largest online music stores include Amazon MP3, Apple’s iTunes, eMusic, Microsoft’s MSN Music, Napster, Rhapsody, Yahoo! Music, and Walmart.com Music Downloads. These sites sell single songs (tracks) for less than a dollar each and sell albums at various prices (most are between $5 and $12). Although some sites offer subscription plans, most of the sales revenue on these sites is generated using the fee-for-transaction model. The online music market has been complicated because each store does not offer all of the music that is available in digital format and because each store tries to promote its own music file format. Artists and recording companies sometimes only offer their music through one store and some refuse to offer their music online at all. By promoting its own file format, each store is trying to force music consumers to use their store exclusively. Some online music sellers require buyers to download and install software, called Digital Rights Management (DRM) software, which limits the number of copies that can be made of each audio file. This does not prevent illegal copying, but it does make it somewhat more difficult and the sellers hope that the extra effort required will discourage some of this copying.
However, each store has different rules about how many copies are permitted and on which devices the files can be played. Consumers, especially those who buy music from more than one store, have found these varying restrictions confusing. The online music market has been an example of an industry that has failed to embrace the network effect it could gain by adopting one standard file format (or a set of compatible file formats). By trying to gain an advantage in the market, each company inadvertently limited the growth of the overall market.

Some stores (such as Mondomix MP3 and Smithsonian Folkways) have always sold audio files in a generally compatible file format with no copying restrictions. However, the music sold on these sites is not produced by the major recording companies.

In 2007, the Amazon MP3 store was the first major online retailer to offer music tracks from several major recording companies in DRM-free MP3 format. Since then, the other major retailers have followed Amazon’s lead and most of them now offer some or all of their music in DRM-free, compatible file formats. Also, without DRM, it is now easier to convert files from one format to another.

With the problems of the complexity of DRM and incompatible formats nearing resolution, online music sales are increasing rapidly. Industry experts estimate that 80 percent of all music sold in 2012 will be sold online.

Online Video
Digital video can be sold or rented online as either a file download or as a streaming video. DRM software provides control over the number of copies that can be made of the downloaded video, the devices on which the video can be installed, and restrictions on how long the video remains available for watching. Videos offered for sale online include previously released movies, television shows, and programming that is developed specifically for the online market.

Until recently, video sales have been hampered by three main issues: the large size of video files (which can make download times long and streaming feeds uneven), concern that such sales might impair other sales of the video, and technological barriers that prevent downloaded videos from being played on a variety of devices. Online businesses are working continually on these issues and are having some success in overcoming all three of them.

First, videos are still the largest types of files that are regularly transmitted on the Internet, but companies are continually experimenting with technologies that improve the delivery of large files and video streams. You will learn more about these content delivery technologies, pioneered by companies such as Akamai, in Chapter 8.

Second, the companies that produce media are learning more about how online distribution fits into their overall revenue strategy. Movies traditionally have been released by the major Hollywood studios (20th Century Fox, Paramount, Sony, Walt Disney, Warner Brothers, and Universal) into different markets in a well-defined serial pattern. Movies were first distributed to theaters, which paid a high price for the right to show the movie first. After its initial theater run, the movie might then have been sold to airlines for in-flight showings and to premium cable channels such as HBO or Starz. Next, the movie was released on DVD and became available for purchase or rental through retail video stores. Eventually, the movie was sold to broadcast television stations and basic cable channels.

This serial release pattern was designed to provide the movie’s creators with the highest revenue obtainable at each point in the life of the product. Media producers released movies in this pattern for years, out of fear that any online distribution might steal sales away from one of their traditional outlets. These media producers now are experimenting with alternative distribution strategies. Some are now releasing movies online and on DVD simultaneously. As the number of online content distributors that charge either a subscription or a per-view fee for movies increases, media producers will be more amenable to releasing their product online because they can get paid for it.

Finally, the delivery of movies through a standard Web browser (and the appearance of Web browsers on devices other than computers; for example, mobile phones and video game appliances) is mitigating concern about technology barriers on multiple devices. Amazon.com and Wal-Mart both offer video on their Web sites. Video rental giant Blockbuster sells and rents access to video downloads, as does Netflix, which includes online access to movies on its Web site as part of its DVD rental subscription plans. Apple’s iTunes service includes video offerings for rent or purchase in addition to its many free video downloads.

Television programs are also available online. Three of the major U.S. broadcast
networks (ABC, Fox, and NBC) formed a joint venture to operate Hulu, which offers video clips of popular television programs and movies. Hulu offers some programs and movies in their entirety. The other major U.S. broadcast network, CBS, operates TV.com, which operates in a similar manner. Unlike the movie distribution sites mentioned above, which charge a fee or use a subscription for service revenue model, both Hulu and TV.com use an advertising-supported revenue model.

Electronic Books
Another type of digital product sold online is the electronic book. Audible has sold digital audio editions of books for many years, first in the form of CDs, then later as various types of digital files. Today, Audible sells subscriptions that allow customers to download a certain number of books each month. Since the pricing is per book, rather than a subscription fee for unlimited access to books, the service is included in this section of the chapter as a fee-for-transaction revenue model. Audible also sells spoken-word audio of magazines, newspapers, and other information and entertainment digital products.

For electronic books that can be read, Amazon.com offers books, newspapers, magazines, and other digital format items that are delivered directly to its line of Kindle readers, which are portable electronic book storage and display devices. Kindle books can be purchased using a Web browser on a user’s computer or through the Kindle device itself. The items purchased are downloaded to the Kindle, but are also stored on Amazon.com’s servers (in case the Kindle reader is lost or stolen).

Most industry analysts believe that the relatively high initial cost of the Kindle reader (between $300 and $500) and its lack of a color display are the two most important reasons that sales of the device and its related digital media have not been higher.

Fee-for-Service Revenue Models
Companies are offering an increasing variety of services on the Web for which they charge a fee. These are neither broker services nor services for which the charge is based on the number or size of transactions processed. The fee is based on the value of the service provided. These fee-for-service revenue models range from games and entertainment to financial advice and the professional services of accountants, lawyers, and physicians.

Online Games
Computer and video games are a huge industry. In the United States alone, more than $11 billion per year is spent on these types of games. An increasing portion of that revenue is generated online. Although many sites that offer games relied on advertising revenue in the past (and some, such as GSN.com, still do), a growing number now include premium games in their offerings. Site visitors must pay to play these premium games, either by buying and downloading software to install on their computers, or by paying a subscription fee to enter the premium games area on the site. MSN Games, Station.com, RealArcade, and Electronic Arts are among the leading game sites that include subscription game services. The Entertainment Software Association is an industry group that tracks computer and video game use. Its Web site includes a number of interesting statistics about computer game sales and demographics of game players. For example, the average game player is 35 years old and has been playing computer or video games for 12 years.

Professional Services
State laws have been one of the main forces preventing U.S. professionals (such as physicians, lawyers, accountants, and engineers) from extending their practices to the Web. Since most professionals are licensed by individual states, state laws can prevent them from practicing their professions on the Web because online patients or clients would likely be located in other states. If they were to offer their services online to persons in other states, professionals could be charged with unlicensed practice in those other states. State laws concerning the imputed location of service delivery are vague; it can be difficult to determine exactly where a service provided online actually occurs. This uncertainty arises because most state professional practice laws were written long before the Internet existed.

Although some medical, legal, and other professional practices allow patients to make appointments online, and a few professionals do online consultations, most are reluctant to do any element of their practices on the Web. Many professionals are worried about protecting the privacy of their patients or clients online.

The Law on the Web site offers legal consultations on a variety of matters for residents
of the United Kingdom. Accounting professionals in the United States can be located through the CPA Directory, and a number of legal referral sites can direct site visitors to local attorneys. The online version of the well-known Martindale-Hubbell lawyer directory is also available online at Martindale.com. Although a large number of Web sites, such as RealAge, Dr. Andrew Weil's Self Healing, and WebMD, offer general health information, physicians and other health care professionals have been reluctant to sell specific advice to specific patients online. The difficulty of diagnosing medical problems without a physical examination of the patient is a significant barrier to providing most types of health care services online, but some physicians are beginning to offer online consultations to patients with whom they have an ongoing, established relationship.

**Free for Many, Fee for a Few**

Chris Anderson, the editor of Wired Magazine, proposed in 2004 that the economics of producing and selling digital products is substantially different from the economics of producing and selling physical products. In his books (see references to his work in the For Further Study and Research section at the end of this chapter), he explains that physical products benefit from the production of standardized versions that generate economies of scale. Because each product requires materials and labor, using the same materials allows large producers to buy those materials at lower costs by ordering in bulk. Labor costs can be reduced by training workers to do specific production tasks efficiently. Since most of the cost of a physical product is in the manufacture of each unit (as opposed to the design of the prototype), the key to making a profit is to reduce the cost of manufacturing. Digital products work differently. They tend to have large up-front costs. Once those costs are incurred, additional units can be made at very low additional cost. For example, a software program can cost thousands of dollars to create. It can take many hours of expensive programmer time to design, code, and test. But once it is in production, creating additional units (especially if those units are distributed in digital form, online) costs very little. Making minor changes in the program so it works better for different types of customers can be inexpensive, too. Thus, the economics of digital products are quite different from the economics of physical products.

The result of Anderson’s logic is that it can be profitable to offer a digital product to a large number of customers for free, then charge a small number of customers for an enhanced, specialized, or otherwise differentiated version of the product. If you can charge the small number of customers enough to cover the cost of developing the digital product and yield a profit, you can give away many copies of the product, especially if those free copies entice more paying customers for the enhanced product. For example, Yahoo! offers free e-mail accounts to site visitors. This draws visitors to the Yahoo! site and allows the company to sell some advertising on the pages that display the e-mail service. But some e-mail users will want an enhanced version of the service. Perhaps they want pages with no advertising, the ability to send large attachments with their e-mails, or more storage space for their e-mails. Yahoo! charges for a premium version of its service that offers these features. It costs the company very little to offer this service, but it generates considerable revenue.

Companies selling physical products have often used a mixture of free and not-free products. For example, a bakery might have a plate of cookies available for customers to taste. The bakery hopes that enough customers will be impressed with the taste of the free cookies that they will buy cookies or other baked goods. They give away a small number of physical products to boost sales.

Anderson argues that this logic works for digital products distributed online, but in reverse. Companies can afford to give away large numbers of digital products at no cost to lure a few paying customers into buying similar, but enhanced, digital products. This principle underlies many of the mixed advertising-subscription revenue models you learned about earlier in this chapter.

**Revenue Models in Transition**

Many companies have gone through transitions in their revenue models as they learn how to do business successfully on the Web. As more people use the Web to buy goods and services, and as the behavior of those Web users changes, companies often find that they must change their revenue models to meet the needs of those new and changing Web users. Some companies created electronic commerce Web sites that needed many years to grow large enough to become profitable. This is not unusual; both CNN and ESPN took more than 10 years to become profitable and they had both created new businesses in television, which was an existing and well-established medium. Many Web companies found that their unprofitable
growth phases were lasting longer than they had anticipated and were forced either to change their revenue models or go out of business. This section describes the revenue model transitions undertaken by five different companies as they gained experience in the online world and faced the changes that occurred in that world. In the second wave of electronic commerce, these and other companies might well face the need to make further adjustments to their revenue models.

Subscription to Advertising-Supported Model
Microsoft founded its Slate magazine Web site as an upscale news and current events publication. Because Slate included experienced writers and editors on its staff, many people expected the online magazine to be a success. Microsoft believed that the magazine had a high value, too. At a time when most online magazines were using an advertising-supported revenue model, Slate began charging an annual subscription fee after a limited free introductory period. Although Slate drew a wide readership and received acclaim for its incisive reporting and excellent writing, it was unable to draw a sufficient number of paid subscribers. At its peak, Slate had about 27,000 subscribers generating annual revenue of $500,000, which was far less than the cost of creating the content and maintaining the Web site. Slate is now operated as an advertising-supported site. Because it is a part of Microsoft, Slate does not report its own profit numbers, but most industry observers believe that the site does not earn a profit. Microsoft maintains the Slate site as part of its Bing portal, so it is likely that the value of the publication to Microsoft is to increase the portal’s stickiness.

Advertising-Supported to Advertising-Subscription Mixed Model
Another upscale online magazine, Salon.com, which has also received acclaim for its innovative content, has moved its revenue model in the direction opposite of Slate’s transition. After operating for several years as an advertising-supported site, Salon.com now offers an optional subscription version of its site. The subscription offering was motivated by the company’s inability to raise the additional money from investors that it needed to continue operations. Subscribers pay an annual fee to view a version of the magazine called Salon Premium, which is free of advertising and can be downloaded for storage and later offline reading on the subscriber’s computer. Premium subscribers also gain access to additional content such as downloadable music, e-books, audio books, and other extras such as free magazine subscriptions.

Advertising-Supported to Fee-for-Services Model
XdriveTechnologies opened its original advertising-supported Web site in 1999. Xdrive offered free disk storage space online to users. The users saw advertising on each page and had to provide personal information that allowed Xdrive to send targeted e-mail advertising to them. Its offering was very attractive to Web users who had begun to accumulate large files, such as MP3 music files, and wanted to access those files from several computers in different locations. After two years of offering free disk storage space, Xdrive found that it was unable to pay the costs of providing the service with the advertising revenue it had been able to generate. After being bought by AOL in 2005, Xdrive switched to a subscription-supported model (AOL-registered users were eligible for a small free storage service) and began selling the service to business users as well as individuals. In recent years, disk drive costs have dropped and Xdrive frequently adjusted its monthly fee downward. AOL finally closed the service in 2009. Companies that are successful in the online storage business today generally charge a fee for their services that is based on the amount of storage used.

Advertising-Supported to Subscription Model
Northern Light was founded in August 1997 as a search engine, but a search engine that did more than search the Web. It also searched its own database of journal articles and other publications to which it had acquired reproduction rights. When a user ran a search, Northern Light returned a results page that included links to Web sites and abstracts of the items in its own database. Users could then follow the links to Web sites, which were free, or purchase access to the database items. Thus, Northern Light’s revenue model was a combination of the advertising-supported model used by most other Web search engines plus a fee-based information access service, similar to the subscription services offered by ProQuest and EBSCO that you learned about
earlier in this chapter. The difference in the Northern Light model was that users could pay for just one or two articles (the cost was typically $1–$5 per article) instead of paying a large amount of money for unlimited access to its database on an annual subscription basis. Northern Light also offered subscription access to most of its database to companies, schools, and libraries.

In January 2002, Northern Light decided that the advertising revenue it was earning from the ads it sold on search results pages was insufficient to justify continuing to offer that service. It stopped offering public access to its search engine and converted to a new revenue model that was primarily subscription supported. Northern Light’s new model generates revenue from annual subscriptions to large corporate clients. It still offers an individual account option, however. A person who wants to search the Northern Light database can open an account, supply a credit card number, and be billed monthly for the articles accessed.

Multiple Transitions

Encyclopædia Britannica is an excellent example of a company that transferred its existing reputation for high quality to the Web. Over its 240-year publishing history, Encyclopædia Britannica has developed one of the most respected brand names in research and education. It is particularly interesting that Encyclopædia Britannica began in 1768 as a sort of precomputer-age frequently asked questions (FAQ) list. A group of academics collected notes they had made while conducting research and decided to publish them as a series of articles.

When Encyclopædia Britannica first moved onto the Web in 1994, it began with two Web-based offerings. The Britannica Internet Guide was a free Web navigation aid that classified and rated information-laden Web sites. It featured reviews written by Britannica editors who also selected and indexed the sites. The company’s other Web site, Encyclopædia Britannica Online, was available for a subscription fee or as part of the Encyclopædia Britannica CD package. Britannica used the free site to attract users to the paid subscription site.

In 1999, disappointed by low subscription sales of Encyclopædia Britannica Online, Britannica converted to a free, advertising-supported site. The first day the new site, Britannica.com, became available at no cost to the public, it had more than 15 million visitors, forcing Britannica to shut down for two weeks to upgrade its servers. The Britannica.com site then offered the full content of the encyclopedia’s print edition in searchable form, plus access to the Merriam-Webster’s Collegiate Dictionary and the Britannica Book of the Year. One of the most successful aspects of the site was the way it integrated the Britannica Internet Guide Web-rating service with its print content. The Britannica Store sold the CD version of the encyclopedia along with other educational and scientific products to help generate revenue.

After two years of trying to generate a profit using this advertising-supported model, Britannica faced declining advertising revenues. In 2001, Britannica returned to a mixed model in which it offered free summaries of encyclopedia articles and free access to the Merriam-Webster’s Collegiate Dictionary on the Web, with the full text of the encyclopedia available through an annual subscription plan.

Britannica went from being a print publisher to a seller of information on the Web to an advertising-supported Web site to a mixed advertising subscription model—three major revenue model transitions—in just a few short years. The main value that Britannica has to sell is its reputation and the expertise of its editors, contributors, and advisors. For now, Britannica has decided that the best way to capitalize on that reputation and expertise is through a mixed revenue model of subscriptions and advertising support, with the bulk of its revenue coming from subscriptions.

REVENUE STRATEGY ISSUES

In the first part of this chapter, you learned about the revenue models that companies are using on the Web today. In this section, you will learn about some issues that arise when companies implement those models. You will also learn how companies deal with those issues.

Channel Conflict and Cannibalization

Companies that have existing sales outlets and distribution networks often worry that their Web sites will take away sales from those outlets and networks. For example, Levi Strauss & Company sells its Levi’s jeans and other clothing products through department stores and other retail outlets. The company began selling jeans to consumers on its Web site in mid-
1998. Many of the department stores and retail outlets that had been selling Levi’s products for many years complained to the company that the Web site was now competing with them. In January 2000, Levi Strauss decided to stop selling products on its own Web site. Such a channel conflict can occur whenever sales activities on a company’s Web site interfere with its existing sales outlets. The problem is also called cannibalization because the Web site’s sales consume sales that would be made in the company’s other sales channels. The Levi’s Web site now provides product information, but directs customers who want to buy its products to online stores that carry those products. Levi’s product pages also include links that lead to a store finder page, so that customers who want to shop for Levi’s products in a physical store can find stores near them.

Maytag, the manufacturer of home appliances, found itself in the same position as Levi Strauss. It created a Web site that allowed customers to order directly from Maytag. After less than two years of operating its direct sales outlet and receiving many complaints from its authorized distributors and resellers, Maytag decided to incorporate online partners into its Web site store design. Now, after searching and gathering information about specific products from the Maytag Web site, a customer can select a retailer who will deliver and install the appliance. These retail store partners are authorized Maytag distributors. The customer can complete the transaction on the Maytag site or can choose to complete the transaction on the retailer’s site.

Both Levi’s and Maytag faced channel conflict and cannibalization issues with their retail distribution partners. Their established retailers sold many times the dollar volume than either company could ever hope to sell on their own Web sites. Thus, to avoid angering their retailers, who could always sell competing products, both Levi’s and Maytag decided that it would be best to work with their retail partners. Similar issues can also arise within a company if that company has established sales channels that would compete with direct sales on the company’s own Web site.

Eddie Bauer, a retailer of clothing and outdoor gear, was selling through a catalog and retail stores located primarily in major shopping malls when it decided to begin selling products on its Web site. The company believed that it could make online sales more attractive by allowing customers to return unwanted products that they had purchased online at the retail store locations. The managers of these stores were concerned about the time it would take for their sales associates to process these returns and about having to add the items to their stores’ inventories. In a retail store operation, managing labor costs and inventory are very important in achieving store profitability. The managers at the company’s catalog division were also worried. They feared that sales through the Web site would cannibalize sales through the catalog.

By making adjustments in the managers’ compensation and bonus plans, Eddie Bauer was able to convince all of the managers to support the Web site. The retail store managers were credited with an inventory and labor cost allowance for each Web site return they handled. The catalog division managers were given a credit for existing catalog customers who purchased goods from the Web site. By giving their customers access to the company’s products through a coordinated presence in all three distribution channels, Eddie Bauer was able to increase overall sales to those customers. This type of solution is called channel cooperation.

Strategic Alliances

As you learned in Chapter 1, when two or more companies join forces to undertake an activity over a long period of time, they are said to create a strategic alliance. When companies form a strategic alliance, they are operating in the network form of organization that you learned about in Chapter 1. Companies form strategic alliances for many purposes. An increasing number of businesses are forming strategic alliances to sell on the Web. For example, the relationships that Levi’s created with its retail partners by giving them space on the Levi’s Web site to sell Levi’s products is an example of a strategic alliance.

Earlier in this chapter you learned about Yodlee, the account aggregation services provider, and the online bank sites that offer these services to consumers. The relationship between Yodlee and its bank clients is another example of a strategic alliance. Yodlee can concentrate on developing the technology and services while the banks provide the customers. Account aggregation services decrease the likelihood that customers will consider moving to another bank, which helps the bank hold on to its customers. Thus, both parties benefit from the strategic alliance.

As you learned earlier in this chapter, Amazon.com has added many product lines to its original offering of books. In some cases, Amazon.com built these businesses from the
ground up. In other cases, it forged strategic alliances with existing firms. Amazon joined with Target to sell that discount retailer’s products on a Web site devoted to Target products. The Target site is housed within the Amazon.com site. Amazon.com has teamed up with CDnow to sell music and video products on the Amazon.com Web site. Most of these alliances have worked well for both parties, but not all have been fully satisfactory relationships. ToysRUs was one of Amazon.com’s earliest strategic partners, but the two companies have sued each other, alleging violations of their strategic alliance agreement. Now-defunct electronics retailer Circuit City also had a strategic alliance with Amazon.com, but decided to end the arrangement after several years and sell through its own site.