COOKING ON THE WEB
Recipes, Ingredients and Home Delivery

Interview with Dave Taylor:
Author of Elm, Founder of the Internet Mall Describes
"The Good Old Days" & Better Ones To Come

BBS Licenses?
Feds Ponder Ways To Pay for Clinton's
"Universal Access Mandate"

Stalking Baseball Players Online:
Will The Real Galarraga Please Send E-mail to Phyllis?

Consume WinSock Applications:
Reviews, Ratings and URLs

SlipKnot:
Graphical Web Browsing for UNIX
Shell Accounts
GENERATING REVENUES FROM WEBSITES

by Eric Schlachter, Esq.
E-mail:eschlachtere@cooley.com

About the author: Eric Schlachter is an attorney practicing in cyberspace law with the Silicon Valley law firm of Cooley Godwardкаstra Muddelson & Tatum. He has a law degree and an MBA in Entrepreneurial Finance from UCLA. He is an adjunct professor of Cyberspace Law at the University of San Francisco School of Law.

The hoopla surrounding the Internet is slowly being tempered by the realities of the marketplace. Everyone talks about making money on the Internet, but actually achieving profit requires a clear plan of attack and marketing strategy. The former mantra, “There is easy money to be made!” is slowly being replaced by a new mantra, “How?”

This article will summarize some of the trends I have been seeing in my practice of representing Website entrepreneurs. The outcomes may be surprising. While there is a robust and energetic cadre of Web entrepreneurs, many of them are unprepared for the realities of the Net economy. However, this article should provide the savvy Web entrepreneur with ways to identify and maximize the viability of their Website concept.

OVERVIEW

There are competing “physical space” models for Website concepts that will dictate which sources of revenue are most viable for your concept. The models include:

The subscription model. This approach relies on revenue streams generated from end users.

The shopping mall model. This approach simulates the revenue streams a shopping mall landlord might see, which includes a fixed fee plus performance incentives. This model also includes what I call the “travel agent” model, which more generically represents generating revenues from facilitating and/or closing transactions between end users and vendors.

The advertising model. This approach relies on revenue streams from advertisers.

The computer services model. This approach generates revenues from providing computer services, such as storage space, HTML mark up and design services, and consulting services.

The “ancillary business” model. This new and important model does not have an easily identifiable physical space analogy. In this model, the revenue streams do not come from the Website per se, but rather are generated through sales of goods or services ancillary to the Website.

1. THE SUBSCRIPTION MODEL

This is a classic business approach, which endeavors to collect revenues from end users, presumably based on the value of the service to the end users. Comparable analogies might include newspaper and magazine subscription rates and the monthly and hourly charges now levied by the big online services and the small subscription BBSs.

However, many Website entrepreneurs are not prepared to hear that the subscription model is uniquely UNSUITED for the Web environment.

- Web Culture

First, the nature of the Web dictates that users are accustomed to moving freely from site to site. Sites that require registration, even free, present significant psychological barriers to users’ entry. As a result, these sites must offer special and unique services to attract and retain users.

- No Rewards for Distribution Costs

Second, and more importantly, it is a fallacy that subscription models succeed in physical space. For example, in all but the most specialized publications, magazine and newspaper subscription rates cover only the cost of distribution, such as the cost of printing and delivering the content to the end user. Any “profits” are generated from advertisers, not end users.

Another noteworthy example is software and multimedia materials. Many software and multimedia products are now bundled with the hardware at little or no extra cost to the end users. While some mass market software and multimedia products still command high prices, much of the revenues go back into the distribution chain and not to the content creators.

On the Web, the cost of distribution is approaching zero. Therefore, end users will not be willing to pay for any distribution costs. When distribution value is subtracted, the only value rewarded by users is the value of the content—a surprisingly low value.

- Content is Cheap

Although many entrepreneurs are not prepared for this, content is cheap. The other revenue streams I describe in this article will be enough to support a large and robust industry of content developers. This will mean that content will be widely and freely available to end users. “Subscribing” to content will soon seem archaic—if you can get good content for free, only extraordinarily high value content will warrant and receive subscriptions.

This is not to say that end users will not pay for “gatekeepers,” or indexers who scan the Net and make the most useful items available. In “drinking from the firehose,” users can easily be overwhelmed by the quantity of information available on the Net. As a result, providing indexing services will remain a “profitable” strategy available to Website entrepreneurs. But this approach has two caveats. First, the potential entrepreneur must find and extract revenues from the end users willing to pay; a formidable feat in the anarchistic Net. Second, as with ultra-specialized periodicals that generate profits from their content (and not just their distribution), the number of competitors on related topics and the hyper-specialization required to be an expert dictate that the size of the market for such services on any one topic will be small. Global visionaries need not apply.

- Net Access is a Commodity

Finally, I can sense some readers focusing on the supposed profits that must be accruing to commercial online services based on their high monthly and hourly fees. The problem is that it is not clear that any profits are going to be available in Webspace by trying to mimic the commercial online services. Prodigy is not and never has been profitable, and neither are most commercial BBSs. CompuServe and AOL are both annually awaiting Microsoft Network, which will feature a very low monthly fee and will shift the burden of creating revenues to the constituent vendors. With Microsoft placing extreme price pressure on providing Internet access and the explosion of content providers, the commercial online service industry is not going to be for the faint of heart.

Furthermore, to the extent that these services are getting away with high monthly and hourly fees, consider how much of these revenues are being spent on either providing service access or on “distribution” services. The major online services all have their own proprietary-and expensive-network of distributed computers and telephone POPs. Remember, on the Web, end users are not going to pay Websites for this type of infrastructure.

60 Boardwatch - July 1995
End users *will* pay for Internet access, but it will be to their Internet service provider. Some Website entrepreneurs will also be Internet service providers--but this is not the same as generating revenues from the Website, and entrepreneurs should not be confused on this point.

**Conclusion**

The era of end user subscriptions for content is coming to an end. There will always be subscription services, but they will be small in number and size, profiting purely on the high value of the content to a narrow segment of users. Mass market content producers who relied on making profits from the distribution chain will find the users' attitudes and the Net economy quite unforgiving.

**2. SHOPPING MALL MODEL**

For all the Internet hype, there is one certainty: online commerce will become an industry of mind-boggling proportions. According to *Upside Magazine*, home catalog shopping was a $51 BILLION industry in 1993--and economics and convenience dictate that this entire industry alone will probably be handled online in the near future.

There are a number of ways that these and other vendors will reach their target audiences. However, one of the best conceptual models is the regional shopping mall--Website entrepreneurs will bundle vendors together in online malls, and then work with the vendors to bring consumers onsite and facilitate commerce.

In a typical shopping center lease, the landlord has a two-tier revenue stream. The landlord charges a base rent and also receives a percentage of the gross sales the vendor actually makes. This structure makes a lot of sense: the base rent covers fixed expenses, while the percentage kicker gives the landlord incentives to bring consumers onsite and facilitate commerce.

Similarly, the crafty Website entrepreneur can find potential profits here. The process of setting up a Website is reasonably simple and not extraordinarily expensive, so over time many potential vendors will set up their own Websites. However, the true entrepreneur will recognize that having a Web presence does not translate into sales, and therefore a market discontinuity exists for entrepreneurs to find better ways to bring to the vendor the right kind of shoppers.

I expect that the base rent with percentage kicker model will become a standard model for compensating Websites. It gives plenty of incentives to the Website entrepreneur while allowing the vendor to pay for results. I like to think of it as a superior model to selling direct marketing mailing lists--the Website is delivering potential customers to the vendor, but the vendor only has to pay for results, not prospective results.

Note, however, that this model works only for transactional relationships. It is easy enough to measure the revenues that come in through transactions made online, but it is difficult to measure when the Website led to other revenues (such as orders through an 800 number or increased in-store sales).

Further, this model is predicated on the availability and security of online financial transactions. There are a number of solutions in the pipeline for credit card encryption and anonymous "digital cash," but at the moment these solutions are not reliable or universally accepted.

**3. ADVERTISING MODEL**

As juicy a target as online shopping is, the advertising industry is a juicy target in its own right. According to *Upside Magazine*, in 1993 TV, cable, and classified advertising collectively generated $43 BILLION in revenues. Not all of this will translate into the online sphere, but a large chunk of it will.

The advertising industry can be roughly divided into two segments: mass market advertising and special interest advertising. Because of the difficulty of reaching broad segments of the market while online (other than by the disfavored spamming technique), I suspect that much of the mass market advertising will remain with broadcast/one-to-many media for the foreseeable future and the online industry will see only a small chunk of these revenues.

However, the Web truly shines in narrowcasting, and the ability to reach small, self-selected groups of interested consumers will prove very alluring to advertisers.

Extracting revenues from these advertisers is a little more tricky and requires some savvy marketing on the part of Website entrepreneurs. Because advertisers can set up their own Websites, Websites will need to offer an enhanced ability to identify and pull the potential consumers valued by advertisers, and will need to document or demonstrate this in a tangible way. There are a number of ways to measure the Website's success, each with its own opportunities and pitfalls.

• "Hits"

One solution I continually encounter in my practice is the use of "hits." Virtually all Website programs allow the sysops to track the number of "hits" the Website is receiving. Some Websites have used this information to indicate the number of "eyeballs" being delivered to the advertisers, and some Websites further charge the advertisers based on the number of hits.

"Hits" is an ambiguous term. Sometimes hits can mean the number of times a screen is displayed. Other times hits means the number of mouse clicks made by users. Either way, hits are a very poor metric.

Frequently, sysop access counts as one or more hits. Unscrupulous sysops can easily run up the tally, but even scrupulous sysops will generate many hundreds of hits a week in the normal course.

Also, hits does not translate into quality viewership. For example, assume that an advertisement is two levels deep. I access the first level and then the second. To exit the second level and return to the introductory screen, I could hit some "go to home" button on the second level screen, or I could just click on the "go back" menu option on Netscape or Mosaic twice. Passing through the first level screen would count as a hit, even if I did not look at the screen a second time (and even if I did, I had seen it previously on my way down to the second level).

There are many other ways to pad the hits count or to register hits without receiving the intended benefits. Although this hits padding is ostensibly more favorable to the Website, I still recommend that Websites do not use this measure at all. Savvy advertisers will clearly not allow it, and unsophisticated advertisers will soon be disenfranchised with the dichotomy between charges and results. The Website entrepreneur with an interest in having happy advertisers will use the "hits" measure very judiciously.

• "Per Subscriber"

Currently many Website programs keep data only on the identity of the servers used by individuals who access the Website. This can obscure key data on the number of individuals coming to the site: 500 accesses from a Netcom server could mean accesses by 500 different individuals or 500 accesses by one zealous user.

In the future, Websites will be able break down the aggregated data and
show the number of individuals who accessed the site and the number of accesses per individual. Clearly, potential advertisers will find this information useful, both to see the number of eyeballs they are reaching as well as the depth of interest among those eyeballs. However, even as the technology is developing to do this, Websites are currently having a fair amount of success in generating this information voluntarily. Many Websites have voluntary registration forms that they request users to fill out; surprisingly, users fill the forms out! A central maxim in marketing is to "know your customer" and these forms allow you to do so.

- "Fixed Price" with Bonuses

The other primary approach for charging advertisers is to charge a fixed price per month. This fee is analogous to the advertising fees charged by print periodicals and can and should vary based on the location of the advertisement in the Website and the demographic statistics of the Website.

To develop the demographic statistics, Websites should generate the user information by using registration forms and tracking user/server identity. Hits can be used as a generic metric, so long as this is not the sole measure of Website activity.

We are seeing a cyberspace-unique spin being used in these contexts. Much like the idea of collecting a percentage of transactions generated online, Websites can and should ask for financial compensation if the Website can demonstrate that the user requested and received more information than a generic amount. For example, the Website could use a modified hits metric to charge an increasing amount for each level deeper into an advertisement that a user goes. In such a scheme, if the user goes one level deep, there would be no additional charge; if the user goes a second level, there would be a nominal charge (maybe a nickel per hit); if the user goes deeper, the charge would increase rapidly since this would indicate that the Website has delivered a very interested user. Similarly, if the Website or the advertiser uses a "request for more information" form, the Website should be entitled to a relatively high amount per form submitted (maybe on the order of $1.00 per form). These progressive payment systems are appropriate in that they again give Websites the incentive to deliver the right kinds of users while the advertiser pays more based on the interest expressed by the user.

Of course, if users are able to order online, the Website should expect to get a percent of the transaction. If your Website can generate results, you should share in the upside!

- Privacy

Websites are uniquely positioned to deliver extremely high-value marketing research information to advertisers. Whether done automatically or based on voluntary user forms, Websites could easily provide advertisers with key information about users: what server they most immediately came from, what server they went to next, or the sequence of mouse clicks and keystrokes each user made. Not only would this information be useful in the aggregate, but it would allow the Websites to provide profiles about each individual user. Websites in turn could sell this information to advertisers and marketing research companies, presumably for significant sums.

There are numerous laws that might govern the disclosure of this information, but consumers and users should not misinterpret this to mean that their information is required to be kept private. On the contrary, it is much more likely that this information can be legally disclosed by Websites, who will have a great deal of financial incentive to do so.

Nevertheless, I believe Websites have an ethical or moral obligation to be circumspect before making these disclosures. My recommendation is that Websites plan to collect and disseminate this information, especially if it involves individual user profiles, should make full and clear disclosure to end users before this information is gathered.

This solution actually should lead to optimal results in a free marketplace, because users who do not wish to make such disclosure will choose to go to other Websites. Meanwhile, Websites who want to gather and disclose this information will have incentives to provide extra-valuable information that will attract users. Note, as an analogy, the ability of companies to set up focus groups, do test screenings of movies, and exchange free coupons for filling out surveys. If users have a choice and full disclosure, they will make the decision right for them.

- Conclusion

I think we are going to see an explosion of advertiser-supported Websites, much akin to the oft-remarked 500 cable channels. Websites are uniquely able to attract and segregate users with narrow but well-defined special interests, and advertisers will be willing to pay for access to these potential consumers.

However, Website advertising is an area where I believe the fair and ethical sysops can and should win over those looking to make a quick buck. You can use hits as your metric or sell data about your users, but over the medium run these strategies will prove less profitable than using fair metrics and making full disclosure. Website administration is a multiple iteration process—bending the rules to maximize the value of one iteration will negatively affect the value in the next iteration.

4. COMPUTER SERVICES MODEL

Website sysops can find a lucrative set of revenue streams by offering various forms of computer services. Especially given the volume of technically untrained people and companies seeking to get on the Net, Website entrepreneurs find many opportunities to use their valuable expertise and resources.

- Computer Storage/Personal Web Pages

You may encounter people and companies who want a Web presence. You may have extra storage space and bandwidth capacity. Many Websites are using this to offer "Website litesses"—that is, Website space and Internet connections without the user having to obtain the hardware.

For example, many Internet service providers now offer users the opportunity to create their personal home pages. With the ability to obtain domain names cheaply, the Website can present these personal pages as their own seemingly autonomous Websites.

One client asked me to draft a contract that charged customers "per page." Clearly, "pages" are not a good metric, since a home page could contain a large number of links or items making heavy storage and bandwidth demands (such as sound or video files). The client ultimately used storage space as a metric, a very sensible result.

There is a robust industry of entrepreneurs who help people establish their own Website for an initial service fee (see below) and a monthly "storage and bandwidth" charge. I have seen the monthly fees range from $25 to $200 per month and more, so it will not take many clients to start the cash flow pouring in.

The lawyer in me demands that I point out an important and dangerous legal pitfall here. The legal issue of whether and when a sysop or sysadmin is liable...
for the statements and actions of their users is unsettled right now. It is quite possible that users will abuse their rights and create legal liability for the Website. Some of this liability can be allocated or even avoided contractually, so good contracts are a must in this arena. It would be foolish to bet a company on an uncertain legal risk, or to try to protect it with a weak contract.

- **HTML Mark up and Design Services**

No matter how technically savvy customers are, there are still many reasons why they will seek HTML mark up and design services. A well-linked and good looking page really stands out, and customers know this. Non-technical customers will almost certainly be willing to pay for the mark up and design services—in the case of corporate customers, they may have no problem spending thousands of dollars on these services. The lesson: expect some revenues from these services, and do not give them away.

- **Consulting Services**

Even today, more than 15 years after the introduction of the PC, many consultants make a great living teaching people how to use computers. With the Internet and the Web, the need for support is even greater.

The Website entrepreneur's computer, Internet and Web expertise will be highly prized by customers running around scrambling to "get on the Information Superhighway." Even better, the Website can be the perfect marketing tool for the creator's expertise.

5. **ANCILLARY SERVICES**

The Net is unique in many ways, but one dimension really stands out. Many users of the Net offer their intellectual product for free, and in the case of personal home pages, sometimes the time investments made are extraordinary.

In some cases this is merely an ego statement: on the Net people can reach a global audience, and some get giddy with the power. In other cases, there is an explicit profit motive that I'll describe in a moment.

In either event, the result is a commodification of content. So much content is being put out for free that users will pay only for indexing or for ultra-high value information.

Truly savvy entrepreneurs have recognized the profit POTENTIAL of putting information on the Net for free. Time and time again an entrepreneur has started out giving something away for free, only to make countless profits on the next round. A good example is the video game Doom. Other examples have occurred with list moderators who now are the nation's expert on the topic of their list. Or take the example of a client of mine: they are willing to set up vendor storefronts at nominal cost in order to set up relationships with these vendors for highly profitable software and services. Or consider two Silicon Valley lawyers, who have made their "Multimedia Law Primer" ubiquitous on the Web—as an entree to sell their book at $20.00 a copy, which in turn is an entree to sell their legal services at $200.00+ an hour!

A well-designed, information-packed, topic-specific Website could be the key to making you the expert in your field. A Website giving away your freeware or shareware could be the key to developing demand for version 2.0 (at $50 a copy, natch). A well-designed and attractive Website could be the key to landing Website consulting and design business. And a few well-considered co-marketing relationships could lead to a bonanza of commissions or revenues.

The maxim "help out your peers on the Net" has become good business. In the many-to-many world of the Net, it will be hard to find your customers. By disseminating something that they value and making it widely available, you will create a reason for them to find YOU.

- **Conclusion**

Obviously, the models I have set out do not exist independently. Indeed, good entrepreneurs will find ways to generate revenues from each potential stream. The important lesson is to isolate the revenue streams you are relying on, test whether or not they are sustainable, and find the appropriate ways to maximize them.

We live in a truly amazing era for entrepreneurs. Not since the advent of personal computers in the late 1970s and early 1980s has a $100 billion plus industry been so wide open to anyone and everyone. The industry is raw and full of pitfalls, but this article has given you many ways to generate revenue. Armed with the right tools and attitude, the possibilities seem bright indeed.