Madison Avenue & Direct Navigation Domain Names

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Introduction

The debate over the value of direct navigation[1] to companies has intensified and has taken center stage at the TRAFFIC conference.[2] To understand its value contribution to a brand name, one needs to first analyze its two components: the sources of value creation and the value of these sources to a company. The methodologies for analyzing the latter are well established in the finance and statistics literature and have been tailored to value domain names.[3]

This essay addresses the source of value creation of direct navigation to a company by pointing out the misconceptions voiced in some of the public statements on the subject, highlighting additional issues that "Madison Avenue"[4] needs to contend with, and outlining issues that the domain name industry need to address.

Incorrect Claims

1. "If Hyatt had bought the domain hotels.com a few years back they would have had the power to have the surfer type-in hotels.com and end up directly on the Hyatt.com site. Enabling Hyatt to get first shot at selling a hotel room over their competition."[5]

   Although the statement is true, such an acquisition does not necessarily translate into value to Hyatt. Hyatt has to first consider whether searchers' direct navigation intent to hotels.com is congruent with their website's content, which should objectively be driven by their business strategy and provision of optimal visitor experience, as implemented through the website's "look and feel." Thus, if a large number of visitors to hotels.com were looking for hotel-related information other than Hyatt, there would be a mismatch of intent and content. Hence, under such a scenario, had

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[1] In its simplest form, direct navigation is an information retrieval method that is initiated by type-ins, thus, bypassing search engines. Type-ins retrieve information on a topic when a searcher inputs a keyword into a browser's search box followed by .com.

[2] http://www.targetedtraffic.com/

[3] See Alex Tajirian, "Valuing Domain Names: Methodology" and "Likelihood of Sale, Given a Domain Name's Ask Price?"

[4] "Madison Avenue" refers to advertising agencies on Madison Avenue that represent companies in a position to acquire and/or advertise through direct navigation domain names.

[5] http://www.targetedtraffic.com/lv_schedule.html. Last visited January 12, 2007.

Hyatt bought hotels.com at a fair market price, they would have paid too much if used to exclusively capture the direct navigation traffic. Conversely, if they had bought the domain name, they would have the option to use it to exclude competitors from access to the traffic, re-sell it, or "open it up" for joint industry development.

Moreover, implicit in the argument is the assumption that sellers of domain names in general are willing to sell them at their fair market price. However, with the dominant prevailing view that "the value of the domain name is whatever the buyer wants to pay," sellers might have an inflated estimate of the price. A domain name is not valued in the same way as a Picasso, but rather as an asset whose intrinsic value is driven by the fundamentals of value creation to the acquiring company.

Nevertheless, the above ownership claim of hotels.com is tantamount to recommending that advertisers should bid for the number one position on search engine results, as the strategy results in the highest number of visitors. Similarly, the argument that one should open a store on Rodeo Drive, as they will be able to capture the traffic of all these rich shoppers, is flawed. Advocates of such arguments are ignoring the fact that the objective of a company is not to maximize traffic, but to maximize shareholder value.

2. "… owning the keyword and the FREE and PERPETUAL business that comes with it in the form of thousands of people typing it into the browser bar each and every day."[6] It is not free, as there is opportunity cost associated with owning the domain name.

3. The TRAFFIC site also claims that the consequences of not owning hotels.com is that Hyatt is "forced to compete with all other hotels at lower room prices and have to pay a commission for the lead to the tune of many millions over the years." This is an interesting competitive strategy recommendation! However, one should wonder why Bank of America, which bought loans.com in the hay days of the Internet, still competes with other banks on loans?

4. "As a marketer, investing in direct navigation generally pays for itself within a year or two, dependent of course on the quality of the domain and how well you can convert the traffic into sales."[7] This suggests an average price-to-earnings ratio of 1.5. One should wonder if such opportunities still exist!

5. "However, instead of being an expense as with purchasing clicks from a search engine, acquiring a domain (or portfolio of domains) for direct navigation purposes

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[6] Ibid.

[7] Matt Bentley, "Bypassing the Search Engine: Using Direct Navigation to Your Advantage" (August 22, 2006); Available online at http://www.marketingprofs.com/login/join.asp?adref=rdblk&source=/6/bentley1.asp.

becomes an asset that retains its value (possibly even increasing in value) and can even be re-sold in the future should your marketing objectives change."[8]

a. First, for the comparison to be meaningful, the purchased clicks from search engines have to appear on direct navigation sites. Otherwise, if the purchased clicks appear only on search engine results, then one would be comparing apples and oranges, as the two marketing venues (search engine and direct navigation) target complementary markets. Nevertheless, estimating the value of such clicks is not a trivial task.

b. There is no unambiguous answer as to whether a lump-sum payment (purchase price outlay) is preferred to a stream of future cash outflows representing purchasing clicks over time, even when these two cash flows have the same present value. That's why a well-developed market for financial swaps exists.

c. The argument ignores two other marketing options that a company has, namely, the leasing and co-developing of such domain names with one or multiple companies interested in the traffic source.

d. The statement dismisses the possibility that prices of such domain names can go down, despite empirical evidence that domain names with certain characteristics have exhibited negative returns.

Other Issues for Madison Avenue to Contend With

In addition to the question of intent, and the above dubious claims, Madison Avenue needs to contend with the following issues:

a. The original allocation of the original extensions (.com, net, org) were based on a first-come, first-served basis, rather than allocated to the domain name's best use. Thus, it was an inefficient mechanism to allocate scarce resources.

b. Companies were slow to take advantage of the drop mechanisms.

c. Bureaucracy within large institutions hinders their ability to act quickly to capture domain names when the owners are interested in selling them.

d. History is important in competition. Thus, if you already own a valuable, unique asset, whether by luck or analysis, you are in a better competitive position. And if the asset is more valuable to someone else, then you can create even more value by selling it.

e. Looking at the number of unsold domain names on the market, Madison Avenue might incorrectly conclude that they must be "lemons," based on a model developed by Nobel Laureate in economics George Akerlof, i.e., there must be something wrong with domain names offered for sale. However, the

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[8] Ibid.

lemon argument does not apply to domain names, as illiquidity in the market is not driven by asymmetric information[9], but in a large number of cases by irrational fear on both sides of the transaction.

What Does the Domain Name Industry Need to Do?

1. The industry needs[10] to accept the fact that acquisition decisions typically involve the best option among alternatives, given a budget. Thus, if Hyatt, for example, did not acquire hotels.com, it does not necessarily imply that they are ignoring direct navigation, i.e., a portfolio of other direct navigation domain names might have been superior.

2. Accept blame for some service shortcomings. It failed to implement quality control, which diminished the credibility of a number of service providers and thus, increased the suspicion of the messenger. For example:

    a. Typical appraisals do not come with the rigor necessary for the deciding acquiring manager to evaluate.

    b. The domain name industry has failed to efficiently disseminate information on the firms that are engaged in analytical and quantitative models.

    c. Industry seems to ignore empirical studies, which demonstrate that direct navigation does not necessarily lead to higher conversion rates.[11]

3. Understand that risk-return preferences of potential buyers are important in the acquisition decision. Thus, higher returns offered by a domain name, say, hotels.com, over an alternative does not necessarily imply that hotels.com is a better purchase, *ex ante*.

Concluding Remarks

Madison Avenue needs to understand the source of value, namely, the congruency of site content with user intent, and needs to be convinced that the domain name industry has been providing rigorous analytical models and robust valuation techniques. With such an understanding and conviction, they will be better equipped to evaluate the alternatives for capturing the unique visitors through purchase of such domain names, advertise on such domain names, lease them, or co-develop.

On the other and, the domain name industry needs to also understand the sources of value creation to Madison Avenue, to tackle Madison Avenue's concerns, and to facilitate a more efficient information sharing mechanism. ■

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[9] Asymmetric information leads to "lemons" in second-hand product markets, but not in "value shops."

[10] Also see Alex Tajirian, "Increasing Domain Name Industry Pie."

[11] See, for example, Alex Tajirian, "Value in Direct Navigation: Empirical Evidence."