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Online Ad Pricing

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Whether for direct response or branding, whether for relationship building or customer retention, whether for customer relationship marketing or to sell the goods, online advertising must be cost effective — both by itself and relative to other media — in order to work. The traditional approach to pricing online ads (if the term "traditional" may be used in a still-young industry) falls into two camps: cost-per-impression vs. cost-per-performance. That is, head counts vs. measurable results.

Impressions are priced typically on a cost-per-thousand (CPM) basis. For example, a Web site that charges $1,200 per ad and reports 75,000 visits has a CPM of $16 ($1,200 divided by 75). This pricing model is also called cost-per-view (CPV).

The main performance measurements include:

Cost-per-click (CPC), where advertisers pay on the basis of how many users click on their ads. Many online publishers resist this pricing model, since click-throughs have dropped greatly. (By the way, click-through rate — CTR — is defined as the average number of click-throughs per hundred ad impressions, expressed as a percentage.)

Cost-per-action (CPA) is an expanded version of CPC, since with this measurement, the cost of an ad is based on the user taking some specifically defined action in response to an ad. Actions include not only clicks, but sales and leads as well.

Cost-per-lead (CPL), where advertisers with an offer or promotion specify the number of leads they want to generate, and pay only for those that are delivered. Cost per lead ranges from 25 cents to $2.50, with B2B pricing at the high end.

Cost-per-acquisition (CPA) is similar to CPL, but in this case, advertisers pay only when users make an actual purchase or acquisition. (This is also called "cost-per-buy" or "cost-per-sale.")

Within this alphabet soup, which pricing model works best depends on the advertiser's objectives and the publisher's needs or tolerance level for absorbing financial risk.

Take the CPA performance model, which publishers tend to dislike for four key reasons. One, if the ad campaign fails, the advertiser pays little or nothing, but the publisher takes the financial risk. Two, in many cases, a CPA deal corresponds to a low CPM deal.

Three, some advertisers take advantage of CPA pricing to showcase ads designed not for direct response but for branding. And four, too often, direct-response media are seen as cheap media, and naturally enough, many publishers don't want to see their sites in that way. There's also the fear of damaging the long-term value of the online advertising market by defining it for advertisers as an electronic direct-response vehicle. However, some Web sites, especially smaller publishers who might be struggling, are acquiescing to CPA deals in order to move unsold ad space.

But typically, advertisers like the CPA approach because of its low risk factor-they pay only for successful transactions, leads, registrations, and so forth. Performance models also reinforce the Internet's claim to advertising accountability -- when they perform well, delivering the goods such as instantly measurable ROI. Even with that, CPA advertising is best for direct response, not most branding-oriented campaigns.

In contrast, the CPM pricing model locks in a rate for the publisher, making it a safer bet. That's especially true if the Web site is highly targeted to higher income users, raising the "cost" side of the CPM pricing, or if the Web site is highly popular, raising the "thousand" side, pegged to impressions. That corresponds to the traditionally more expensive nature of most branding media.

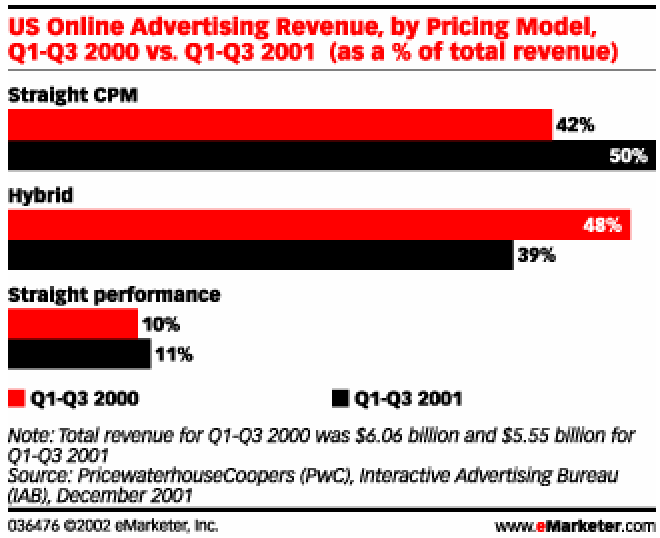
In addition, according to a recent article in Interactive Advertising & Branding News, "That's why some Web publishers... have begun to take their cue from their print-bound brethren, who typically put a premium price on such choice ad spots such as inside covers and tables of content. The idea, they say, is to create not only better CPM prices for themselves, but greater value for their advertisers." The Interactive Advertising Bureau, which first started tracking premium placement last year, refers to the practice as "slotting fees."

The potentially greater certainty of pricing, targeting and popularity can turn the CPM model to an advertiser's advantage as well. That's more true if the intent is branding, rather than direct response.

As the Internet becomes a standard element in cross-media marketing, advertisers will want a blend of CPM, CPC and CPA deals -- sometimes one, sometimes the other and sometimes a hybrid of impression and performance. In one kind of hybrid pricing schemes, the marketer first tests the offer on a limited audience, and the campaign is priced on a CPM basis (usually lower than normal). Then, depending on test results, the campaign can move to performance-based pricing.

What's significant, however, is not the pricing model but understanding budget and objectives and finding the right solution. No matter what the pricing model, the severe drop in online advertising offers a silver lining for media buyers and advertisers: lower prices. For example, the usual CPM for banner ads in 1999 and 2000 varied from $30 to $40. Today, the average CPM has dropped to the $7 to $15 range, which puts online advertising on a more even financial footing with other marketing options.

In addition, it would seem that the increased ad inventory has helped media buyers and advertisers haggle for more performance-based deals. However, the latest figures from the Interactive Advertising Bureau/PricewaterhouseCoopers shows that straight CPM deals increased from 42% to 50%, comparing the first three quarters of 2000 to the same period in 2001. And hybrid deals, combining elements of impression and performance, dropped off to 39% of US online ad revenues.



Still, when you drill down to quarter-by-quarter results, straight performance deals grew from 10% to 13% going from Q2 2001 to Q3 2001, perhaps indicating a trend.