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Google's Gamble

As investors fear falling ad revenue, the search giant pushes ahead with its bid to boost quality clicks

by [Catherine Holahan](#)

Can fewer clicks on its search ads lead to more revenue for Google? That is the question investors, analysts, and the company itself are trying to answer.

The debate was launched after a Mar. 26 report from researcher comScore ([SCOR](#)) showed a decline in the number of clicks from the prior month on Google's search-related ads. According to the research firm, clicks on ads declined 3% in February from the prior month and were up just 3% compared to last year. Some analysts cautioned investors against buying additional Google ([GOOG](#)) shares; Google's stock declined 3%

on Mar. 27, to \$444.

But Google supporters warn that the number of clicks doesn't necessarily correlate with the revenue generated from those clicks. The company has been working to improve what it calls the "quality" of clicks, minimizing the number of clicks that don't lead to revenue for advertisers. The result, at least in theory, is that advertisers may be willing to pay more for each click because the chances that a click will result in a sale will be higher. Clicks may go down. But Google's revenue would go up.

Errant Clicks

Ross Twiddy is a believer. He depends on Google search ads to drive clients to his Web site and, ultimately, into the houses that he rents out for vacations along North Carolina's Outer Banks. As far as he's concerned, clicks can go down as long as Google ads keep bringing in the customers. "What we care about is not just traffic but that it translates into vacation rentals," says Twiddy, who is so pleased he appeared for free in a promotional video for Google's AdWords site.

The challenge Google faces, as it heads for its Apr. 17 earnings report, is convincing Wall Street that Twiddy is representative of its advertising clientele. So far, analysts are wary. Clayton Moran, an analyst with [Stanford Group](#), shaved \$115 off his target price for Google stock on Mar. 27, cutting it to \$500. He thinks the slowing economy is leading to an industrywide slowdown in consumers clicking on ads, at Google as well as competitors Yahoo! ([YHOO](#)), Microsoft ([MSFT](#)), and Ask ([IACI](#)). "Checks and data indicate softness," wrote Moran in a research note.

The skepticism is understandable. Google, like other online advertisers, [has built its business](#) (BusinessWeek.com, 2/27/08) convincing customers, analysts, and investors alike that a click is a corollary for a customer in

a store. The more clicks, the more potential customers, and, ultimately, the more sales.

Still, [a click has never been](#) (*BusinessWeek*, 2/28/08) quite like a customer walking the aisles, wallet in hand. Sometimes a click is simply the reaction of a confused searcher. Other times, it's driven by the curiosity of a bored Web surfer. There are even cases of a malicious competitor clicking on ads to drive up a rival's marketing expenses.

Pricier Keywords

As Google and its competitors have come to understand this, they've been working to reduce the number of clicks that don't translate to genuine potential shoppers. Google stepped up its efforts last year, reducing the area around an ad on which a person could click and be directed to a store's Web site. The purpose was to minimize accidental clicks on ads by people not actually interested in the advertiser's Web site. It also rolled out a "conversion optimizer" in January for its AdWords search advertising customers to enable them to effectively buy ads based on the number of sales or customers those ads generate. "That really improves the advertiser return on investment," said Google co-founder [Larry Page](#) during a Jan. 31 earnings call.

The idea is that, as marketers and small business owners such as Twiddy see more clicks translating into paying customers, they will value clicks more and ultimately increase the amount they bid per click to offset the reduced volume of clicks. Indeed, Google has reported that the price per click on most keywords has steadily increased as it has improved the quality of those clicks. (Google won't say what those prices are because the system is an auction model.) Google executives hope advertisers will be happy enough with the increased sales per click that they will spend more money with Google overall.

Twiddy's experience supports Google's theory. After seeing more customers, he ultimately increased his

advertising spending on Google. He now buys more than 1,000 keywords, instead of the 50 to 100 keywords he started off buying four years ago. Twiddy says he now spends tens of thousands of dollars with Google each year. (He declined to give the exact figure because of competitive concerns.) "When I see some of the changes Google has done, I get very excited," says Twiddy. "They are very strict about keeping the advertising relevant."

Pressure on Google

Twiddy may not be the average AdWords user, however. A sale to Twiddy is worth tens of thousands of dollars, maybe more if he can get a repeat vacation home renter. He's not that sensitive to the cost per potential customer. That's not necessarily the case for someone selling lower-margin items such as \$10 vinyl records or a \$20 book.

It's also not clear how much of comScore's reported click declines derive from quality improvements at Google and other search engine providers, and how much are due simply to people shopping less online. In its Jan. 31 earnings call, Google executives said they have not seen economic-related softening to date. However, comScore's report of industrywide declines has convinced many analysts that the numbers can't simply be explained by efforts to cut down on bad clicks. "The data supports our cautious near-term view on Google shares," wrote UBS ([UBS](#)) analyst Ben Schachter in a Mar. 26 note to investors. "Regardless of comScore, we believe that without meaningful monetization improvements, Google will have trouble meeting [first-quarter] consensus numbers."

There are other signs that online advertisers simply want to cut back on their spending as the economy slows. On Mar. 18, research firm [eMarketer reduced its estimates](#) (BusinessWeek.com, 3/18/08) for the U.S. online

advertising market this year by \$1.7 billion, to \$25.8 billion.

To allay the concerns swirling around Google, the company will have to post strong financial results for the upcoming quarter. Doing so will be the only thing to convince Wall Street that, when it comes to online ads, it's about much more than the number of clicks.

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