

Yahoo! in a Maturing Digital Economy

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Nearly everyone has heard the name “Yahoo!”. Because it was the first true Internet portal, it enjoys one of the largest user bases on the Internet, and one of the most recognizable brands online. Based in Sunnyvale, CA, Yahoo! is an international provider of news, information, and Internet-based services to both consumers and businesses, and can be found in 25 countries and 13 languages. In many of the vertical markets it participates in today, Yahoo! has a significant if not dominant market power.

But while Yahoo! owns vast properties ranging from Internet search, city guides and Web-based e-mail, to broadcast services, DSL and dial-up Internet access, its revenue comes in only three flavors: marketing services, fees, and listings. The largest of which is marketing services, capturing 68% of their \$953 million 2002 revenues and 74% of their \$1.6 billion 2003 revenues, leaving fees and listings trailing far behind.

Revenues from marketing services, such as advertisements, primarily depend on the high traffic generated by e-mail, news, games, and other related content, much like

magazines and newspapers rely on readership to support their sponsors’ ads. Thus far, Yahoo! has been able to maintain its substantial traffic volume. However, because the startup costs to compete with many of the Web-based services it provides are so low, a competitor with a better “mouse trap” can quickly steal a significant proportion of its visitors, consequently damaging Yahoo!’s revenue, and leaving management to maintain millions of dollars worth of underutilized equipment.

Because of its strong brand, broad offerings and a well-established user base, Yahoo! can avoid its would-be competition *and* achieve higher profits by aggressively enhancing its current offerings, creating new services which rely on a broad user network for success, and venturing into new, more capital intensive markets.

Paradoxically, the most important source of Yahoo!’s current strength is its strength. Where Yahoo! primarily competes, it shares the market, and consequently market power, with AOL and MSN in content, and eBay and Amazon.com in e-commerce, while smaller firms fill in the gaps in the big players’

offerings. Much of what separates these big firms from the rest of the pack is brand recognition. People continue to use and talk about these companies because they know they exist and know what they offer.

For Yahoo!, much of this was built on its long history with its users. Unlike MSN, which is a relatively new, deep pocket competitor, Yahoo! has the advantage of being the first mover. As the first Internet portal (something like a content mall), Yahoo!'s fundamental mission has continued to be to offer content of interest to a broad range of audiences in order to garner high levels of traffic.

News, stock quotes, e-mail, and other services remain highly undifferentiated between the sites that provide them. In Yahoo!'s case, much of its content is subscribed from third parties, and like most other companies it offers the majority of it for free. So in industries which, for all intents and purposes, have little product differentiation, companies' brands and domain names prove to be their greatest assets. While many simpler vertical markets such as online e-mail have competition from many smaller players, real profits demand the high volumes which only names like Yahoo!, eBay, AOL and MSN, can generate. The brand then acts as an alternative barrier to entry, when the cost of doing business is low.

In Yahoo!'s 2002 annual SEC filing, its management agreed. "We believe that maintaining and expanding the Yahoo! brand (and other vertical brands, including HotJobs) is an important aspect of efforts to attract and expand our user and advertiser base. We also believe that the importance of brand recognition will increase due to the relatively low barriers to entry." Its name gives an instant stamp of approval and easy word of mouth advertising as it moves into new markets.

In addition to its brand and established market power, Yahoo!'s ability to maintain such high traffic volumes is aided in the bundling of the products and services it provides to its visitors. Even though Yahoo!'s

properties like news, auctions, city guides and maps, may be offered elsewhere on the Web and possibly at a higher quality, because they are offered as a bundle, visitors remain on the Yahoo! network because the bundle creates an additional value – convenience.

Users could read their national headlines by visiting their local newspaper's site and get their financial news from Bloomberg while checking their e-mail with Yahoo! Mail, but Yahoo! offers and promotes all these products within their network. As a result, users tend to surf within Yahoo! because of the increasing value they place on their own time. Additionally, with the My Yahoo! service, users can custom bundle the information and services that are most important to them and access them on a single page, causing an even stronger and voluntary lock-in effect. This provides a competitive barrier to all but the most deep-pocketed and highly trafficked competitors.

While smaller competitors can subscribe to national news feeds from the AP and Reuters, publish online games or build a Web-based e-mail system, much of the value is in offering *all* these services together. Without the established user base and necessary financing or revenue to support those activities, the cost for small firms to compete would be prohibitive. But even though they may not be able to afford the network that Yahoo!, MSN and AOL have out of the gate, they can still compete by building their traffic up with a so-called "killer app".

Killer apps, roughly defined, are products that make it easy for users to justify modifying their behavior. They are a "reason to switch." Like what Google did with Web searching (which Yahoo! originally pioneered), companies with the ambitions to compete with Yahoo! and MSN need only to come up with a new or better "mouse-trap" to create the critical user mass and market power they need to move into the markets companies like MSN, and Yahoo! participate in. And the fact is, the next killer app is right around the cor-

ner, which makes Yahoo!'s current primary business very risky.

The principal challenge that most incumbent firms competing in Web-based markets face is the low start up costs associated with entering the market. To be sure, the need for a large user base and strong brands are significant barriers, but with a killer app are by no means insurmountable. Any firm with a significant user base, compelling products and clever marketing staff has a chance to steal away precious market share. In those very simple vertical markets such as online e-mail, start-up costs to build a competitive product are extremely low if not virtually non-existent. The products in content publishing markets such as entertainment and news services can be purchased, and because many of the contracts signed with magazines and news wires are non-exclusive, anyone with the right capital can buy their way in.

Market-share theft is especially dangerous when the contending firm also has a preexisting relationship with its users. Yahoo! cites local Internet service providers as one of the primary risk factors it faces overseas. These local firms, who already have billing relationships with their users and provide the software they connect to the Internet with, can reasonably provide news and content of interest allowing them to make it far more convenient for their users to take advantage of their services over their competitors'. In the United States, AOL has similar access to its users through America Online, which provides content and services, in addition to Internet access in an integrated environment. Additionally, because the entry costs into even the more expensive of these markets are relatively small for big money contenders like AOL and Microsoft, they can match product offerings given the time to catch up, and force

their way into a user base with marketing muscle and tying with their other products.

Without proper barriers in place, Yahoo! will always be running for its life trying to out-market its competitors. It needs to develop a plan to erect barriers to entry into their new and existing markets so they can stem the tide of firms taking aim at it. New research and analysis targeted at Yahoo!'s customer base would allow it to uncover these new markets that would prove valuable in fending off their competition. Additionally, investing in research & development for new technologies that could be integrated into its products would create additional development costs for companies that would try to compete.

The reason so many of these Web-application products such as online auctions and Web-based e-mail as are so easy to compete with is because they are so fundamentally immature. By building more technologically advanced features into current applications, competitors' costs to develop a competing product would rise substantially. This is seen today in many software markets such as video editing that have only a few competitors splitting near total market share.

Additionally, developing new products that build on the network of users that Yahoo! already has would bar entry to only the largest competitors by setting a large user base as a prerequisite to participate. New markets that have higher entry and per-user costs, such as media broadcasting, which Yahoo! is currently exploring, would also exclude lower budget firms. At that point, with those higher barriers, and higher value products on their network, Yahoo! would have a much safer position in maintaining its large user base and profitability.