Interactive Local Media Advisory

Classified Advertising at a Crossroads

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Document: ILM Advisory #05-06
Date: 5/17/05

Summary: Classified advertising in the U.S. is at something of a crossroads. The U.S. print newspaper industry is in a very similar position to the U.S. print Yellow Pages industry; growth is largely online while revenues remain largely offline. At just under US$2 billion, online classified revenues are significant, but they don't compare to the US$16.6 billion in print revenues. Yet the data collectively indicate that consumer trends are not in the newspapers' long-term favor. While online newspaper sites are arguably in a better position, the Internet is much more competitive than traditional newspaper markets.

The issue for print classifieds publishers, then, is figuring out how to preserve existing revenues while growing the online pie in a very competitive environment. The challenge for the online, and often free classified vendors, by contrast, is to develop a model that doesn't simply put price pressure on traditional classifieds and ultimately undermine any sort of classifieds business model on the Internet.

On April 13, 2005, during the second day of the American Society of Newspaper Editors' annual convention in Washington, DC, an hour was set aside to discuss the future of newspaper advertising and classifieds. During that session, panelists Andrew Nachison and Dale Peskin of the Media Center at the American Press Institute presented an overhead slide of Craig Newmark, the founder of Craigslist. They asked how many people in the room of several hundred newspaper representatives recognized Newmark. A small number of hands rose, and only a few more went up at the mention of Craigslist.

The informal poll seemed to reflect that the better part of a representative sample of the U.S. newspaper industry is not aware of the market forces and changing competitive landscape that potentially threaten its revenue base. A frequently cited (and often disputed) estimate from Peter Zollman's *Classified Intelligence* is that Craigslist annually captures up to US$65 million in job-related revenue from local newspapers' classifieds in the San Francisco Bay Area alone.

More bad news came at last month's Newspaper Association of America annual conference in San Francisco, as representatives of the consulting firm McKinsey & Co. projected that newspapers could lose US$4 billion in classified revenues to the Internet by 2007. "Once upon a time, classifieds was the exclusive property of newspapers," Mort Goldstrom, NAA's vice president of advertising told AdAge. "That time is over."

Borrell Associates, which also tracks the newspaper industry, estimates that approximately 70 percent of newspaper ad revenues came from the three big classified advertising categories – Jobs, Cars and Real Estate. All three categories, to varying degrees, have been or are coming under competitive pressure from the Internet. More specifically, an emerging group of "free" classifieds sites, led by Craigslist and joined by sites such as LiveDeal, is putting further pressure on newspaper pricing models.

In short, classified advertising in the U.S. is at something of a crossroads as print newspapers begin to genuinely confront the challenge of the Internet and retaining their classifieds revenue base.

Classifieds Today: Is the Sky Really Falling?

The U.S. print newspaper industry is in a very similar position to the U.S. print Yellow Pages industry – growth is largely online (but so is intense competition), while revenues remain largely offline. Yet from a distance, the print revenue numbers appear to paint a fairly healthy portrait of the industry.

2004 Classified Revenues (U.S.)

Print Revenues		Online Revenues	
Recruitment	$4.6 billion	Recruitment	$800 million
Real Estate	$4.2 billion	Real Estate	$200 million
Automotive	$5.0 billion	Automotive	$400 million
Misc.	$2.8 billion	Dating/Misc.	$550 million
Total: $16.6 billion		**Total: $1.950 billion**	

Sources: NAA, The Kelsey Group estimates (2005)

At just under US$2 billion, online revenues are significant, but they don't compare to the US$16.6 billion in print revenues. Despite these impressive offline revenues, there are several pieces of evidence that suggest print newspapers are in trouble. Many of these are familiar by now:

- Craigslist has more job listings than all Bay Area newspapers combined. For the week of November 21, 2004, Craigslist featured 12,200 active listings vs. 1,500 for the San Francisco Chronicle, 734 for the Oakland Tribune, 1,700 for the San Jose Mercury news and roughly 1,000 in the Contra Costa Times (Classified Intelligence, 2004).
- eBay has more listings than all daily U.S. newspapers combined (Morgan Stanley 10/04).
- Newspapers are the "first choice" media of only 3.2 percent of 18- to 34-year-olds vs. the Internet at 45.6 percent (Online Publishers Association, 9/04).
- Burst! Media in a recent survey of 2,600 Web users found that people were spending less time with "old media." Accordingly, 36 percent of respondents were spending less time than a year ago watching TV, 34 percent less time reading magazines, 30 percent less time reading newspapers and 27 percent less time listening to radio.
- Daily circulation of U.S. newspapers peaked in the mid-1980s according to the NAA and has slowly been declining since. Last year, a number of circulation scandals (Chicago Sun-Times, Dallas Morning News, Newsday) showed the pressure many newspapers are under to maintain numbers for the benefit and perception of advertisers.
- Newspapers are going to be overtaken by the Internet in terms of local reach relatively soon. The Internet as a local shopping resource grew from 60 percent to 70 percent reach between October 2003 and February 2005. Conversely, newspapers declined from 73 percent to 70 percent during the same time frame. Use of print newspapers for local shopping grew only among those without Internet access (The Kelsey Group, 3/05).

These pieces of data collectively indicate that general consumer and demographic trends are not in the newspapers' favor. Online newspaper sites are arguably in a different position, with many reporting strong growth and profitability. However, online newspapers and, by extension, online newspaper classifieds operate in a much more competitive environment than has historically been true for traditional newspapers.

How Do You Compete with Free?

Craigslist has grown in roughly 10 years from an obscure personal pastime of its founder into an international brand. Globally, there are four million classified postings and two billion page views per month in more than 100 cities and 20 countries.

Craigslist's revenue consists exclusively of job listing fees in San Francisco, New York and Los Angeles, and real estate listing fees in New York. All other listings are free to sellers. And unlike traditional newspapers, the cost structure of the organization is minimal; there are only 18 full-time employees.

Other new sites such as LiveDeal and ZiXXo also offer free classifieds to sellers. And while these sites are much younger than Craigslist, there is evidence of momentum. For example, though roughly a year old, LiveDeal recently surpassed US$1 billion in merchandise on its site, with more than 200,000 items for sale. Furthermore, any would-be entrant or competitor in the online classifieds market will adopt some version of the free model as a way to gain attention and a foothold.

The question thus arises: How will paid classified revenue models continue to compete with Craigslist and others like it? In other words, how do you compete with free?

Some newspapers have begun offering free classifieds on their own sites for items below a certain price threshold. There is some evidence to suggest that many such items would otherwise not be listed in the newspaper anyway, thereby expanding the market and avoiding cannibalization of traditional revenues. Knight Ridder Digital, which is possibly the most progressive of the online newspaper divisions, has recently done this, offering free classifieds for items under US$200. Many print newspapers are starting to do this as well.

"We feel very confident that the creation of robust online classified marketplaces is going to lead to revenue opportunities in a variety of ways," said Tom Mohr, president of KRD. "You're going to have some categories that are free and some categories that are paid. When the robust free categories begin to build true marketplaces with a lot of genuine use and engagement by consumers on a regular basis, then when the day comes that that consumer wants to sell a house or hire somebody, they're going to use the paid services."

Yahoo! also recently made its private-party merchandise classifieds free (they were previously US$7.95 to US$9.95). It still charges for jobs, real estate sales and rentals, autos and pets. It's safe to assume these moves are a response to Craigslist in particular and the free model in general.

But is this bifurcated or hybrid model (some price levels or categories free, some not) enough to be competitive in the future? For purposes of argument, let's assume they are not. What happens then to the billions in revenues that are today associated with newspaper paid classified listings? (eBay is also threatened by the free model.) Do they substantially migrate online to free sites? Do the newspapers have to discount print? Are prices maintained by bundling print and online? There's a great deal, obviously, at stake in answering these strategic questions.

(Answering all these questions is beyond the scope of this Advisory; they will be taken up in an upcoming Interactive Local Media White Paper.)

Panelists Sound Off on a New Model

At The Kelsey Group's recent "Drilling Down on Local" conference, there was a panel of online classifieds vendors that directly followed a newspaper panel. Both sets of panelists were asked about classified revenues and the business model in the future. Something of a consensus emerged from the discussion: The hypothetical new model involves a free basic listing (perhaps including an image too), followed by up-sells offering more photographs, preferred placement, and perhaps video, where relevant.

"I don't think they will all be free, but I think that the default pricing and the default paradigm will be a basic online listing, and then it's going to involve upgrades," Craig Donato, CEO of classifieds aggregator Oodle, told the audience. "It's a way for you to take that basic listing for free and put it in new places to merchandise it more effectively." Donato says this model could also involve print promotions as an up-sell where the print medium includes a premium selection of the larger online marketplace.

KRD's Tom Mohr holds a similar view. "We see the emergence of these free classified services as being ultimately a good thing," Mohr said. "The first thing we have to recognize is that by having created a free online marketplace, the marketplace expands dramatically. So the pool of customers from which you can up-sell something grows significantly."

In addition to placement, etc., e-commerce, instant messaging and e-mail communication tools and a list of other capabilities might also fetch fees from sellers who want more functionality than offered with the basic listing.

The caveat is that as technologies become better, more efficient and cheaper, the bar might be raised on what is bundled for free, especially in a highly competitive online environment. One analogy might be what happened with e-mail. MSN's Hotmail and Yahoo! Mail were trying to build a fee-based business model around e-mail storage. Then Google came along and destroyed the model by providing what amounts to unlimited storage for free (it's ad supported). The others have been forced to follow suit. Might this happen in the classifieds arena with product features?

"I would say that the base classified ad is going to be free but the question is, what is the base classified ad?" asked Mike Hogan CEO of ZiXXo during the classifieds panel discussion. "Because as we all compete in the market, the base classified ad will become a lot more complex. It's already including images and it's soon going to start including video, and [virtual] walkthroughs."

In one hypothetical future scenario, online classified marketplaces effectively become "loss leaders." They drive traffic, against which newspaper sites and others serve keyword-targeted and/or contextually or behaviorally relevant advertising at the margins. But that's a pretty tepid and uncertain substitute for current offline classified revenue models. And it is guaranteed not to replace the billions in print classified revenues mentioned above.

Differentiating the User Experience

Some of the things that have been cited as assets of Craigslist also represent weaknesses that others might learn from and potentially exploit. The site's simple design and functionality make the site accessible but leave some users and sellers frustrated. For example, realtors have to continually repost listings to remain "above the fold" and visible to prospective buyers; there's no preferred placement option for those who might like to buy it. In addition, all transactions occur offline; there's no "buy now" or e-commerce capability. (By contrast, LiveDeal also focuses on offline transactions, but offers PayPal and even online loans for larger ticket items to facilitate the financial aspect of the deal.)

"The big trend is really moving from advertising to an e-commerce model," Peter Krasilovsky, president of technology and media consulting firm Krasilovsky Consulting, told the Drilling Down audience. "We saw it with eBay with the 'Buy It Now' [function] in their auctions. If you can get into the actual deal, you're better off than selling your classified advertising."

Leif Welch, vice president of business development for newspaper and Yellow Pages vendor AdMission, agrees. "Advertisers want the consumers to interact with them, so we provide them some tools – all within the ad. This gives them more of a payoff and facilitates the conversation between buyer and seller," he said. The company's software includes a transaction engine that utilizes PayPal, as well as communication features for negotiating with sellers.

Product features such as dynamic mapping can also help build a better user experience and in the long term also help build loyalty and traffic. More traffic, especially high-quality traffic, would allow fee-based revenue models to succeed. Until very recently, eBay has been able to raise seller fees consistently because it had critical mass. There were really few online alternatives of any scale, with the possible exception of Craigslist.

Seller and customer support is another area of potential differentiation that would, indirectly, support fee-based revenue models over time. Genuine customer service and support can promote user and seller loyalty. In addition, fraud protection systems can instill confidence among users and further enhance loyalty.

User-Generated Content and Community

Another loyalty mechanism is community. User-generated content and reviews have been around for some time on sites such as shopping search engines, Citysearch, Amazon and CNET. User-content initiatives are now expanding and proliferating on AOL Local, Yahoo! Local, Yahoo! 360, Netflix and on new directory sites such as Insider Pages and Judy's Book. Some traditional directory publishers are also considering adding such features to their Internet Yellow Pages sites.

One of the more interesting models to push user-generated content front and center is Backfence.com. The site, now live in the Virginia suburbs of McLean and Reston, allows users to post content about local issues and businesses at a ZIP code level. The idea is that the community will "own" and effectively develop the site's content and that will, among other benefits, create sustained loyalty. That loyalty will in turn generate advertising/listings and usage of those listings because of the site's "hyper-local" character.

Backfence offers a self-service advertising model where users can place their own display and classified ads, as well as directory listings. Given that it has no classifieds legacy to address, Backfence has come out of the starting gate with a free basic ads/listings model that offers premium upgrades (personal classifieds are free for 30 days, but a photo costs US$10, while business classifieds and enhanced Yellow Pages listings are US$50 and US$10 per month, respectively).

"Clearly people love free classifieds and that's why we did it. It drives traffic. Craig [Newmark] has proven that," said Backfence co-founder and former WashingtonPost.com pioneer Mark Potts. "We believe by including local news that you can't get anywhere else, we create something that is a regular visit – a daily if not multi-times daily visit that creates a huge amount of stickiness and a huge amount of regular traffic. That in turn drives people to the classifieds and Yellow Pages and other things that we have."

The company is in discussions with major media companies (including newspapers) to help them reach new markets. “We’re considering affiliate sites that might license the technology and/or partnering with other media companies as distribution channels in their areas,” said co-founder Susan DeFife. “We can help them reach the last mile, which they are not currently doing.”

Backfence intends to be in 15 metro markets within 36 months, each consisting of eight to 10 community sites. The exact timing and expansion destinations will hinge upon the media partners and investment funding it attracts in the coming months.

Online-Offline Leverage

Newspapers, like directory publishers, have a local sales force and local advertiser relationships. The importance of this is not to be underestimated. And there are various ways publishers may be able to leverage those assets to maintain and grow revenues.

MediaNews Group Inc., for example, publishes the Denver Post and 49 other daily newspapers. The company announced a resale and distribution agreement in April with Yahoo! HotJobs, which will place MediaNews Group’s local affiliate classified ads on HotJobs. HotJobs’ listings will appear on MediaNews Group local newspaper sites.

“With this we get additional distribution for our jobs and they get additional distribution for their jobs and frankly we get to go after some key advertisers in local markets that we don’t typically go after,” said Tim Lambert, vice president of business development for HotJobs. “So the benefit is that they give us extended reach in terms of going into their local markets, we give them distribution for those customers and vice versa; we are getting distribution for our customers that we have on their sites.”

By leveraging local advertiser relationships and sales assets and obtaining online distribution beyond their own sites, newspapers may be able to retain advertisers and build fee-based models around new services. For example, the Hearst-owned Houston Chronicle has started reselling search distribution to local advertisers – à la Yellow Pages publishers. It’s not unlike bundling services in the cable arena (Internet, phone and television); local advertisers get access to multiple ad vehicles and distribution points by dealing with one entity. That in itself potentially creates loyalty, or at least inertia.

Along the same general lines, the Classified Ventures papers, including Tribune Co., Knight Ridder Digital and Gannett, have developed an elaborate online vertical distribution strategy, which has to date been successful. Among other online brands, the consortium owns ShopLocal, Cars.com, Apartments.com and news aggregator Topix.net.

“We leverage that relationship not only in terms of the co-branding we do on our site but also in terms of the sales organization,” said KRD’s Tom Mohr. “We leverage our existing newspaper sales organization to drive CareerBuilder.com sales, for instance, or Cars.com sales, and that strategy has proven very successful over the past few years. It’s been a major driver of our revenue growth.” Last year, KRD’s sales rose 39 percent, to US$114 million, and its operating profit more than doubled, to US$36 million.

“Newspapers can use their huge distribution, listings, marketing and cash flow power and partner with somebody with great technology because it’s a technology play here, and the combination of both could be a win-win opportunity for everybody,” said Rajesh Navar, CEO, of LiveDeal during the classifieds panel discussion at Drilling Down on Local. The company itself is actively discussing opportunities with newspaper publishers to combine these strengths.

Oodle's Craig Donato agrees. "One of the reasons newspapers are in a good position with local classifieds is because they have feet on the street with existing relationships," he said. "They have the ability to up-sell in unique ways. So they have the ability to package and have different types of opportunities to have people sell. If they attack it aggressively they can be very well positioned."

The Bottom Line: Vision and Execution

As The Kelsey Group has repeatedly said, the consumer trends are very clear: The Internet is growing, often at the expense of traditional media. Eventually, we expect a large percentage of classified advertisers to follow consumers online (although online and offline advertising isn't a zero-sum game). The issue, then, for traditional classified publishers, especially newspapers, is figuring out how to do the difficult task of protecting print revenues while growing the online pie in a very competitive marketplace. (This is almost the identical challenge directory publishers face.)

By contrast, the challenge for the online, free classifieds vendors is to develop a model that doesn't simply put price pressure on traditional classifieds and ultimately undermine any sort of classifieds business model on the Internet. While complete destruction of the classifieds revenue model is highly unlikely (the free/fee model described earlier is more likely), potentially massive changes are afoot.

Can the newspapers leverage their assets – including their local brands – to establish themselves as premier classified destinations online? Can they bundle services to grow online while preserving print revenues? Will new sites like LiveDeal be able to develop a model that allows them to generate real revenues over time that can approach today's print numbers?

It will take very clear thinking and bold execution for the traditional media companies and sobriety and thoughtful choices by the Internet pure-plays to make the transition from a static, print classifieds marketplace to a very dynamic, yet profitable online one. (These issues will be explored in further depth and detail, as mentioned, in an upcoming Interactive Local Media White Paper.)

