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NOTHING BUT NET

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Searching for Trouble?

Keyword ads are big earners for Google, Yahoo!, and AOL, so trademark lawsuits currently in the courts could spell major hassles

Search engines have emerged as the Clydesdales of the booming online advertising industry. Just look at Google's upcoming initial public offering, which could value the search giant at \$25 billion. Wall Street anticipates the biggest IPO since the dot-com bubble burst. Google's chief competitor, Yahoo! (YHOO), just announced a wildly successful fourth quarter, with revenues up 132% from a year earlier, thanks in part to surging ad revenues. Seeing dollar signs in searches, Microsoft (MSFT) is hastily building up its own engine to compete with these two gorillas.

What's driving this online arms race? Two words: keyword advertising. It works like this: Google, Yahoo, and other search companies sell keywords to the highest bidders. Whenever Web surfers enter those words into the search box, they receive a list of results that includes spots for the advertiser who bought those terms.

Let's say you entered "Resorts in Barbados" in the Google search box and hit "Search." You would get listings from advertisers who paid for placement with the keywords "resorts" and "Barbados." Google puts those listings off to the right side of the screen, clearly marked as ads. Yahoo does the same and also puts paid listings at the top and bottom of the page, sandwiching the actual search results. Ditto MSN Search.

OUTSIDE HELP. These types of ads account for anywhere from 50% to 75% of Google's estimated \$1 billion in 2003 revenues, according to analysts. A keyword ad network run by Yahoo subsidiary Overture also accounts for an undisclosed but significant chunk of Yahoo's revenues, the same analysts also note. Google and Yahoo claim keyword advertising in search engines is more effective in reaching consumers than other types of online ads, and many advertisers agree.

Keyword advertising is also an essential revenue stream for Microsoft's MSN portal and search engine. Right now, Redmond contracts with Overture to provide advertising to match keyword queries for MSN searches. Likewise, America Online (TWX) contracts with Google for this service, which has been one of the only areas of ad revenue growth for the nation's largest Internet service provider. AOL and MSN share revenues with Google and Overture for keyword ads placed on their search pages.

Some hot brushfires are cropping up around this business model, however, and investors might want to pay close attention in the days ahead. Take the complaint of American Blind & Wallpaper Factory, a small Plymouth (Mich.) company that makes both, plus draperies and other products. It owns and operates the Web site Decoratetoday.com.

LEFT HANGING. In July, 2002, American Blind sent a letter to Google requesting that it stop selling keywords linked directly to the phrase "American Blind." They also requested that Google cease offering a broad range of keyword combinations, including "american wallpaper discount," "decoratetoday.com," and "American wallpaper." American Blind alleged that Google was selling trademarked keywords to rivals in the blind and wallpaper field, thus confusing potential customers and unfairly capitalizing on American Blind's reputation for quality.

EXHIBIT B

Google agreed to remove keyword ads linked directly to verbatim, trademarked phrases. But it balked at removing terms that Google believes to be descriptive, even if trademarked. These included "American blind" and "American wallpaper." After further unfriendly e-mail exchanges last November, Google took the unusual step of asking the U.S. District Court in San Jose, Calif., to quickly and forcefully adjudicate the disagreement.

Google's request for a preemptive legal decision was clearly aimed at getting the issue resolved ASAP, in advance of the IPO. The search giant released a statement saying, "Google filed this action because we were being threatened with an imminent lawsuit by American Blind & Wallpaper Factory. We seek to have the court confirm our view that this methodology properly respects trademark owners' rights, while at the same time simplifying the ad targeting process for our advertisers. Such a decision will ultimately benefit the online advertising industry at large, as well as Google."

SLEEPING GIANTS. The American Blind keyword case is but one of several wending their way through the courts that could affect the future profitability of the search-engine business. On Jan. 14, Playboy Enterprises (PLA) got the green light to proceed with a lawsuit against Netscape and American Online for trademark infringement based on sales of pop-up and banner ads keyed to the terms "Playboy" and "Playmate."

And in France, Louis Vuitton, the French luxury-goods giant, is suing Google for trademark infringement, alleging that its practice of selling keyword ads against search terms violates its trademark. Two other companies have already won five-figure judgments against Google in France with similar lawsuits.

Back in the U.S., some big companies have taken proactive steps to halt keyword advertising they deem to be against their brands' best interests. Dell (DELL), eBay (EBAY), and Hewlett-Packard (HPQ) have all requested that Google not sell keywords against their names, and Google has complied.

FRIGHTENING PROSPECT. Most search-engine outfits have policies that allow companies to remove their trademarked names from consideration for keyword sales. But many big companies haven't noticed the issue yet. If and when they do, they could cut into the revenue streams of Google, Yahoo, and others. And should the courts decide in favor of Playboy, Louis Vuitton, and American Blind, it could set off a rush of trademark complaints against search-engine companies.

Of this much I'm sure: Google will be forced to look a lot harder at its keywords in the near future. Take a Google search for Hallmark. It now returns three AdWords listings. One of them links to Speedycards.com, one of Hallmark's competitors in the greeting-card business. If every trademarked company made its name off-limits for use as a keyword, it would mean significant potential for disruptions in the online-ad marketplace.

Then there's the more frightening prospect, at least for search engines, of dealing with the masses of lesser-known trademarks of smaller to midsize companies. Plus the millions of domain names that could be construed as trademarks. That's why Google wants a clarification of the rules from the California court -- fast.

RESTRICTIONS COMING? The stakes for Web advertising are enormous. This sector racked up \$1.75 billion in sales during the third quarter of 2003, according to the Internet Advertising Bureau. Much of that came from keyword sales. And the IAB expects even more growth, assuming the courts don't blow a gaping hole in this revenue model.

"If search engines cannot sell ads linked to words...then their revenue basis as well as their utility to the Web becomes threatened," writes Danny Sullivan, editor of Web site Search Engine Watch, in an e-mail. Sullivan testified as an expert witness in the Playboy-Netscape case.

My hunch is that, under any scenario, the use of trademarked keywords to sell advertising will become more

- restricted. And that's hardly what shareholders of soaring Internet company stocks -- or prospective buyers of
- issues in Google.com -- want to hear.

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