Ads That Built Google Could Now Pose Test

By Peter Whoriskey
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Most people pay little mind to the text ads that surface after an Internet search.

Flowers at 1-800-FLOWERS

Same Day Delivery Available

Your Satisfaction at 1-800-FLOWERS

1800flowers.com

But appearing as they do millions of times daily, such unremarkable quatrains form one of the largest single sources of the $21 billion Internet advertising market in the United States. For Google, the undisputed master of delivering them, those slivers of text are the foundation of a digital empire.

Now that company's dominance in Internet advertising and its proposed agreement to provide some search ads to its nearest competitor, Yahoo, is being closely scrutinized by federal antitrust investigators, according to sources familiar with the Justice Department's thinking.

In what could emerge as the first serious regulatory challenge to the burgeoning Web giant, Justice Department lawyers are asking whether the proposed $800 million alliance with Yahoo will be good for consumers or another step toward a behemoth Internet monopoly.

Google and Yahoo have said since the deal was announced in June that they were confident their arrangement would win the government's blessing.

But over the summer, the department has made moves that suggest the approval is not being treated as a routine matter. In a signal that a formal investigation had opened, The Washington Post reported in July that the department had issued "civil investigative demands" for information to the companies involved. This week, the Wall Street Journal reported that investigators had hired Sandy Litvack, a veteran antitrust attorney, to oversee the review.

"From all outward signs, the department is seriously considering a lawsuit," said M.J. Moltenbrey, a Freshfields Bruckhaus Deringer lawyer who was director of civil nonmerger enforcement in the Justice Department's antitrust division in the 1990s.

Whether the government decides to try to block the deal, moreover, the investigation allows antitrust regulators the opportunity to probe the records and interview the customers of the world's most dominant Web company. Maybe they won't find anything. But as Microsoft, the similarly dominant player in PC
software, learned in the 1990s, one investigation can lead to another.

Although there are lots of types of Internet advertising -- e-mail, display ads, etc. -- the ads that pop up alongside search results account for one of the largest single chunks of Web advertising dollars. Their value stems from the fact that search ads present an advertising message to a consumer just as that consumer is expressing an interest. And just 10 years after the company was incorporated, Google's search engine handles 71 percent of the search queries in the United States, according to Hitwise.

The company's genius in search advertising stems from its ability to "monetize" search terms. That is, when someone types in keywords, Google is generally far better than its competitors at selecting an advertising message to run, based on the search query that the consumer will click on. The ads appear at the top of or alongside the search results.

Under the Google-Yahoo agreement, Google will use that same technology to provide search ads to run alongside some search results from Yahoo's search engine. Exactly which search keywords Yahoo will hand over to Google's ad technology is not known. But Yahoo has said that Google does a better job of monetizing less popular terms and those are the ones it will turn over to Google for help.

Yahoo would realize as much as $800 million in added annual revenue from the deal, company officials have said, helping to bolster the company, whose stock price has sagged of late. The deal emerged earlier this year as Microsoft was trying to buy the company, and it has been presented as a means of bolstering its fortunes.

"This deal will allow Yahoo to remain in the marketplace as a better, stronger, independent competitor," said R. Hewitt Pate, a consultant to Yahoo who was the former head of the antitrust division at the Justice Department.

Advertisers and consumers will benefit from the deal, he said, because Yahoo customers will get the more relevant ads sent by the Google technology.

Moreover, he said, Yahoo will use the added revenue from the Google deal to improve its own ad technology and make it a better competitor. "Yahoo is not interested in outsourcing the whole of its sponsored search to Google," he said. "Yahoo intends to remain an active competitor in sponsored search."

But some critics of the deal, including rival Microsoft, argue that the alliance between the first and second most popular search engines will in the end reduce competition.

The Association of National Advertisers, a trade group, has written a letter to the Justice Department citing just such objections to the deal.

Noting that Google and Yahoo "control 90 percent of search advertising inventory," the group said the deal "will likely diminish competition, increase concentration of market power, limit choices currently available and potentially raise prices to advertisers for high quality, affordable search advertising."

Some antitrust attorneys say it is likely that the Justice Department's ongoing review will focus on just such concerns.

"Because the deal allows Yahoo to share in the revenues from ads placed with Google, it could dramatically
lessen Yahoo's incentive to compete," Moltenbrey said.

But, she noted, regulators will also consider whether the deal would provide benefits to some industry participants, as Google and Yahoo argue.

Ultimately, the regulators will have to determine whether the negatives of the arrangement outweigh its benefits. "If the evidence of harm to competition is clear, however, the parties will need clear and persuasive evidence of both the existence of and the magnitude of the alleged benefits," she said.

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