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Trouble clicks

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"Click fraud" could undermine the boom in online advertising

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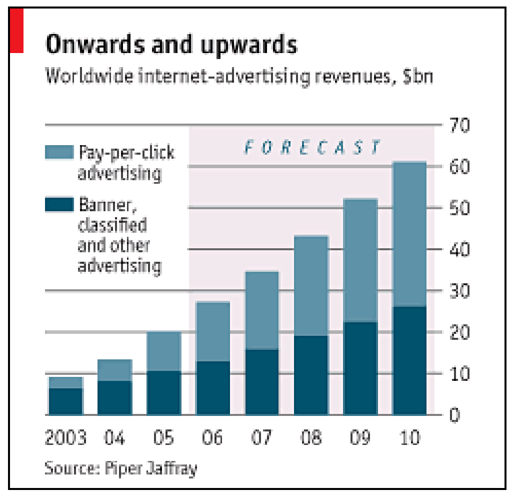

INTERNET advertising is booming. The industry has gone from $9.6 billion in revenue in 2001 to $27 billion this year, according to Piper Jaffray, an investment bank. And it is still early days. The internet accounts for only 5% of total spending on advertising, but that figure is expected to reach at least 20% in the next few years. The single largest category within this flourishing industry, accounting for nearly half of all spending, is "pay-per-click" advertising, which is used by firms both large and small to promote their wares.

It works like this. Advertisers bid on keywords that they believe potential customers will be interested in. This enables internet firms such as Google, the market leader, and Yahoo!, its smaller rival, to display advertisements alongside the results of internet searches. Somebody searching for a particular type of wine, for example, might see advertisements from wine merchants. Google, Yahoo! and other firms also place ads on affiliates' websites—so wine merchants' advertisements might also appear on a wine-appreciation site. The advertiser pays only when a consumer clicks on an ad; the owner of the website where the ad was displayed then receives a small commission.

The benefits of the pay-per-click approach over traditional advertising (television, radio, print and billboards) are obvious. Since advertisers pay only to reach the small subset who actually respond to an advertisement, the quality of the leads generated is very high, and advertisers are prepared to pay accordingly. The price per click varies from $0.10 to as much as $30, depending on the keyword, though the average is around $0.50. "Mesothelioma", for instance, the name of an asbestos-related illness, is an especially valuable keyword, because lawyers are prepared to pay a lot to make contact with sufferers in the hope of representing them in a lucrative compensation lawsuit. Google made most of its $6.1 billion in revenue last year from pay-per-click advertising.

But as pay-per-click advertising has grown into a huge industry, concern has mounted over so-called "click fraud"—bogus clicks that do not come from genuinely interested customers. It takes two main forms. If you click repeatedly on the advertisements on your own website, or get other people or machines to do so on your behalf, you can generate a stream of bogus commissions. Click fraud can also be used by one company against another: clicking on a rival firm's advertisements can saddle it with a huge bill. Bogus clicks are thought to account for around 10% of all click traffic, though nobody knows for sure.

Bill Gross, the entrepreneur who pioneered the pay-per-click model back in 1998, was aware of the problem even then. (Yahoo! subsequently acquired his firm, known at the time as Overture.) He installed a three-layered defence system: a filter to weed out clicks from known fraudsters at the outset, statisticians and software to spot suspicious click patterns, and co-operation with advertisers to enable them to analyse the leads generated and sound the alarm if necessary.

But generally the industry adopted a rather cavalier attitude to click fraud. Eric Schmidt, the boss of Google, caused uproar a few months ago when he seemed to suggest that the “perfect economic solution” to click fraud was to “let it happen”. He was responding to a theoretical question during a debate at Stanford University, but his response reinforced the perception that Google had higher priorities than addressing the problem.

Such a flippant attitude has not gone down well with advertisers, who are up in arms about the problem. Some have even resorted to legal action. Google reached a settlement in March with Lane's Gifts and Collectibles, a gift shop based in Arkansas, and agreed to offer refunds to advertisers who claim they have been charged for bogus clicks. Such refunds are capped at $90m, however, so many observers think Google got off lightly. And in June Yahoo! promised to intensify its efforts to fight click fraud as part of a settlement with CheckMate, a fraud-detection firm. As well as offering refunds for clicks determined to be fraudulent, Yahoo! agreed to appoint a “traffic-quality advocate” to voice advertisers' concerns within the company.

In the wake of these legal challenges, Google and Yahoo! recently joined a working group at the Interactive Advertising Bureau (IAB), a trade association, which will establish standards for pay-per-click advertising, including the introduction of industry-funded auditing and certification, by the middle of 2007. “I believe Google and Yahoo! are now taking the issue very seriously,” says David Jones, chief executive of Euro RSCG, an advertising company. But Rishad Tobaccowala, head of innovation at Publicis, one of the world's biggest advertising groups, says it is too early to say whether the measures being taken against click fraud will be enough to satisfy advertisers.

A few months ago Mr Gross pioneered an alternative to the pay-per-click model. In February Snap, a search engine backed by Mr Gross, launched “pay-per-action”, a new model in which advertisers pay only if a click on an ad is followed by an action such as a purchase or a download. Google is testing a similar model and Turn.com, another ad network, adopted the pay-per-action model a few weeks ago.

Might this put an end to click fraud? Don't bet on it, says Mike Zeman at Starcom, an advertising agency. Pay-per-action will be a niche, he predicts, since converting a click into an action depends on a variety of factors such as the ease of use of the advertiser's website. Google and its peers will be reluctant to be so dependent on factors outside their control. But Mr Tobaccowala thinks pay-per-action could become a real alternative to pay-per-click. As bigger companies spend more on internet advertising, they will demand more accountability and a wider range of options, he says. At the very least, that means clamping down on click fraud; but it also presents an opportunity for entrepreneurs to invent new models that are less vulnerable to abuse.