

# Portal Economics and Business Models

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## INTRODUCTION

In late 2005, the market capitalization of Google was the envy of every major media and telecom company. More than any other Web portal, Google had succeeded in benefiting from the superior economics inherent in digital interactive channel systems. At the core of Web portal success is a set of economic mechanisms, including, but not limited to transaction cost savings, economies of scope, and positive network externalities. These advantages are rooted in how structure and competition have evolved in digital channel systems, which is discussed based on organizational theory in a separate article titled "Digital Interactive Channel Systems and Portals: Structure and Economics." One subcategory of transaction cost, lower search cost, has played a particularly important role in the success of portal business models.

In the late 1980s information technology had evolved to inspire the development of online services and the first

digital interactive channel systems. Of the many companies that entered the new business space (Prodigy, CompuServe, America Online, etc.), few survived and succeeded in creating a sustainable business. The failure of the many and success of the few became the focus of many studies. One of the early empirical investigations highlighted one category of business models, originally labelled as Online Networks, the predecessor of today's Web portals (see Figure 1; Schlueter Langdon, 1996; Schlueter Langdon & Shaw, 1997, 2002).

The study identified search cost savings as a key advantage and foundation of the portal business models. Google has evolved as one of the strongest verifications of this finding.

However, despite favourable economics, portal success is not guaranteed, and pitfalls can be avoided.

*Figure 1. Strategic roles in emerging e-channels (Schlueter Landon, 1997)*

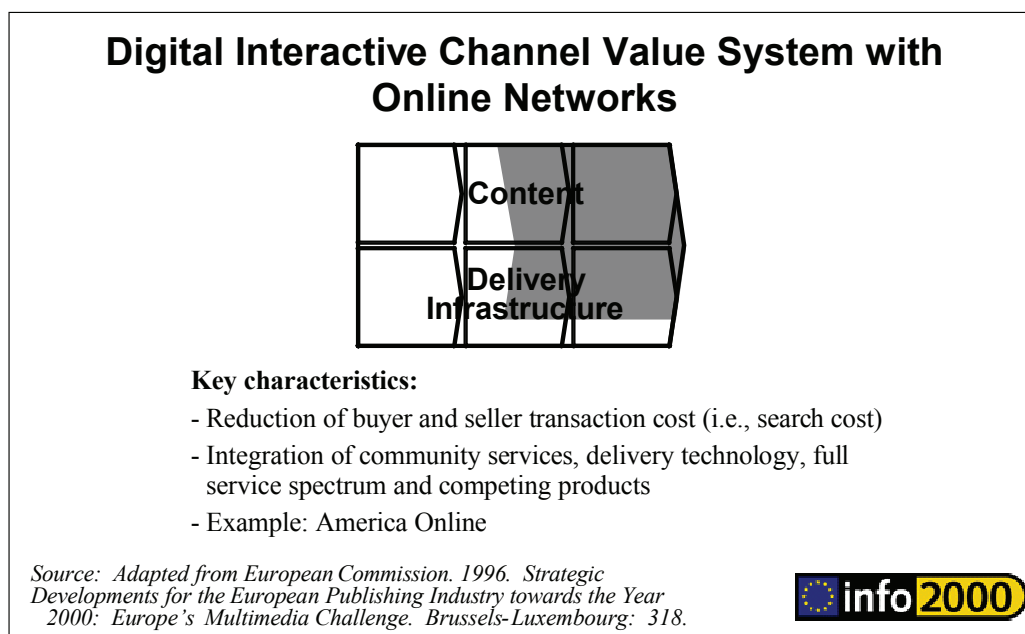
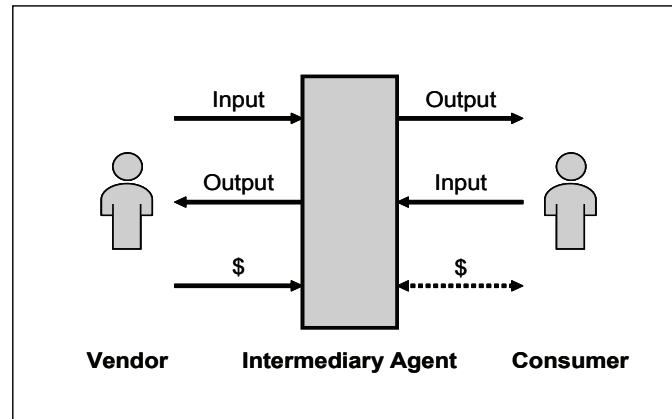


Figure 2. Benefiting from a two-sided market



## TRANSACTION COST ECONOMICS: OLD WINE IN NEW BOTTLES

Despite the attention that new technology receives, seasoned investors know that, in the end, it is all about economics. Specifically, how can new technology either improve the economics that underlie current business models or enable entirely new models? Google's success and high market capitalization underscore the importance of economics, and its success is spectacular, considering the odds it faced. Firstly, it entered the portal game very late (see Figure 2 in the related article on "Digital Interactive Channel Systems and Portals: Structure and Economics"). Secondly, it dominates a business that had often been considered as subject to first-mover advantages, despite being a late entrant. One explanation for this success is Google's singular focus on the economics that are a pillar of any portal business model, transaction cost savings, a concept in economics pioneered by Coase (1937) and refined by Williamson (1975). Google reduced search costs by focusing on the performance or "intelligence" of its search algorithms, and developed what is widely considered as the best search technology. In search, there are typically three ways to improving performance: First, by adding intelligence to the search algorithm or agent (an experienced and more knowledgeable real estate agent is better than a rookie); second, by providing structure to the search space (the phone book or yellow pages are a good example); and third, by combining options one and two. Google focused on "intelligent" search algorithms, while Yahoo! tried to structure the search space using directories. Some competitors even outsourced search altogether, essentially leaving the core or key pillar of the portal busi-

ness to third parties. This apparent misunderstanding of the fundamentals of the portal business has been corrected, as competitors have insourced search or formed strategic alliances (AOL and Google in December 2005), but this strategic fumble has clearly aided Google's ascendance, and stands as a reminder of the importance of understanding a business' fundamental economics.

## BENEFITING FROM A TWO-SIDED BUSINESS

Google's business or revenue model, the implementation of its exploitation of transaction cost economics, also had an interesting twist. Any search has a dual outcome and therefore can be conceptualized as a simultaneous bidirectional process: a consumer/buyer finding a good and a seller/advertiser finding a buyer/lead. Alternatively, Google can be viewed as operating in two related markets: first, providing search results to consumers, and second, providing leads to advertisers (see Figure 2; another example of a so-called two-sided market is the credit card: providers, like MasterCard, make cards and credit available to consumers; they also provide terminals and processing for merchants to accept the cards; for an overview of two-sided markets, see Evans, 2002).

While incumbents, such as AOL, were charging the consumer/buyer end of a search process (the monthly, flat AOL fee), Google collected fees from the other side, from buyers/advertisers. In other words, Google's *free* search is, in essence, always advertiser/buyer paid search, which in retrospect appears to be a more fitting model: Sellers are

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