

Chapter 14

Governance Mechanisms in Internet-Based Affiliate Marketing Programs in Spain

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ABSTRACT

Internet-based affiliate marketing programs have emerged as one of the fastest-growing methods for online retailers to acquire customers and increase sales by tapping into the power of independent web sites to reach a large, diverse audience of potential customers. However, while these programs have proven effective in increasing website traffic and sales, illegal or inappropriate activities on the part of affiliates could negatively impact a retailer's brand in the eyes of customers. This study is an exploratory analysis of governance mechanisms (formal contracts, partner selection, incentives and monitoring) in one-to-many affiliate programs in Spain. Agency theory and transaction cost analysis provide the theoretical background. The conclusion is that there is a significant lack of transparency in the guidance and restrictions communicated to affiliates, and a lack of systematic monitoring of affiliate behavior, which increases the risk of opportunism or misconduct. General recommendations for managers of affiliate programs are considered.

INTRODUCTION

Revenue-sharing affiliate marketing is potentially the most cost-effective method for acquiring new customers on the Internet. Also called pay for performance marketing, an affiliate marketing

program consists of an on-line retailer (merchant) who places a link on a third-party website (affiliate). If a visitor to the affiliate site clicks on the link and performs a specified action (e.g. visits the merchant's website, fills out a form, or purchases a product), the affiliate receives a commission. The arrangement has been described as similar to

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having a large, independent sales force working solely for commission and absorbing the total risk associated with marketing a retailer's products (Duffy, 2005).

While Amazon is generally credited with creating the first major affiliate program on the Internet (launched in 1996), Hoffman and Novak first focused the attention of the academic community on this strategy in 2000, concluding that of the various forms of advertising used by online retailer CDnow, their affiliate program was by far the most cost effective (after word-of-mouth, to which they attributed a cost of zero), since it allowed the retailer to "draw a direct line from advertisement to sale" (Hoffman & Novak, 2000, p. 188).

Hoffman and Novak are not the only researchers who have taken an interest in affiliate marketing. Papatla and Bhatnagar (2002) propose a guide to choosing affiliate partners, while Libai Biyalogorsky, and Gerstner (2003) perform a theoretical analysis of affiliate referral fee structures in order to determine the optimal program for different types of affiliates. Other research includes case studies of merchants (e.g. Walthieu, 2000) as well as affiliates (e.g. Moon, 2000).

Despite these initial efforts to bring the topic of affiliate marketing to the fore, recent empirical studies have been few and far between. This might lead one to the conclusion that affiliate marketing was merely a fad which was popular for a time, but has since faded into obscurity. This is not the case. Duffy (2005) recently observed that "affiliate marketing is likely to become the principal mainstream marketing strategy for e-commerce businesses in the future" (p. 161). It is difficult, however, to find exact estimates of market size, as affiliate marketing has yet to be clearly defined, and the entrance of dozens of intermediaries further complicates the situation (Molander, 2005). While ValueClick (2006) estimates the global affiliate marketing sector to be in the range of \$400 - \$500 million, MarketingSherpa places the figure at \$6.5 billion (MarketingSherpa, 2006a).

Today, 9-40% of a typical online retailer's sales come from affiliates (MarketingSherpa, 2006b).

In light of the growing practical importance of affiliate marketing, there are critical issues which have not received sufficient attention by researchers thus far. An area of particular interest, and the topic of this paper, is the governance mechanisms used in affiliate programs to control the promotional activities of affiliates. One of the principal advantages of affiliate marketing is its ability to accurately track the behavior of visitors in terms of website visits, lead generation and sales. However, there is a significant risk that while promoting merchants' products and services, affiliates may engage in activities that are fraudulent, unethical, or somehow destructive to the brand value of the merchant. As affiliates are often the first point of contact with a potential customer, negatively-perceived activities on their part could have a disastrous effect on the retailer's business.

The need for further investigation in the area of governance of affiliate marketing programs is corroborated by a recent survey from AffStat (2006), in which nearly 200 affiliate managers were asked their biggest challenge in affiliate marketing. About half indicated some form of governance issue (detecting fraud, properly managing the affiliates, monitoring affiliates for brand risks and monitoring affiliates' use of trademarks in search engines).

Transaction cost analysis (Coase, 1937; Williamson, 1975, 1985, 1991) and agency theory (Eisenhardt, 1989; Jensen & Meckling, 1976; Ross, 1973) provide the theoretical background for the constructs used in this study. Opportunism has appeared in the literature in many different forms (see Wathne & Heide, 2000 for a detailed treatment of the construct), but can be generally described as "some form of cheating or undersupply relative to an implicit or explicit contract" (Wathne & Heide, 2000, p. 48). In the TCA and Agency theory literature, the primary relationship considered is that between a principal and an agent, which in affiliate marketing would be the

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