

Investors to Web Start-Ups: Where's the Advertising?

By REBECCA BUCKMAN August 21, 2007; Page B1

Tech entrepreneur Glenn Kelman's online real-estate brokerage, Redfin Corp., allows consumers to buy or sell homes online and takes a cut of each real-estate transaction it brokers.

To Mr. Kelman, it's a sensible business model. But when he sought backing from venture capitalists this past spring, he found the process much tougher than he had expected.

During his meetings with Silicon Valley financiers, many kept urging the Seattle company to start selling advertisements on its Web site instead of making money from commissions. "Today, there's nothing more fashionable than having an ads-driven model," says Mr. Kelman, 36 years old. Content to be unfashionable, he stuck to his guns and ultimately raised \$12 million. But is he bringing in the revenues he could if he maximized the potential of his website by including ads?



Mr. Kelman's experience is one of many like it as venture capitalists increasingly advise consumer-focused tech start-ups to follow the same business model: online advertising. Chief executives of Web start-ups such as EnjoyMyMedia Corp. and Cake Financial Corp. say they have also recently faced tough questions from venture firms over their business models that don't rely on advertising income.

According to research firm VentureOne, U.S. investors in the first half of this year poured \$317 million into "Web 2.0 companies" -- generally ad-supported Web sites in fields like social networking or blogging -- up nearly 21% in the year-earlier period. Venture capitalists typically take stakes in start-ups with the hope of cashing out later through a sale or initial public offering.

Venture capitalists are fans of ad-driven sites for good reason: advertising revenue has proven to cover the cost of giving away a Web service free, and free sites attract users much faster than sites that charge money. **Ad-based free sites are typically also cheap to run because there is often no need for customer-service agents or costs for physical goods, ergo, high profit margins parallel success.** Indeed, many of today's hottest Web properties are based on the online-ad model,

U.S. Internet-advertising revenue reached nearly \$17 billion last year, up 35% from 2005. Revenue has been rising since 2002, and "we have every confidence that this growth trend will continue," says Randall Rothenberg, CEO of the Interactive Advertising Bureau trade group in a May statement.