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The Truth About Online Ad Exchanges

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EXECUTIVE SUMMARY

Online ad exchanges introduce an ad sales model that serves both ad buyers and sellers by opening access to inventory and pricing based on market demand. Smart advertisers and publishers will seek to join an exchange immediately, selecting a partner that is transparent, supports desirable media, and offers an open architecture. As exchanges evolve, Forrester expects that they will supplant ad servers, force ad network consolidation, and gradually infiltrate offline ad sales.

DEFINING THE ONLINE AD EXCHANGE

Rising search marketing costs, rich media and targeting advances, and a re-emphasis on branding are infusing online media with new energy.¹ One of the most considerable changes to date is the new model for buying and selling online ads: the online ad exchange. Forrester defines an online ad exchange as:

An automated marketplace that connects advertisers to desirable inventory at a price advantageous to both ad buyers and sellers.

It's easy to confuse online ad exchanges with ad networks, because both facilitate online media buys between advertisers and publishers. However, there are key differences between the two (see Figure 1). Although different flavors of exchanges are emerging, we find that a company can be called an exchange if it:

1. **Enables marketplace pricing.** The fundamental trait of an exchange is that it creates a universe where supply and demand determines the price for ad inventory. Most exchanges also manage relationships between participating buyers and sellers.
2. **Provides a technology platform to support its marketplace.** The other key characteristic of an exchange is that it owns a platform that manages the bid-based transactions. Like ad networks, exchange platforms usually also provide ad serving and targeting, billing management, and reporting, although these functions are secondary to its primary purpose of enabling auction-based ad sales.



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Figure 1 Online Ad Networks Don't Provide A Marketplace

| | Online ad network | Online ad exchange |
|---------------------|--|--|
| Originated | ~1997 | ~2003 |
| Primary value | Aggregates and sells inventory on behalf of a group of publisher sites | Automates a marketplace where ad buyers and sellers transact based on fair market pricing |
| Pricing model | Typically a commission (30%-50%) of ad sale generated | Some charge a commission on sales generated (10%-30%), others a flat CPM, others via an arbitrage model. |
| Number in existence | Hundreds | Less than 10 |

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Source: Forrester Research, Inc.

Why Online Ad Exchanges Matter Now

Although not brand new — some exchanges, like the one from Right Media, launched in 2003 — exchanges matter now more than ever because:

- **Marketers embrace bid-based ad buying.** Before paid search ads, marketers bought online ads just like they did offline ads, on a cost per thousand impressions (CPM) basis. Now, the Interactive Advertising Bureau (IAB) reports that 50% of all ad sales during the first half of 2007 were performance-based.² Marketers fluent in cost-per-click deals where ad placement depends on bid price are ready to buy display ads through an exchange.
- **Online media supply is skyrocketing.** Online media has always been more plentiful than offline. Now, user-generated blogs, photos, videos, and podcasts introduce millions of new places where marketers can buy ads. However, these media are hard to find through existing online ad-buying models. Ad exchanges help non-traditional publishers with variable day-to-day inventory monetize their impressions outside of a controlled ad sales environment.³
- **New exchanges are coming online.** The exchange market is still small compared with the number of ad networks. However, lured by Google's success with bid-based advertising and advertiser demand for more flexible pricing options, new exchanges are emerging. Several — including DoubleClick and TRAFFIQ — have launched within the past year. And many ad networks talk of creating their own exchanges to compete with proprietary ones. The increasing prevalence of exchanges and demand-based pricing will make advertisers savvier about the going rate they should expect to pay for desired inventory.

PUBLISHERS AND ADVERTISERS: START WORKING WITH AN EXCHANGE TODAY

In addition to providing a new way to buy and sell ads, some exchanges offer tools like yield management and ad serving that support traditional display ad-buying models. Publishers and advertisers should evaluate the differences between exchanges to find a partner that best suits their marketing goals and approach to ad sales (see Figure 2). We recommend that both buyers and sellers look for an exchange that:

- **Is transparent.** As opposed to blind ad networks, a transparent exchange allows publishers and advertisers to identify each other before agreeing to a match. This lets advertisers control where ads run and lets publishers control which advertisers have access to their inventory. Some exchanges — like The Right Media Exchange (RMX) — extend transparency into data ownership as well. RMX owns the exchange platform, but exchange members own, and can trade, data assets — like user site behavior or response to previous ad campaigns — with other members.
- **Matches their media needs and preferred commission model.** Publishers and advertisers should partner with an exchange that fits their business model and targeted media. For example, AdBrite auctions placement in mid- and long-tail media including user-generated content, blogs, and niche Web sites and makes commissions on all ad sales. RMX delivers primarily branded site inventory and charges for any transaction managed through the RMX platform, while AdECN processes a mix of inventory, but only through ad networks.
- **Has an open architecture.** Forrester believes that successful interactive marketing technologies will be those able to network with other best-of-breed solutions to create an online marketing suite.⁴ To this end, the more easily the exchange can integrate with other applications, the better. For instance, AdECN has an API interface that allows it to connect with third-party systems for functions like order management, CRM, or reporting.

Additionally, advertisers should look for an exchange that:

- **Scales.** Advertisers will get the best deal from a large exchange — one with a volume of impressions diverse enough to support demand-based pricing. Since its beta launch in late summer, TRAFFIQ already has more than 1 billion impressions in its exchange. Advertisers should also seek exchanges that can accommodate new ad formats as they emerge. In addition to supporting IAB ad units, AdBrite has proprietary ones — such as a branded video player, page takeovers, in-line contextual ads, and ads on photos and images — that yield strong results. Advertisers like buy.com and Safeway find that consumers spend 30-35 seconds engaged with their AdBrite full-page takeovers.

Figure 2 Current Online Ad Exchanges Provide Different Value

| | Exchange (parent company) |
|--|---|
| AdBrite | |
| Primary value: | <ul style="list-style-type: none"> • Connecting advertisers to mid- and long-tail publishers • Providing a revenue stream for small publishers and content creators |
| Pricing: | Charges a commission (~30%) of all ad sales generated |
| Comments: | <ul style="list-style-type: none"> • Provides a self-service interface for publishers and advertisers • Creates new ad formats to monetize user-generated content |
| AdECN (Microsoft) | |
| Primary value: | Increasing liquidity for ad networks |
| Pricing: | Charges flat rate of \$1.01-\$0.03 per thousand impressions traded |
| Comments: | Individual advertisers and publishers can't join the exchange |
| ADSDAQ (ContextWeb) | |
| Primary value: | Creating an auction for reserved inventory (futures) and bidded inventory (spot media) |
| Pricing: | Earns the spread between a publisher's bid price and an advertiser's ask price |
| Comments: | <ul style="list-style-type: none"> • Specializes in contextual, but also supports other forms of targeting • Publishers set CPM rate for inventory |
| DoubleClick (Google) | |
| Primary value: | Providing an auction-based environment for trading premium inventory |
| Pricing: | Charges a commission (~20%) of all ad sales generated |
| Comments: | Integrates with existing DART ad serving tools for publishers and advertisers |
| The Right Media Exchange (Yahoo!) | |
| Primary value: | <ul style="list-style-type: none"> • Enabling the open exchange of ad inventory and other marketing assets • Consulting on strategies to increase revenue and ROI from ad sales |
| Pricing: | Charges a fee (~10%) for every dollar traded |
| Comments: | <ul style="list-style-type: none"> • Exchange platform includes ad inventory management • Also licenses platform to ad networks that want to create proprietary exchanges |
| TRAFFIQ | |
| Primary value: | <ul style="list-style-type: none"> • Providing advertisers with well-priced direct access to target audiences through midsize and large publishers • Selling blocks of publisher inventory in advance of the market value |
| Pricing: | Charges a commission (~30%) of all ad sales generated |
| Comments: | <ul style="list-style-type: none"> • One of the newest entrants in the space • Allows advertisers to cherry pick the sites on which their ads will appear |

- **Auctions both spot media and futures.** Smart advertisers care about more than just paying for a particular ad spot on a given Web site. They also want — and will pay for — the ability to select the date and time an ad runs. Recently launched exchange AdBidCentral focuses solely on auctioning guaranteed future placement in premium inventory. This self-described “rolling upfront” marketplace contrasts with the DoubleClick Advertising Exchange, which primarily auctions well-targeted spot inventory.

Publishers, specifically, should evaluate an exchange on its:

- **Workflow.** Publishers should make sure that their exchange partners have easy-to-use tools that suit their business goals. Some exchanges, like TRAFFIQ and AdBrite, have Web-based interfaces that walk publishers through the process of profiling inventory and audience. Others, like The Right Media Exchange, provide a customizable interface so publishers can use the RMX platform to create their own proprietary exchanges. Personality quiz and social networking media company Tickle did this and increased non-premium revenue by 771% across Tickle.com and its viral site network, the Tickle Grapevine.⁵
- **Transaction management.** As with a good ad network, publishers should expect an exchange to offload billing — but exchanges can often provide additional value on top of simple transaction management. While processing payments for its publishers, TRAFFIQ found that many US publishers were selling their UK IP addresses at a discounted rate to US advertisers. TRAFFIQ targeted these addresses for UK advertisers like BSkyB’s Sky Sports and generated higher premiums for the publishers while delivering UK advertisers valuable customers for 25% less than their cost outside of the exchange.

WHAT IT MEANS

ONLINE AD EXCHANGES WILL REDEFINE AD SALES ACROSS CHANNELS

As ad exchanges evolve and advertisers, publishers, and ad networks become more proficient with them, we expect exchanges to become more important in all facets of ad sales. Specifically, the development of online ad exchanges will cause:

- **Ad exchanges to replace ad servers.** By integrating its exchange with its existing DART products, ad-serving giant DoubleClick is already taking a significant gamble that exchanges will supplant existing ad serving technologies. We think that at first, providing exchange capabilities — demand-based pricing, inventory, and transaction management across a marketplace — will be one way for today’s commoditized ad servers to set themselves apart from competitors. Over time, however, as exchange sales become commonplace among publishers and advertisers, both entities will want to upgrade existing ad servers for ones

that can handle all types of buys. This means that common ad servers without exchange capabilities will perish. For example, the key to Atlas' survival is to join another Microsoft family resource: AdECN.

- **Exchanges to force ad network consolidation.** Already some consolidation of the hundreds of undistinguishable ad networks is under way.⁶ But Forrester expects that as ad buyers and sellers grow accustomed to the transparency and appealing CPMs offered by ad exchanges, advertisers and publishers will gradually reduce the number of intermediaries — including blind networks — with which they work. LookSmart moved its remnant inventory from three ad networks to The Right Media Exchange because RMX generated a 400% greater effective CPM.
- **Marketplace economics to penetrate the offline environment.** Ad exchanges are revolutionizing how online media is bought and sold by enabling access to volumes of valuable inventory and demand-based pricing. But these benefits need not be isolated in the online space. As exchange expertise increases and more inventory is traded through online marketplaces, Forrester expects both advertisers and publishers to extend this method of trade into offline ad sales as well. In fact, we'd encourage existing ad exchanges to follow TRAFFIQ's lead and craft their offline strategy now. Otherwise, all their work training advertisers and publishers on how to use and get value from an exchange will simply push business to Google — the only auction currently trading offline inventory.

ENDNOTES

- ¹ Display ads will never be the stars of the interactive marketing show, as search has been for the past three years, but they will be key to the interactive marketing budget by stepping up to a subtle but essential supporting role in all interactive campaigns. See the October 10, 2007, "[US Interactive Marketing Forecast, 2007 To 2012](#)" report.
- ² The Internet Advertising Bureau (IAB) is a membership organization of online advertising buyers and sellers that is dedicated to providing resources and support to drive the growth of the online advertising industry. In conjunction with PricewaterhouseCoopers, the IAB publishes a quarterly and annual report on Internet advertising revenue. Source: IAB Internet Advertising Revenue Report, Q2 2007 (http://www.iab.net/media/file/IAB_PwC_2007Q2.pdf).
- ³ Much of the new online content is created by individuals like bloggers or amateur videographers. These individuals have neither the expertise nor infrastructure to support the sale of advertising as would a traditional publisher with an online presence (like a magazine or television network).
- ⁴ The strongest online marketing suites will maximize the size of their network to include myriad best-of-breed channel specialists and facilitate hub/network connections through common standards like Web services, XML, and service-oriented architecture (SOA) that support rapid application integration. See the October 17, 2007, "[Defining The Online Marketing Suite](#)" report.

- ⁵ Source: “PMX works for Tickle” (<http://www.rightmedia.com/content/rmx-members/tickle-case-study/4,605.php>).
- ⁶ There have been a number of ad network acquisitions in recent months, including AOL’s purchase of behavioral ad network TACODA and most recently, Yahoo’s purchase of BlueLithium.