

ONLINE SEARCH



LOCAL SEARCH

Growing Revenue in a Transitional Market



Online Search

Volume 1, 2004

Research Topics

- Paid Search
- Local Programming & Revenues

Business Benefits

- Increasing Revenues
- Pricing & Packaging
- Industry Value Chain Analysis

LOCAL SEARCH

Growing Revenue in a Transitional Market

The paid search market has grown from \$250 million to \$1.6 billion in only four years. Industry attention has now turned to local search to increase this dramatic rise.

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Research Highlights

Local Content: Programming Strategies for Regional Media

A recent Jupiter Consumer Survey indicates 60 percent of consumers regularly access local content online. Despite the category's position as the third most popular online activity, local advertising will command 19 percent of all online ad spending by year-end 2005. (Entertainment & Media, October 3, 2002)

Online Advertising Through 2008: Paid Search Drives Modest Recovery

After several lean years, online advertising will increase slightly to \$6.3 billion in 2003, and growth will continue through at least 2008. Paid search is driving this recovery, with nearly 50 percent growth in 2003. Display advertising will decline for the third straight year but will start to rebound in 2004 as brand marketers increase spending on rich media advertising. (Online Advertising, August 28, 2003)

Executive Summary

The paid search market has grown from \$250 million to \$1.6 billion in only four years. Industry attention has now turned to local search to increase this dramatic rise.

Key Questions

- When consumers search for local merchants, is the Internet more valuable than are print yellow pages?
- Which types of advertisers will lead the growth of local search, and when will they do so?
- Which barriers constrain growth of the local search market?
- How should local search providers attract service-based advertisers?

Key Findings

Landscape: Consumers' Interest in Local Search Has Been Moderate

Growth of local search use has not kept pace with growth of the overall online population, and consumers use the Internet to look up known local merchants more than they do to discover new ones. Also, the three categories driving print yellow pages use—physicians, restaurants, and automotive service—have been among the slowest to shift advertising spending online.

Outlook: Local Search Will Grow Slower than Online Advertising

Local search, a market in flux, will grow slower than will overall online advertising. Local search will total \$824 million in 2008, representing a compound annual growth rate (CAGR) of 15 percent, versus a 19 percent CAGR for overall online advertising.

Mandate: Compete on Comprehensiveness, Not Convenience; Launch Pay-per-Call Options for Service Advertisers

Local search providers must aim for breadth, not convenience, to dethrone print yellow pages. The key is adding depth to merchants' content through technology, and then leveraging the direct sales force. Pay-per-call pricing should be introduced to lure service-based advertisers.

Landscape

Consumers' Interest in Local Search Has Been Moderate

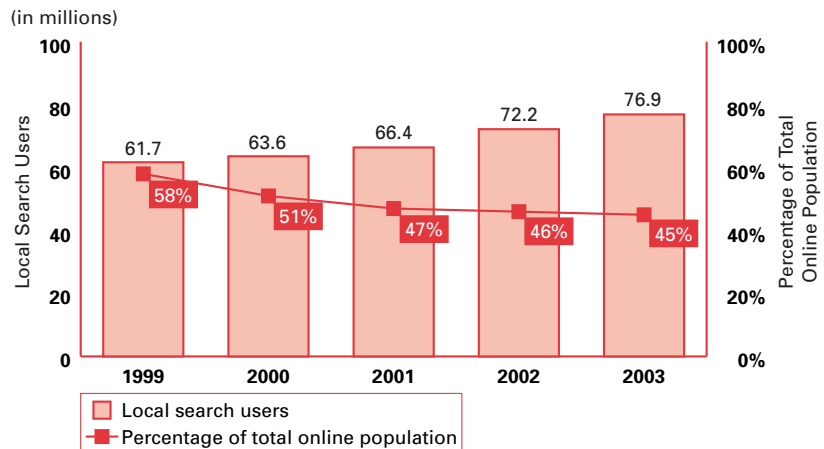
Reach of Local Search Is Eroding

Fig. 1 Online Local Search Reach and Users, 1999 to 2003

Question: Thinking about your use of the Internet over the past year, which of the following activities did you conduct online monthly or more frequently? (Select all that apply.) "Visited an online directory site to find addresses or phone numbers" is shown.

Source: Jupiter Research/Ipsos-Insight Individual User Survey (6/03), n = 4,075 (US only); Jupiter Research/The NPD Group, Inc. Individual User Survey (5/02), n = 4,341 (US only); Jupiter Research/NPD Individual User Survey (5/01), n = 3,150 (US only); Jupiter Research/NFO Consumer Survey (5/00), n = 2,312 (US only)

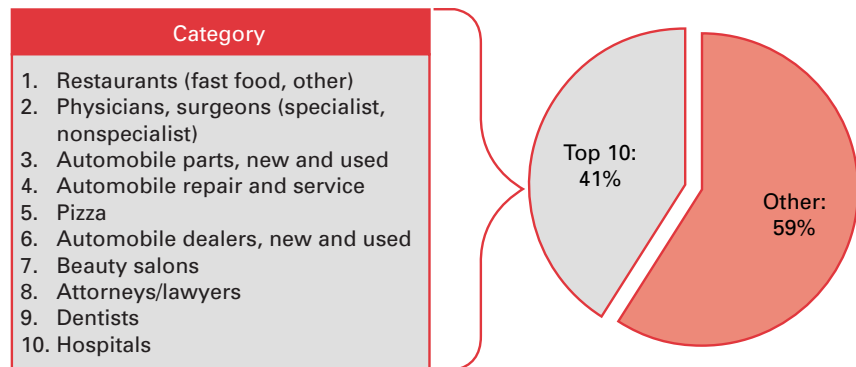
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Growth of local search use has not kept pace with growth of the overall online population. According to Jupiter Research's annual individual user survey, the percentage of the online population who used an online directory site declined from 58 percent in 1999 to 45 percent in 2003. Although the number of local search users grew over the period, the rate was not commensurate with overall online population growth, suggesting a current limitation of local search properties and need for consumers' experience to improve.

A Few Categories Drive Print Yellow Pages Use

Fig. 2 Use of Print Yellow Pages, 2002



Source: YPIMA 2002 Usage Study/Knowledge Networks S.R.I.
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Off-line use of the yellow pages is relatively concentrated and relies on a few industries. The top-10 print yellow pages categories drive over 40 percent of use of the directory. This pattern of use is largely replicated online, with a few subtle differences. Restaurants represent the largest category both online and off-line, but there is a heavier skew toward travel-related use online, versus in the print directory.

One online yellow pages publisher estimates as much as 20 percent to 25 percent of all queries relate to travel services, such as hotels and car rentals. Jupiter Research previously conducted a segmentation of the local search audience and divided it into six distinct groups: tourists, business travelers, local residents, newcomers, displaced/relocated natives, and college students. (See *Local Content: Programming Strategies for Regional Media*, Entertainment & Media, October 3, 2002.) Tourists and business travelers are the two most likely segments to conduct travel-related local searches. Both have a higher spending power than local residents do, giving the demographic mix of an online yellow pages property a higher value on a per-audience-member basis, compared with print. Jupiter Research believes travel currently represents the greatest opportunity for local search providers, with local search publishers launching performance-based advertising options, and travel (e.g., hotel booking) being a leader in paid search spending.

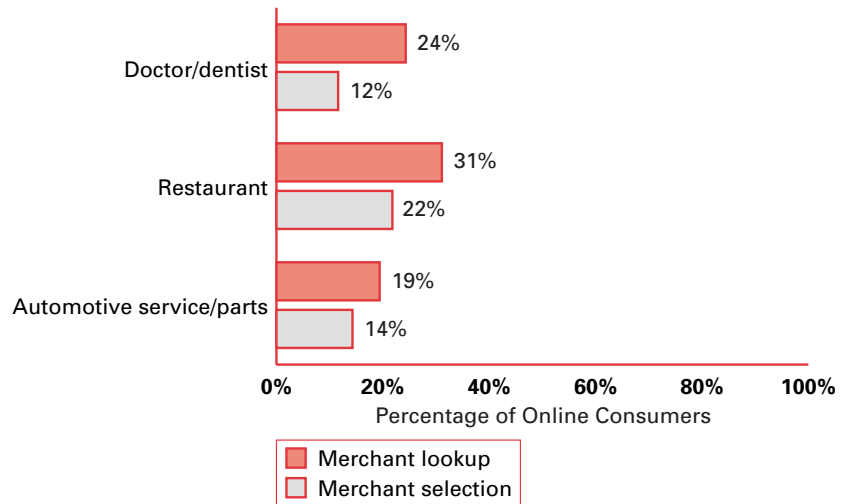
Consumers' Use of Online Local Search Is Rudimentary

Fig. 3 Consumers' Use of Merchant Selection Versus Lookup

Question: Which of the following do you turn to most often to help you choose a local business or service in each of the following categories? (Select one for each column.) Which of the following do you turn to most often to help you find the address and/or phone number of a local business or service in each of the following categories? (Select one for each column.)

Source: Jupiter Research/Ipsos-Insight Consumer Survey (3/04), n = 2,713 (US only)

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Consumers use the Internet to look up known merchants more than they do to discover new ones. Jupiter Research chose the three categories—physicians, restaurants, and automotive repair—that dominate print yellow pages use, and surveyed the importance of the Internet to consumers when searching for firms in these categories. Although far from comprehensive, the three act as a valuable proxy for how local search use has emerged online. In all three instances, the Internet was more important in the task of looking up a firm's address or phone number than in helping consumers select a merchant for a particular need. The primary focus of local search providers should be changing these dynamics, increasing the latter and comparatively more sophisticated type of use, to support strong growth of advertising spending.

Off-line Category Leaders' Affinity with Internet Is Low

Service-based industries primarily drive print yellow pages use. Their distinction from product-based advertisers is important because service-based industries measure and value customers' inquiries uniquely.

Paid search has enjoyed strong growth because advertising spending is overwhelmingly linked to immediate online sales (i.e., the entirety of transactions occurs online).

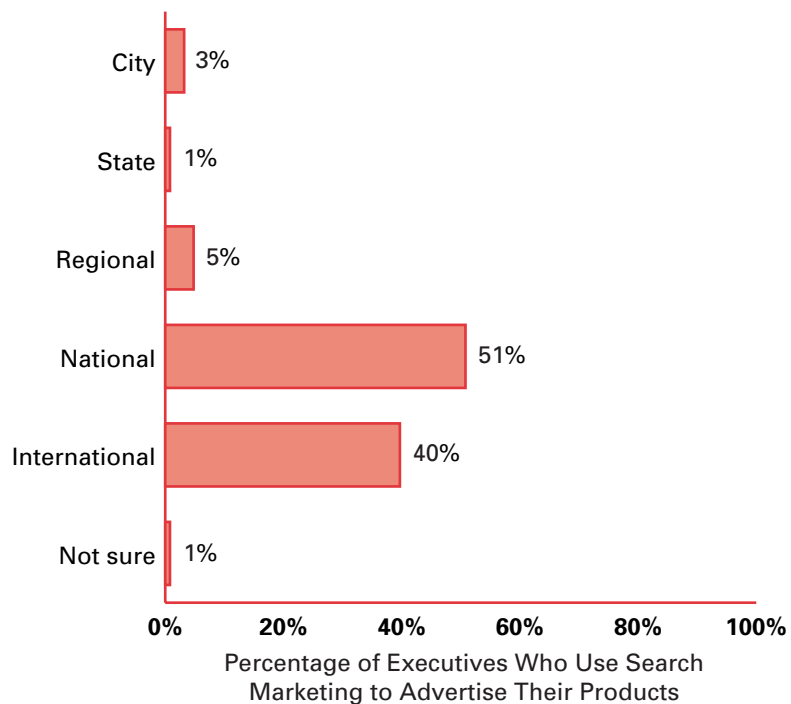
Advertisers are spending with confidence, with ROI calculations based on very conservative and measurable frameworks. The same is not yet possible for service-based advertisers, where sales likely convert over the phone or via walk-in customers, and

clicks are not perceived as meaningful. Value is still certainly provided by publishers. However, value is comparatively harder to articulate, rendering slower market development than that of paid search.

Also important: Health, automotive, and restaurants have historically not kept pace with other categories in Jupiter Research’s online advertising models. These three are the same categories that lead print yellow pages spending.

Advertisers in Paid Search and Yellow Pages Are Currently Discrete

Fig. 4 Geographic Concentration of Customer Base



Question: Which of the following best describes the geographic area of your company’s customer base? (Please select one.)

Source: Jupiter Research Search Marketing Executive Survey (2/04), n = 126 (executives who use search marketing to advertise their products, US only)

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Current advertisers using search marketing are geographically agnostic. A recent Jupiter Research executive survey found nine in 10 have customers spanning at least the US. Although the opening of increasingly targeted local search inventory with a performance-based pricing model will still appeal to a subset of these advertisers, namely travel, it will not likely either attract a meaningful premium to comparatively traditional paid search offerings or support the current sanguine view of local search growth.

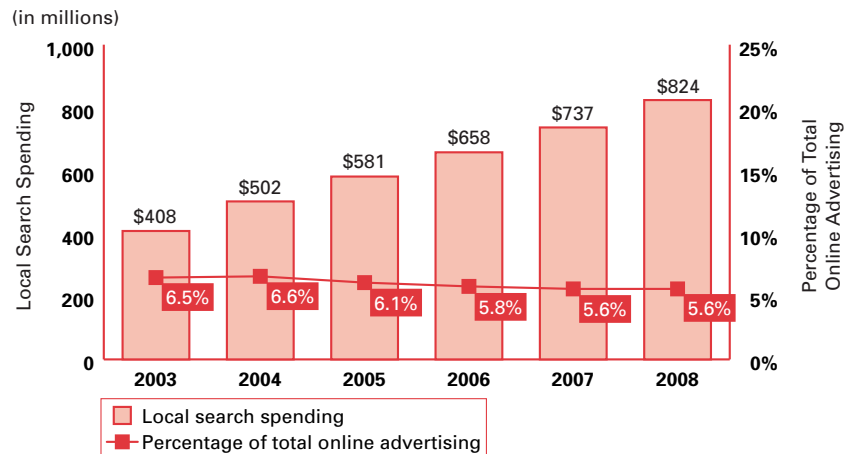
Also, the data suggest an absence among search marketers of the traditional heart of yellow pages advertising—small service-based firms with geographically concentrated customer bases. Consequently, publishers must hold conservative expectations in relation to the adoption of new local search advertising options. Attempts to migrate local small business online have largely failed to date.

Outlook

Local Search Will Grow Slower than Online Advertising

Local Search Will Grow Slower than Overall Online Advertising

Fig. 5 Local Search Spending, 2003 to 2008



Source: Jupiter Research Local Search Model, 3/04 (US only)
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Jupiter Research forecasts local search will increase at an admirable 15 percent CAGR through 2008, to \$824 million. However, local search will underperform overall online advertising, which will increase at a 19 percent CAGR over the same period.

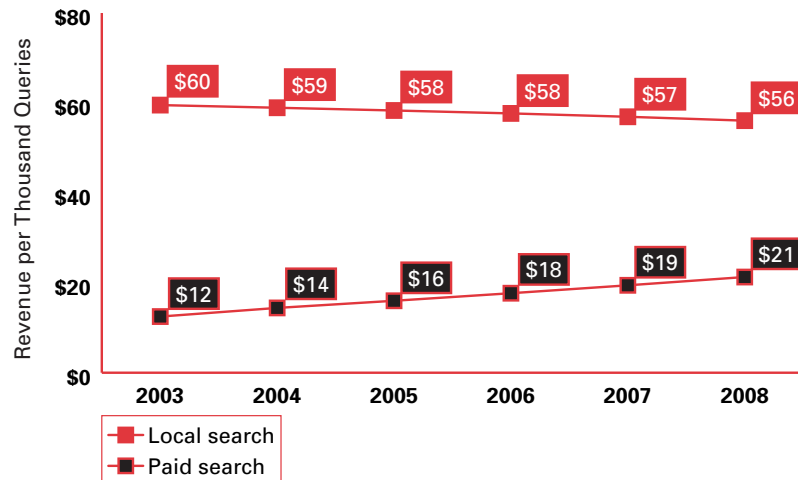
The opportunity for local search is not new. Verizon SuperPages, the large yellow pages publisher, already has in excess of 100,000 advertisers—comparable with the number of US advertisers currently spending on Overture and Google. The current market exuberance around local search stems from expectations that performance-based advertising options will be effortlessly bolted on to current properties. These expectations will largely go unfulfilled. Specific constraints on local search that prevent a meteoric rise (like paid search has experienced in the past few years) include the following:

- **Service-based versus product-based advertisers.** A click is perceived as comparatively less valuable for service-based advertisers that dominate print yellow pages spending. Consumers' search may originate online, but the tail end of transactions or conversions is usually handled on the phone. Thus, ROI for local search is less transparent and harder to measure than it is for paid search, where the entirety of transactions is usually conducted online.

- **Cannibalization from fixed to variable pricing.** Internet yellow pages publishers will launch performance-based options in addition to the fixed contracts they currently sell, and will not eliminate the latter. Even so, the introduction of performance-based options immediately devalues index listings by demoting listings down the page to make way for new performance-based inventory. In the next one year to two years, publishers will face a delicate task of launching variable pricing options, while continuing to maintain the value of their traditional fixed-fee online offerings. Cannibalization is mainly tied to the dynamics of performance-based advertising, initially rewarding advertisers with low cost-per-click (CPC) rates that rise as more advertisers enter the marketplace. Paradoxically, in the initial stages, variable advertising options will have not only higher prominence, but also lower pricing.
- **Value of quasi-hosting component will decline.** A key component of current local search advertising options is a basic online presence for advertisers. For firms without Web sites, listings or profiles are often an appropriate interim step. Over time, however, the value of this component of advertising will decline both as the cost of technology decreases and as Web site adoption among businesses increases, decreasing demand for this interim presence. Although need for this interim step will still be significant through 2009, it will also decrease in value as hosting costs naturally decline with time.

Local Search Yield Is High and Will Fall

Fig. 6 Comparison of Revenue per Thousand Queries



Source: Jupiter Research Local Search Model, 3/04 (US only); Jupiter Research Paid Search Model, 7/03 (US only)
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By its very nature, a local search query is more commercially focused and valuable than an overall online paid search query is, but the size of the premium that exists between the two is not sustainable. **Jupiter Research forecasts the revenue per thousand queries (RPQ) on online local search sites will fall from \$60 today to \$56 in 2008, as properties open up their inventory to performance-based advertising, grappling with the cannibalization challenges inherent in such a move.**

The chief constraint on future growth: Local search is an already highly monetized sector of search. Internet yellow pages publishers command a particularly high premium, compared with other types of search use. For instance, some are earning more than \$100 per thousand queries served.

RPQ offers a useful metric to compare the developmental stages of various search markets. The benchmark is calculated by dividing advertising dollars spent by the number of search queries. Paid search's RPQ is calculated by dividing paid search spending by the total number of searches through portals and search engines.



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Growth of Local Search Will Be in Two Stages

Jupiter Research believes the growth of local search through 2009 will occur in the following waves:

- **Short to medium term (one year to two years).** Paid search advertisers, particularly travel-related ones, will drive moderate growth in the short to medium term. These advertisers will quickly extend campaigns to local search properties as they open up inventory to performance-based pricing models.
- **Long term (three years to five years).** Traditional print yellow pages advertisers (e.g., lawyers, doctors, and plumbers) will lead the second wave of growth, as the volume and quality of local search improves and publishers launch low-risk performance-based advertising options that grow with marketers. The unknown is pay-per-call advertising, whereby a local search advertiser pays each time a consumer calls, rather than paying monthly or each time a consumer clicks on the firm's listing. Jupiter Research does not assume the wholesale introduction of pay-per-call pricing in this forecast model, but believes such a move could represent an inflection point leading to an accelerated growth curve.

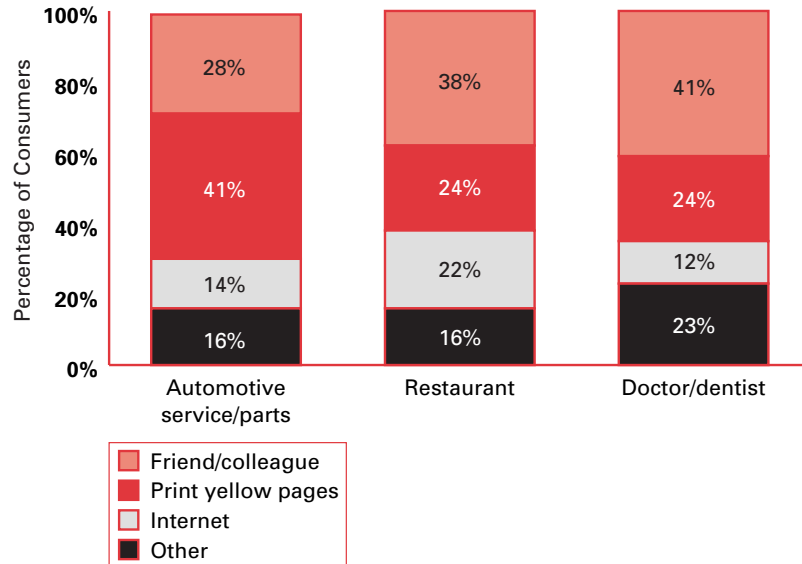
Influence of Internet Will Continue to Trail Traditional Sources

Fig. 7 Primary Way Consumers Discover Restaurants, Physicians, and Automotive Repair

Question: Which of the following do you turn to most often to help you choose a local business or service in each of the following categories? (Select one for each column.)

Source: Jupiter Research/Ipsos-Insight Consumer Survey (3/04), n = 2,713 (US only)

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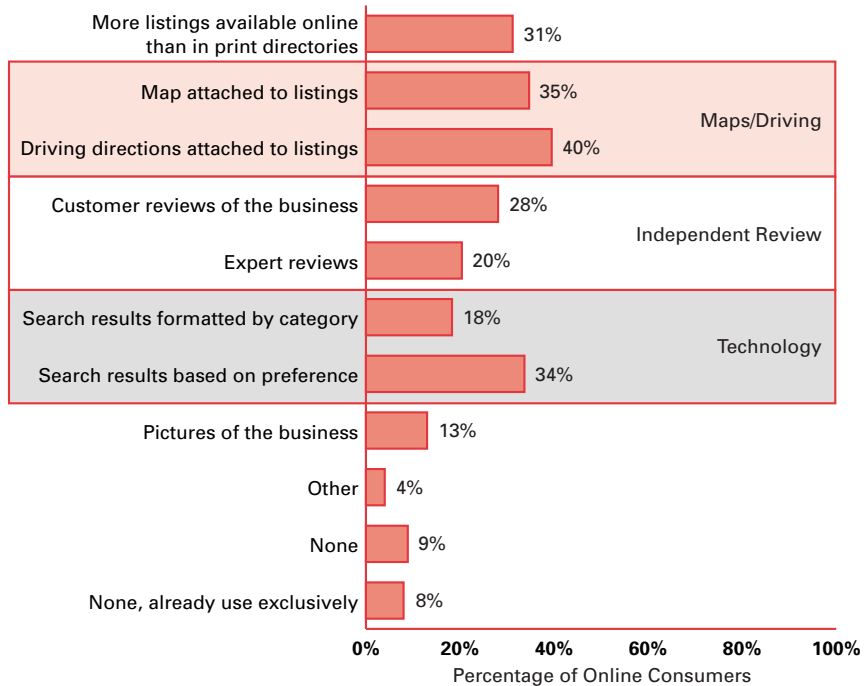
The Internet is less valuable to consumers than are print yellow pages when discovering a local merchant in three proxy categories Jupiter Research investigated. The two media are roughly similar in importance for restaurants, but vastly different for physicians or automotive repair. As with all purchasing decisions, word of mouth from colleagues and friends plays a major role in influencing selection. The ultimate success metric for online local search providers will be surpassing print yellow pages in helping consumers discover merchants. Over time, Jupiter Research believes the gap between the Internet and print yellow pages will close on this measure, but Jupiter Research assumes the crossover point will not occur in the five-year forecast window. Online efforts of local search providers should be primarily geared toward improving this metric of purchasing decision influence.

Mandate

Compete on Comprehensiveness, Not Convenience; Launch Pay-per-Call Options for Service Advertisers

Build Comprehensiveness Through Technology and Content

Fig. 8 Demand for Local Search Features



Question: Which are the top three features that would encourage you to use online directories to search for local businesses more often? (Select up to three.)

Source: Jupiter Research/Ipsos-Insight Consumer Survey (3/04), n = 2,713 (US only)

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Local search providers must compete on the comprehensiveness of their information, not on convenience. Comprehensiveness is a combination of the depth of information and richness of features. Online local search providers are ultimately constrained by the medium through which they distribute their services. The time taken to initiate a connection to the Internet is effectively erased with broadband access, but Jupiter Research estimates 70 percent of online households currently connect via dial-up. Also, unless dial-up users have second phone lines, they must disconnect and ring merchants to complete searches. Even with always-on broadband, the time to boot a computer is significant. In tandem, these factors make the print yellow pages directory comparatively more convenient.

Instead of competing on convenience, online local search providers must focus on creating an increasingly comprehensive experience to help consumers select merchants and improve purchasing decisions. Consumers' demand is roughly equal at 30 percent to 40 percent across three main concepts: maps/driving, establishing credibility through independent reviews, and advanced search technology.

Local Search Providers Must Deepen Content

The effectiveness of technology in creating an increasingly relevant consumer experience is limited by the shallow level of content—sometimes only names, phone numbers, and addresses—from which the search index currently draws. Migrating print advertising content online and making the content searchable via the index is an immediate opportunity for yellow pages publishers. In the long term, yellow pages publishers should leverage their direct sales force, which makes up the majority of the employee base and represents the largest fixed cost to the business, to gather increased insight and information about clients. The data, gathered in a uniform and normalized way, should be published and fed into the search algorithm. These efforts will in turn increase relevancy and improve the overall consumer experience to drive further use.

Search engines must use a combination of structured and unstructured data, which they gather through the algorithmic index. Near-term focus should be on building a foundation of structured data, through a paid or unpaid content feed that merchants can configure and through external business data sources, such as infoUSA and others.

Introduce Pay-per-Call Pricing for Service-Based Advertisers

Pay-per-call advertising options should be rolled out by local search providers because CPC pricing is comparatively less relevant for service-based advertisers. Pay-per-call pricing bills an advertiser if a consumer calls the business, either through dialing a coded 1-800 number shown in the listing or through a mediated call set up after a consumer clicks on a "click to talk" icon. Technology providers such as Ingenio and, to a lesser extent, eStara have launched solutions to allow local search providers to price advertising in such a manner.

CPC models work best when the entire transaction occurs online. In a recent Jupiter Research executive survey of search marketers, three-quarters of the sophisticated paid search advertisers (i.e., those bidding on more than 1,000 keywords) said one of their top three goals was to generate an immediate sale of a product online. When a transaction is not being completed online, as in a search for a plumber, the model has comparatively less relevance.

The tail end of a search for a local service-based advertiser usually involves a phone call, whether the search originates from the print yellow pages or an online local search provider. As such, the more appropriate billing event is the call. With various levels of measurement precision, advertisers have come to value advertising spending on yellow pages by the number of calls generated.

Online local search providers should launch both CPC and pay-per-call advertising options to recognize the two segments of marketers—those converting the customer on the Internet and those doing so on the phone.

Case Study

Verizon SuperPages Deepens Content Through Direct Sales Force

Bottom Line: Verizon SuperPages can leverage an existing asset, its sales force, while proactively migrating small business online. As a result, relevance of search results and usefulness of the online property will dramatically improve.

Participant: Verizon SuperPages, a leader in yellow pages publishing, distributes 1,900 print directories to 48 states, the District of Columbia, Puerto Rico, and six other countries. The combined print circulation totals 137 million. SuperPages.com served 900 million searches in 2003.

Goal: Verizon SuperPages wants to improve consumers' experience and help buyers make increasingly informed purchasing decisions online.

Execution: In unison with a site relaunch in March 2004, Verizon SuperPages said it would begin increasing its depth of knowledge about advertisers, both online and in print, through direct sales representatives who speak with businesses. The information will be added to the firm's online business profile, which will in turn be crawled and indexed by the site's technology.

Economics: The pressure to leverage the existing direct sales force is tremendous. Selling, general, and administrative expenses represent 72 percent of total operating expenses at Verizon Information Services. There is a far greater need for increasingly relevant and comprehensive content in local search than there is for technology investment. Verizon SuperPages can direct its efforts in an economical way through existing interactions the sales force has with advertisers.

Report Methodology

The core of Jupiter Research's products is the perspective and opinion of Jupiter Research's professionals. Jupiter Research's analysts are immersed in the industries they cover through ongoing contact with corporate and technology leaders, daily study of trends and events in the online world, and their collective professional experience. Individual analysts' perspectives are filtered through rigorous collective debate and deliberation, producing research that reflects the combined sensibility of Jupiter Research's entire research team.

Analysts' perspectives are enhanced and refined through Jupiter Research-designed market research. Jupiter Research uses many data research tools, including consumer surveys, systematic polling of leading industry executives, comScore Media Metrix measurement data, and a rigorous approach to building market forecasting models. Specialists with Jupiter Research's data research group assist analysts in the technical development of these tools, such as survey design, sample building, data weighting, and data analysis.

This report benefited from a number of specific market research projects, described below.

Jupiter Research/Ipsos-Insight Individual User Survey

In June 2003, Jupiter Research designed and fielded a survey to online consumers selected randomly from the Ipsos-NPD online consumer panel. A total of 4,075 individuals responded to the survey. Respondents received an e-mail invitation to participate in the survey with an attached URL linked to the Web-based survey form. The samples were carefully balanced by a series of demographic and behavioral characteristics to ensure they were representative of the online population. Demographic weighting variables included age, gender, household income, household education, household type, region, and market size. Additionally, Jupiter Research took the unconventional step of weighting the data by AOL use, online tenure, and connection speed (broadband versus dial-up), three key determinants of online behavior. Balancing quotas were determined by an ongoing weekly random digit dialed (RDD) survey of almost 5,000 US households. The survey data are fully applicable to the US online population within a confidence interval of plus or minus three percent.

In this survey effort, Jupiter Research worked with its research partner, Ipsos-Insight, on the technical tasks of survey fielding, sample building, balancing, and data processing. Ipsos-Insight is a member of the Ipsos Group, the second largest marketing research company in the world, and maintains a general research panel of 400,000 households. Ipsos-Insight also has access to the Ipsos-NPD online panel, which comprises 600,000 Internet users and offers Jupiter Research an easy way to target and survey current online users.

Panel-based market research enables researchers to have baseline knowledge of each survey respondent, to increase survey participation rates, and to permit careful rationing of survey fielding to reduce survey burnout.

Jupiter Research Local Search Model

To quantify the dynamic changes Jupiter Research expects will take place in local search, Jupiter Research built a complex forecast model capturing current online activity in this space and six-year forecasts of revenue. This model defines key growth levers, market drivers, and inhibitors, giving clients a clear, analytical way to think about upcoming changes in their sector. Jupiter Research's analysts use a variety of quantitative methods in modeling the future, including close examination of analogous markets (either previous growth of new technologies or relevant off-line market case studies), consumer and executive intention surveys, scorecard analysis of market drivers and inhibitors, complex market segmentation analysis, and analysis of historical trends. Additionally, all forecast assumptions are rigorously debated and vetted by a large cross-disciplinary group of Jupiter Research's analysts in a process designed to capture the collective sensibility and experience of Jupiter Research's entire analyst team.

As part of the forecast modeling, Jupiter Research develops comprehensive historical and base-year market size estimates based on a variety of sources, including public financial documents, executive interviews, Jupiter Research's proprietary primary consumer and executive research, and analysis of the Internet traffic database of comScore Media Metrix.

All of Jupiter Research's forecasts are designed by a dedicated team of forecasting analysts within Jupiter Research's data research group, who build the models, conduct extensive industry research, and manage the process of formally building consensus among Jupiter Research's analysts. Jupiter Research's forecasting analysts have backgrounds in investment banking, management consulting, and market research, where they developed extensive experience with industry and company forecasting.

Definitions

Jupiter Research defines local search as the combination of use of Internet yellow pages properties and locally directed searches on portals and search engines. Jupiter Research defines local search advertising spending as a paid message—based on a fixed-fee, CPM, or results-based model featured on local search properties.

Forecast Approach

In developing the forecast, Jupiter Research split growth expectations into near-term trends and long-term potential. To understand the near-term trends, Jupiter Research examined growth rates in the revenues of local search providers as well as quarterly growth rates in local search users and queries.

To determine the long-term growth potential of local search, Jupiter Research projected the amount of available local search inventory—online queries directed toward local merchants and services—and then applied revenue-per-thousand and sell-through rate assumptions to determine actual revenue derived from these queries. Specifically, the following growth levers were used to calculate the long-term market size of local search:

- **Online population.** The first lever in Jupiter Research's forecast is the size of the online audience. Expected growth of the online population provides the most substantial boost to market size, with the online audience increasing from 171 million people at the end of 2003 to nearly 231 million at the end of 2009.
- **Local search users.** The next lever in calculating local search inventory is the number of local search users. Jupiter Research expects the number of online consumers who use local search will expand at a CAGR of nine percent, higher than the five percent CAGR at which the overall online population will grow, as local search properties launch new offerings and channel significant investment into online initiatives.
- **Local search frequency.** To calculate local search frequency, Jupiter Research fielded multiple survey questions to draw assumptions on, and then filtered the assumptions through a base of comScore Media Metrix audience measurement data.
- **Revenue per thousand queries.** To translate local search volume into actual revenue, Jupiter Research used the metric of revenue per thousand queries. Jupiter Research derives estimates for revenue per thousand queries by dividing total local search revenue by total searches served in a given period. Jupiter Research expects a negative two percent CAGR through 2008, based on the already high yield local search properties already attract and the opening of inventory to performance-based pricing.

Analogous Markets

Online advertising. Jupiter Research referred to the overall online advertising market to assess the future impact of media consumption on the local search market.

Print yellow pages. Jupiter Research quantified changes in the traditional print yellow pages market and external factors acting on it to inform growth patterns of the local search market.



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