A Critical Review of Online Affiliate Models

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Executive Summary

There are a variety of affiliate models currently in place on the Internet today. The most popular models include percentage of sales, flat referral rate, pay per lead, pay per email, cost per click, and cost per view. Almost every website offers one form or another of these affiliate models. Many recent websites offer a combination of these models. While affiliates offer tremendous promise in generating traffic and sales for the merchant, it must evaluate each potential relationship carefully before embarking on it. We outline a set of critical steps a merchant should take to ensure a perfect match.

Introduction

An online affiliate is an Internet based company (website) that partners with an online merchant to refer customers to the merchant. The affiliate puts links to the merchant on their website or in their email sent to subscribers. These links can be banner advertisements or plain hypertext markup language (html) text that directs the viewer to the merchant's site. If the viewer visits the website, the affiliate receives money from the merchant based on the type of affiliate model the merchant is utilizing.

When the Internet first became popular in the 1990s, there were a variety of online affiliate models that aimed at attracting visitors to their website (Kini and Bandyopadhyay 2009). Many of these models simply paid Internet users to view their ads, many paid the visitor to click on the link and visit the company's website (pay per click), and some paid per purchase made. After the Internet bubble burst, the models were re-evaluated, and only a subset of the original affiliate models survived. Today, the most popular affiliate model is the percentage of the purchase. This is the predominant model in use because it is commission based and does not involve an initial outlay of money; affiliates are paid after the purchase has been consummated.

Affiliate programs have faced trouble since the bursting of the Internet bubble. According to the Aberdeen Group by 2000, many companies were faced with the grim fact that online sales were not creating the anticipated profits and many companies folded their Internet marketing team back into their traditional marketing and advertising teams. As a result, affiliate managers often encountered more traditional marketing philosophies. This created a problem for the affiliate managers because the more traditional marketers did not want to pay commissions forever. The traditional marketers were used to one-time customer acquisition fees. Hence, affiliate managers needed to create new affiliate models. According to Aberdeen:

> "By 2001, it had become clear that ad banners would not deliver the conversion rates that online marketers required. Pay-for-performance and cost-per-activity rates (CPA) metrics began replacing cost-per-thousand (CPM) models that emphasized the importance of driving eyeballs to a Web site."

Hence, new affiliate models have been created that relate more directly to the sales revenue that is generated.

Despite the shake up in the online affiliate business, there is a plethora of new and old affiliate models available to a eBusiness. As a result, a eBusiness often finds it difficult to choose the right affiliate program. What is needed to take the right decision is to (1) identify the suitable affiliate programs available to a eMarketer, and (2) a set of critical success factors for these programs. A thorough review of the articles on affiliate programs did not yield a study that addresses the above issues. Our study is expected to fill this important void in the literature on affiliate programs. Our paper is organized as follows. First, we review all types of affiliate models currently available. We compare and contrast their distinctive characteristics. Next, we develop a set of critical success factors or criteria to evaluate individual affiliate models, and choose the right affiliate. Finally, we suggest how to manage the network of affiliate programs, and to measure the effectiveness of each affiliate.

Types of Affiliate Models

In this section, we examine the types of affiliate models and how they work. There are many types of online affiliate models. Table 1 provides a summary of the major affiliate models. The primary models may be broadly grouped into three categorizes: (1) exposure based models, (2) revenue based models, and (3) hybrid models. Among the exposure based models, three most popular models are (a) pay per view (such as CPM), (b) pay per email, and (c) cost per activity (CPA) or cost per click. As for the revenue based models, three noteworthy models are: (1) percentage of revenue, (2) flat referral rate, and (3) pay per lead. In addition, there are a few hybrid models that combine the characteristics of revenue and non-revenue based models. Notable among them are (1) link exchange, and (2) combination models. In the following paragraph, we provide a brief overview of these models.

Exposure Based Models

Pay Per View

There were a variety of pay per view affiliate models in the 1990's when the Internet first became popular. Pay per view simply means that the website pays an affiliate based on the number of times ads are shown to their customers. This type of model can also be referred to as a CPM (cost per mille or thousand ads shown) model. This type of advertisement has a fixed cost with very little chance of fluctuations. For accounting purposes, it is simple to implement this type of model. In addition, if you are selling a high priced item, it can be costly to provide affiliates with a percentage of the purchase price and hence it may be more cost effective to pay your affiliates based on the number of views your website receives. In addition, advertisers liked this type of model because it was the type of model that had been used in traditional advertising and therefore they were familiar with it.

However, advertisers began to question this model in the early 2000's when the click through rates began to drop substantially. If the people viewing the advertisement are not purchasing the product, the merchant begins to question the value of the banner advertisements. Hence, advertisers were forced to reevaluate this type of affiliate model and adjust it accordingly.

One of the most popular pay per view websites was *AllAdvantage.com*. This company paid its viewers to have an ad banner running on their computer while they were surfing the web. This was a very novel idea at the time, being paid simply to surf the Internet and have an unobtrusive banner ad running on your screen. However, many of their viewers did not even read the ad. Some viewers even found ways to cheat the program by adjusting the screen parameters so that the ad was not even visible, and also, by using software that simulated actual web surfing so that the banner was running when the person was not even online.

Of course, this company has long since closed its doors and no longer offers this service. Their sponsors had their purse-strings tightened when the Internet bubble burst and only received money based on the dollar amount of purchases that they generated. Hence, if you go to *www.alladvantage.com* today, it is an entirely different site. It forwards you to a different website for a totally unrelated company that decided to purchase that domain name. At one time an insurance company owned it and, currently, as of May 2004, the website forwards you to *www.surveysmax.com* which is a website that pays you to take surveys.

Cost Per Click

The cost per click model simply means that merchants pay affiliates every time someone clicks on the advertisement. It is very similar to the CPM model but the main difference is that the merchant is only paying when the person viewing the advertisement expresses interest in the ad by clicking the banner and being directed to the merchant's website. This model has recently been attacked by what is called "click fraud" by Grow and Elgin in their October 2006 article in *Business Week*. According to Grow and Elgin, click fraud occurs when the affiliates may have people clicking on the links who are only clicking because they are being paid to click and have absolutely no interest in the website.

Pay Per Email

Another type of pay per view is the pay per email. It is basically very similar to the pay per view concept. However, in this model the viewer must sign up to receive periodic emails about products or services.

The benefits of the pay per email include a low cost to send the emails to consumers, a relatively fixed advertising expense, and ease of implementation. Email was one of the "killer apps" in 20th Century. Email enables advertisers to send information to potential customers at a very low cost.

However, there are many drawbacks to the pay per email model. First and foremost is the issue of SPAM, which is bulk email that is unsolicited. Many web surfers are tired of receiving SPAM and have instituted SPAM blockers, many email accounts even have these filters built into them. This has presented a huge problem to email marketeters.

Secondly, the pay per email model has a narrow market. Because of SPAM, most email hosting companies are requiring that their subscribers signed up to receive the email. If the web surfer has signed up to receive an email from your company, then they already know about your company and therefore probably know about your products or services.

An example of the pay per email model is shown by *PhoneContent.com*. This company pays $0.05 per email that is sent on their behalf. There are also programs that enable consumers to sign up to receive email from advertisers and earn a percentage of the revenue.

Revenue Based Models

Performance based models are based on the amount of revenue that the referring website generates. This type of model includes several subcategories: Percentages of sales, Flat referral rate, and Pay per lead.

Percentage of Sales Model

As the name implies, the percentage of sales model pays a percentage of the revenue that is generated by the customer who clicked on the link and purchases an item or service. This model is currently the most widespread model in use and was one of the first models pioneered by leading Internet companies including *Amazon.com*.

There are a variety of benefits of the percentage of sales model. This type of model matches advertisement spending with actual results since the affiliate is only paid for their advertising after the viewer has consummated the purchase with the merchant. It enables the direct matching of advertising expense with revenue. In addition, it encourages affiliates to actively pursue new customers. Because affiliates are only paid when the viewer purchases an item, the affiliate will be more involved in the process and try to get the consumer to consummate the purchase.

As with all affiliate programs, the percentage of sales models have their drawbacks. It can be very costly to utilize and maintain. The merchant will have to invest in tracking tools to monitor the referrals. Consequently, many merchants may not operate their affiliate program "in-house." Outsourcing an affiliate program to an external agency of course will have costs of its own.

Tracking sales can also be time consuming and may require the use of staff dedicated solely to this purpose which will add additional employee costs. In addition, there may be issues of integrity. Affiliates may feel like you are cheating them out of referrals. What happens if a viewer sees your link on one website and clicks it, and then the viewer decides not to purchase right then and starts surfing again. The viewer then comes across another advertisement for your company and decides to purchase the item. Which affiliate gets credit for the purchase? For issues such as this it may be beneficial to outsource this aspect of the business to a neutral party.

Flat Referral Rate

If the merchant is dealing with high priced items, even 1% of the sales revenue could be very costly if the mark-up is not that large. Affiliates may not like the sound of less than 1% revenue, for example 0.25% of the sale may not sound like being worth the effort. In cases like this, it may be better to utilize a flat referral rate. It sounds much better to say the affiliate will get a $20 reward for each customer who makes a purchase rather than saying the affiliate will get 0.25% of the sale.

Pay Per Lead

The pay per lead model is very similar to the flat referral rate model but the customer does not have to purchase an item, the affiliate is paid when the potential customer clicks on the site to gain more information. This type of program is popular among companies specializing in loans and mortgages.

Hybrid Models

Hybrid models are those that are more complex than a purely exposure based or a revenue based model. Some of them may involve link sharing partnership between two willing partners (e.g., link exchange models) while others may combine features of the exposure based and the revenue based models (e.g., Ebates.com). Below we outline the unique features of these two types of models.

Link Exchange

Another very novel approach to affiliate programs involves a type of joint venture. One website will show your banner advertisements and in exchange you show their banner advertisements. In their book, *The Age of E-tail*, Gerbert, Scheider, and Birch explain how *Amazon.com* and *Dell* began this "cross marketing" in 1999 when *Dell* displayed advertisements for *Amazon.com* and vice-versa.

This is a cost-effective way to get advertisements. In many cases, this can be a free service if your company can find another company that complements your business. The two companies can simply show each other's advertisements and establish a relationship. This type of advertisement may provide higher quality hits, if the merchant is able to establish a link sharing arrangement with another merchant that is a perfect fit. For example, two online casinos, *Gold Nugget* and *Intertop*, have forged a successful link exchange relationship because they share the same target market but offer different products. While *Gold Nugget* specializes in online gaming, *Intertop* focuses on online sports betting.

There are, however, several drawbacks to this type of model. It can be time-consuming to establish link exchange relationships. Some merchants may not evaluate the proposal in a timely fashion. In addition, it is important to determine if the exchange will be symmetric. If one website handles more traffic than the other, then a pure link exchange may not be fair.

Also, according to the noted affiliate *linkexchange.com*, link exchanges do not bring an immediate surge in web visitors rushing to your web site. It is more like long term advertising, slowly building up the momentum by increasing your link popularity.

Combination models

As the name implies, a combination model uses two or more of the affiliate models that were discussed in the previous sections. The strength of this type of model is that it incorporates the benefits of each of the individual model types to meet the changing needs of the industry.

In some instances a merchant may wish to have different affiliate models for different products. For example, the merchant may wish to provide a flat referral rate for each customer who signs up to receive the weekly email and provide a percentage of sales for each item purchased.

Another type of combination model rewards the buyer as well as the affiliate. Programs that operate using this model are themselves affiliates with the merchants. But instead of pocketing all of the affiliate revenue, these types of websites pass on some of the revenue to rewards the buyer for their purchase.

Ebates is a good example of all of these models. This website gives customers cash back from their affiliate rewards. It operates on the combination principle, and uses percentage of revenue as well as flat referral methods of payment. The viewer can earn up to 25% of their purchase price in the form of an Ebate (rebate). Not only does this website provide a percentage of your purchase price, but they also include coupons to save the viewer even more money and to encourage them to spend more money at the merchant's website. In addition to providing a percentage of sales, *Ebates* offers flat referral rates.

There are many benefits to this type of model. The affiliate increases their revenue because buyers come back to their website before making the purchase. However, the models that reward the buyer can be costly to the merchant. Customers only want to purchase from your company if they are receiving the reward and the reward will be expected to increase if you want to maintain your customer base. In addition, the models can become complicated to track. As more and more layers enter any type of affiliate model, the model becomes more difficult to manage at an exponential rate.

Critical Success Factors

There are many factors that are critical to consider when implementing an affiliate program. Based on our rich experience in eBusiness, and a thorough review of all major online affiliate models, we have identified the following set of factors that are critical for the success of an affiliate relationship:

Choose the correct affiliate, one with a good “fit”

Choose the affiliate program that offers maximum profit

Design an easy to use affiliate program

Track referrals constantly and accurately

Constantly monitor the performance of the affiliates

Choosing the Correct Affiliate

There are many factors to consider when choosing the appropriate affiliate who will bring you the most customers and sales revenue. It is clear that you need to select an affiliate who carries related products because those are the type of customers who may also purchase your product. Your company should screen the affiliate's website to ensure a proper "fit" between their website and yours and periodically check up on the website.

In addition, you need to ensure that the affiliate maintains a high level of security for customers because you do not want the affiliate giving your company a bad reputation. If customer information is shared by the affiliate, the customer has no way of knowing who divulged their information and they may blame your company. The affiliate program industry is yet to embark on developing a process of trust and legitimacy in guaranteeing the security of customer data. Already there are a large number of reported cases, where, the unencrypted and unsecured customer data are hacked and/or stolen from the data storage. The industry probably should develop a certification process (like the ones for eCommerce by Truste, Verisign, etc.) for affiliates and/or third party program coordinators. Such a supporting certification process, globally, can significantly enhance the adoption and diffusion of eCommerce as well as supporting affiliate programs.

What Makes a Good Fit

Marketers have long been faced with the problem of determining which advertiser provides the best fit for their company. This is the same for "click" marketers as well as “brick" marketers. The company should look for a website that offers complementary products. For example, a website that sells cameras would be a good place to display Kodak film advertisement. A website that sells *Game Boy* units would be a strategic place to advertise the latest *Game Boy Advance* games. These examples are overly simplistic, but they enforce the point that marketers should look to recruit affiliate websites that feature complementary items.

Maximizing Profit

It is also important to evaluate the models in terms of profit. As discussed previously, if your company is selling a big ticket item you may wish to consider the flat rate model. However, if your item is a low ticket item, it may be more beneficial to utilize the percentage of sales or pay per view. This factor will need to be critically evaluated to determine what type of affiliate model will work best for your company to maximize profit.

Ease of Use

In addition, it is critical to create an easy to use affiliate program. Affiliates do not want a program that is too hard to utilize or too hard to receive their payment. In addition, many affiliates like programs that allow them to track their referrals (discussed in the next section).

Also, your company should be cautious not to require a tedious application form to become an affiliate which may dissuade a potential affiliate to sign up. However, you also want to ensure the quality of the affiliates so it is important to have some rules which your lawyer can help determine. Many companies have decided that it is too costly to implement their affiliate in-house and have contracted it to outside firms that provide affiliate network management services (discussed later in more detail).

Tracking Referrals

There are a variety of tools available to the affiliates to track their "referrals", the viewers that clicked on a link for the merchant from the affiliate's website. The most popular way to track these "referrals" is through the use of cookies. Cookies have been controversial since privacy issues came to the forefront in the early 2000's. Cookies provide websites with invaluable information that enables the site to provide customization based on the customer's clicking patterns. According to *www.howstuffworks.com*, cookies allow a web site to store information on a user's machine and later retrieve it. The pieces of information are stored as name-value pairs. For example, when a viewer clicks on the link on the affiliate's website for the merchant, a cookie is placed on the viewer's website that contains a unique ID number. This enables the merchant to track which affiliate referred the viewer.

Currently, performance metrics are at a nascent stage of development for affiliate programs. The use of cookies can provide a challenge since many web savvy surfers disable cookies. If a website tracks their referrals by the use of cookies, they may not be receiving credit for all of their referrals. Therefore, this area of performance metrics needs to be studied further and new metrics created. This is in line with the recommendation made by the *Aberdeen Group* in a 2003 report.

Monitoring

Finally, it is important to continuously monitor and update these critical success factors. The Internet is constantly evolving, hence it is critical to monitor your factors and update them as new trends come into play. It may, however, be difficult for an eBusiness to commit substantial resources to develop its own monitoring system. Fortunately, there are several websites that offer consolidated management of affiliate programs. In their 2003 book, *Strategic Affiliate Marketing*, Goldschmidt, Junghagen, and Harris suggest that many large companies prefer to pay an outside company to monitor their affiliates and sales generated by the affiliates. Also, many affiliates feel more comfortable with a neutral third party that is monitoring the performance. Websites that offer this type of service also offer performance metrics for the affiliates.

For example, in addition to tracking sales, *LinkShare* provides other valuable information that is obtained from data mining. *LinkShare* transforms the raw data received from your website into valuable knowledge which can increase your earnings at an exponential rate. It also offers drill down menus to analyze the effectiveness of the links.

There are many programs aimed at simplifying the affiliate process. A major affiliate company, *Commission Junction* was one of the first companies that offered affiliate services. If a new web developer, or even a seasoned web developer, wanted to make some extra money by linking their websites to other websites, the developer could just go to the *Commission Junction* website which listed various companies who were looking for affiliates. *Commission Junction* revolutionized the industry and simplified the affiliate process. Their website showed the affiliates their metrics: the number of times their links were clicked and the revenue that they earned from the clicks. Every time, the affiliate's account reached the required amount, the affiliate could request a check for the revenue they had generated.
Commission Junction provided advertising services for companies. Many affiliates and merchants were looking for a third party to provide services with low risk and high rewards for the company because of the nature of the business being pay per performance. Some major companies that utilize *Commission Junction* include: USA Today, eBay, Expedia, and MSN.

How to Measure the Effectiveness of the Affiliate Model

It is not only critical to implement an affiliate program, but it is also vital to monitor its performance. In the infancy days of the Internet, companies measured the effectiveness of their advertising by counting the number of people, commonly referred to as the number of "eyeballs," that visited the website during any given period. However, now that Internet companies no longer have unlimited investor capital, most advertising campaigns have to have some type of measurable result.

A more accurate way to measure the effectiveness of advertising is to examine the number of people who come to the merchant's site and actually purchase the product or service that is for sale. Of course with offline advertising campaigns, it can be difficult, if not impossible, to determine which advertisement was responsible for bringing in the customer. However, it is much easier to determine this for online ads than traditional ads with the use of cookies and other tracking tools. By examining all the data contained in the tracking tool and mining it, advertisers can determine what campaigns are most effective. In addition, advertisers can reward the affiliate who referred the customer to the merchant's website.

Conclusion

There are a variety of affiliate models in use today. The most popular models are the revenue based models, and those that combine the properties of the revenue based and exposure based models. During the formative years of the Internet, advertisers thought that the number of "eyeballs" the website received would translate into revenue. Hence, when that was disproved, the pay per view models lost popularity.

The Internet is a dynamic and evolving medium. Consequently, online affiliate models need to be adaptive to adjust to the current market trends. What works today for online affiliate models may be obsolete in the near future. It is critical to choose an affiliate that offers a good “fit” with your business, that maximizes profit, that is easy to use and track referrals, and constantly monitor and update the factors. It is clear that affiliate models form an important part of your website that will help your website achieve success.

Each merchant needs to evaluate carefully which model or combination of models will be the best for their particular company. The model will need to be adapted to fit the goals of the company and to fit the target market.

Additional Reading

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Type Affiliate Models	How It Works	Advantages	Disadvantages	Current Status
<u>Exposure Based Models</u> • Pay-per-View	The merchant pays the affiliate based on the number of ads shown to customers	• Simple to implement • More cost-effective for high priced item • Preferred by advertisers because it is similar to traditional advertising	• Ad exposure may not necessarily lead to sales	Not popular
• Cost-per-Click	The merchant pays off affiliates every time someone clicks on the ad	• Simple to implement	• People may click to collect payment but have no interest in the website	Popular but facing increasing problems due to “click fraud”
• Pay-per-Email	The viewer signs up to receive periodic emails about Products and services	• It is cheap to send emails to potential consumers	• More web surfers are taking steps to block SPAM emails • It has a narrow market	Not so popular
<u>Revenue Based Models</u> • Percentage-of-Sales	The merchant pays a percentage of revenue that is generated from each purchase transaction	• It matched ad spending with actual sales • It encourages affiliates to seek new customers to generate sales	• It is costly to utilize and maintain • It is expensive to track every sales	Popular with lower priced items
• Flat Referral Rate	The merchant pays a fixed fee as referral to the affiliate	• It is suitable for high priced items	• It gives no incentive to the affiliate to generate more sales from each customer	Popular with high priced items
<u>Hybrid Models</u> • Link Exchange	Two web sites share each other’s banner ads	• It is a very cost-effective way to show ads • It can provide high	• It can be expensive to establish link relationship	Very popular