

# Consumer Heterogeneity and Paid Search Effectiveness: A Large Scale Field Experiment

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## Abstract

Internet advertising has been the fastest growing advertising channel in recent years with paid advertisements on search platforms (e.g., Google and Bing) comprising the bulk of this revenue. We present results from a series of large-scale field experiments done at eBay that are designed to detect the causal effectiveness of paid search advertisements. Results show that brand-keyword ads have no short-term benefits, and that returns from all other keywords are a fraction of conventional estimates. We find that new and infrequent users are positively influenced by ads but that existing loyal users whose purchasing behavior is not influenced by paid search account for most of the advertising expenses, resulting in average returns that are negative. We discuss substitution to other channels and implications for advertising decisions in large firms.

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# 1 Introduction

Advertising expenses account for a sizeable portion of costs for many firms and corporations across the globe. In recent years the internet advertising industry has grown disproportionately, with revenues in the United States alone totaling \$31.7 billion for 2011, up 21.9 percent from 2010. Of the different forms of internet advertising, paid search advertising, also known in industry as “search engine marketing” (SEM) remains the largest online advertising revenue format, accounting for 46.5 percent of 2011 revenues, or \$14.8 billion, up almost 27 percent from \$11.7 billion in 2010.<sup>1</sup> Google Inc., the leading SEM provider, registered \$37.9 billion in global revenues in 2011, of which \$36.5 billion, or 96 percent, were attributed to advertising.<sup>2</sup>

In this study we report the results from a series of controlled experiments conducted at eBay Inc., where large-scale SEM campaigns were randomly executed across the U.S. Our contributions can be summarized by three main findings. First, “brand” keyword advertising (where firms purchase advertisements on searches for their own brand name), a practice used by many companies, is ineffective because, absent paid search links, consumers simply substitute to (unpaid) organic search links. This implies that brand keyword advertising expenses have neither persuasive nor informative value to well known corporations, and arguably, for other companies as well. Second, the effectiveness of SEM for non-branded keywords is small for a large and well-known brand like eBay and the channel has been ineffective on average. Finally, we show that there is a small yet detectable positive impact of SEM on new user acquisition and on informing infrequent users about the value of using eBay. This last finding supports the *informative view* of advertising and implies that targeting uninformed users is a critical factor for successful advertising.

The actual effects of advertising on business performance have always been considered hard to measure. A famous quote attributed to the late 19th century retailer John Wannamaker states that “I know half the money I spend on advertising is wasted, but I can never find out which half.” Traditional advertising channels such as TV, radio, print and billboards have somewhat limited targeting capabilities, and advertisers often waste

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<sup>1</sup>These estimates were reported in the *IAB Internet Advertising Revenue Report* conducted by PwC and Sponsored by the Interactive Advertising Bureau (IAB) 2011 Full Year Results published in April 2012. See [http://www.iab.net/media/file/IAB\\_Internet\\_Advertising\\_Revenue\\_Report\\_FY\\_2011.pdf](http://www.iab.net/media/file/IAB_Internet_Advertising_Revenue_Report_FY_2011.pdf)

<sup>2</sup>See Google’s webpage <http://investor.google.com/financial/tables.html>

valuable marketing dollars on “infra-marginal” consumers who are not affected by ads to get to those marginal consumers who are. The advent of internet marketing channels has been lauded as the answer to this long-standing dilemma for two main reasons.

First, the technology allows advertisers to target their ads to the activity that potential consumers are engaged in (Goldfarb (2012) argues this is the main differentiator between online and offline advertising channels). For instance, when a person is reading content related to sports, like ESPN.com or Yahoo! Sports, advertisers can bid to have display ads appear on the pages that are being read. Similarly, if a user is searching Google or Bing for information about flat-screen TVs, retailers and manufacturers of these goods can bid for sponsored search ads that are related to the user’s query. The belief is that these ads will better target the intent of the user, and not waste valuable resources on uninterested shoppers.

Second, the technology allows advertisers to track variables that are supposed to help measure the efficacy of the ads. An online advertiser will receive detailed data on which of its website’s visitors were directed by the ad, how much was paid for the ad, and using its own internal data flow, whether or not the visitor purchased anything from the website. In theory, this should allow the advertiser to compute the returns on investment because both cost and revenue data is available at the individual visitor level.

Despite these advantages, endogeneity concerns present serious challenges to correctly detecting the causal returns from internet advertising. Traditionally, economists have focused on endogeneity stemming from firm decisions to increase advertising during times of high demand (e.g., advertising during the Holidays) or when revenues are high (e.g., advertising budgets that are set as a percentage of previous-quarter revenue).<sup>3</sup> Our concern, instead, is that the amount spent on SEM (and many other internet marketing channels) is a function not only of the advertiser’s campaign, but is also determined by the behavior and intent of consumers. For example, the amount spent by an advertiser on an ad in the print edition of the New York Times is independent of consumer response to that advertisement (regardless of whether this response is correlated or causal). In contrast, if an advertiser purchases SEM ads, expenditures rise with usage (i.e., consumer click-through).<sup>4</sup> Our research highlights one potential drawback inherent in this form of targeting: While these

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<sup>3</sup>See Berndt (1991), Chapter 8, for a survey of this literature.

<sup>4</sup>Pay per click and pay per impression models are the predominant pricing regimes for these channels. Many of the problems of evaluating the causal returns from pay-per-click advertising also apply to tracking coupon usage.

consumers may look like good targets for advertising campaigns, they are also the types of consumer that are already informed about the advertiser’s product, making them the less susceptible to informative advertising channels. In many cases, the consumers who choose to click on these SEM ads are loyal brand customers or otherwise already informed about a firm’s product. Advertising may appear like it is successfully attracting these consumers, when in reality they would have found other channels to the firm’s website. It is this challenging endogeneity concern that we are able to alleviate with the design of our controlled experiments.

We begin our analysis with experiments that test the efficacy of what is referred to as “brand” keyword advertising, a practice that has been used by most major corporations to date. For example, when this paragraph was written (February 16, 2013), Google searches for the keywords “AT&T”, “Macy”, “Safeway”, “Ford” and “Amazon” resulted in paid ads at the top of the search results page directly above *natural* (also known as *organic*) unpaid links to the companies’ sites. Arguably, consumers who query such a narrow term intend to go to that firm’s website and are seeking the easiest route there. Paid search links simply intercept consumers at the last point in their navigational process. Thus, brand keyword advertising highlights an extreme version of the endogeneity concern described above. We seek to quantify any value from advertising in this setting and then generalize to non-brand advertising, where these concerns might be less extreme but still present.<sup>5</sup>

Our brand keyword experiments show that there is no short-term value in brand keyword advertising. In March of 2012, eBay conducted a test to study the returns of brand keyword advertising (all queries that included the term eBay, including multi-word terms such as “ebay shoes”) by halting SEM queries on these keywords on both Yahoo! and Microsoft (MSN), while continuing to pay for these terms on Google, which we use as a control in our estimation routine. The results show that almost all of the forgone click traffic and attributed sales was immediately captured by natural search.<sup>6</sup> That is, substitution between paid and unpaid traffic was nearly complete. Removal of these advertisements simply raised the prominence of the eBay natural search result. Shutting

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<sup>5</sup>A quick search for the term “brand keyword advertising” will yield dozens of sites many from online ad service agencies that discuss the importance of paying for your own branded keywords. Most of the discussions are somewhat obfuscated, but one reasonable argument is that competitors may bid on a company’s branded keywords in an attempt to “steal” visitor traffic. Such behavior was absent in our studies and we discuss this issue further in section 6.

<sup>6</sup>Throughout, we refer to sales as the total dollar value of goods purchased by users on eBay. Revenue is close to a constant fraction of sales, so percentage changes in the two are equivalent.

off paid search advertisements closed one (costly) path to a firm’s website but diverted traffic to the next easiest path (natural search), which is free to the advertiser. We confirm this result further using a geography-based experiment on Google’s search platform in Europe. Halting brand keyword advertising also resulted in no detectable drop in traffic and sales.

Non-branded keyword advertising presents a more general problem. eBay historically managed over 170 million keywords and keyword combinations using algorithms that are updated daily and automatically feed into Google’s, Microsoft’s and Yahoo!’s search platforms.<sup>7</sup> Examples of such keyword strings are “memory”, “cell phone” and “used gibson les paul”. Unlike branded search, where a firm’s website is usually in the top organic search slot, organic placement for non-branded terms vary widely. Furthermore, even if substitution between paid and organic search does not occur (for instance, if eBay does not appear in the organic search results), consumers may use other channels to navigate to a firm’s website, such as directly typing in the website name or navigating through other internet advertising channels. Hence, with non-branded search, we suspect that organic search substitution may be less of a problem but substitution to other channels could continue to drive purchases even in the absence of SEM. To address this question, we designed a controlled experiment using Google’s geographic bid feature that can determine, with a reasonable degree of accuracy, the geographic area of the user conducting each query. We designate a random sample of 30 percent of eBay’s U.S. traffic in which we stopped all bidding for eBay’s non-brand keywords for 60 days. The test design we implemented lends itself to a standard difference-in-differences estimation of the effect of paid search on sales. This design allows us to explore heterogeneous responses across a wider consumer base, not just those searching for eBay directly.<sup>8</sup>

The non-brand keyword experiments show that SEM had a very small and statistically insignificant effect on sales. This suggests that on average, U.S. consumers do not shop more on eBay when they are exposed to paid search ads on Google. To explore this further, we segmented users according to the frequency at which they visited eBay the year before the test. We find that SEM accounted for a statistically significant increase in new

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<sup>7</sup>see “Inside eBay’s business intelligence” by Jon Tullett, news analysis editor for ITWeb at [http://www.itweb.co.za/index.php?option=com\\_content&view=article&id=60448:Inside-eBay-s-business-intelligence&catid=218](http://www.itweb.co.za/index.php?option=com_content&view=article&id=60448:Inside-eBay-s-business-intelligence&catid=218)

<sup>8</sup>A number of papers have looked at topics related to paid search advertising. See Sahni (2011), Rutz and Bucklin (2011), Yao and Mela (2011), Chan et al. (2011), and Yang and Ghose (2010).

registered users and purchases made by users who bought only one or two items the year before. For consumers who bought more frequently, SEM does not have a significant effect on their purchasing behavior. We calculate that the short-term returns on investment for SEM were negative because more frequent eBay shoppers are accountable for most of paid search sales.

To interpret our results in light of the economics literature, consider the *informative view* of advertising, which suggests that advertising informs consumers of the characteristics, location and prices of products and services that they may otherwise be ignorant about. This will promote competition among producers, and allow consumers to find better and/or cheaper products for purchase. Intuitively, SEM is an advertising medium that affects the information that people have, and is unlikely to play a persuasive role.<sup>9</sup> It is possible that display ads, which appear on pages without direct consumer queries, may play more of a persuasive role, affecting the demand of people who are interested in certain topics.<sup>10</sup>

The heterogeneous response of different customer segments to paid search advertising supports the intuition that SEM plays an informative role. Consumers who have completed at least three eBay transactions in the year before our experiment are likely to be familiar with eBay's offerings and value proposition, and are unaffected by the presence of paid search advertising. In contrast, more new users sign up when they are exposed to these ads, and users who only purchased one or two items in the previous year increase their purchases when exposed to SEM. These results echo findings in Ackerberg (2001) who considers the effects of ads on the purchasing behavior of consumers and shows, using a reduced form model, that consumers who were not experienced with the product were more responsive to ads than consumers who had experienced the product. To the best of our knowledge, our analysis offers the first large scale field experiment that documents the heterogeneous behavior of customers as a causal response to changes in advertising. We are also able to demonstrate a more refined set of responses based on purchase recency and frequency.

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<sup>9</sup>A recent survey by Bagwell (2007) gives an excellent review of the economics literature on advertising as it evolved over more than a century. Aside from the informational view, two other views were advocated. The *persuasive view* of advertising suggests that consumers who are exposed to persuasive advertising will develop a preference for the advertised brand, increasing the advertiser's market power. The *complementary view* posits that advertising enters directly into the utility function of consumers.

<sup>10</sup>A few papers have explored the effects of display ads on offline and online sales: Manchanda et al. (2006), Goldfarb and Tucker (2011a) and Lewis and Reiley (2010).

A simple rationalization of our results is that a large majority of potential consumers have fairly good information about eBay’s site and its offerings, and they receive no additional information from paid search ads. Only a relatively small fraction of consumers are unaware of the brand, or have used it infrequently enough to not fully understand the scope of its offerings. It is this small set of consumers who are impacted positively by ads because of their interest in purchasing once they become informed of the products and prices offered.

The results and arguments laid out above, and the analysis described in detail in sections 3-5 below, suggest that the efficacy of SEM is weak, a conclusion that is likely to apply to other large brands that together spend billions of dollars a year on internet marketing. Of the \$31.7 billion that was spent in the U.S. in 2011 on internet advertising, estimates project that the top 10 spenders in this channel account for about \$2.36 billion.<sup>11</sup> If, as we suspect, our results generalize to other well known brands that are in most consumers’ considerations sets, then our study suggests that the amount spend on internet advertising overall is beyond the peak of its efficacy. We discuss the challenges that companies face in choosing optimal levels of advertising, as well as some of the reasons that they seem to overspend on internet marketing in Section 7.

## 2 An Overview of Search Engine Marketing

SEM has been celebrated for allowing advertisers to place ads that directly relate to the queries entered by consumers in search platforms such as Google, Microsoft (Bing) and Yahoo!, to name a few.<sup>12</sup> SEM ads link to a landing page on the advertiser’s website, which typically showcases a product that is relevant to the search query.

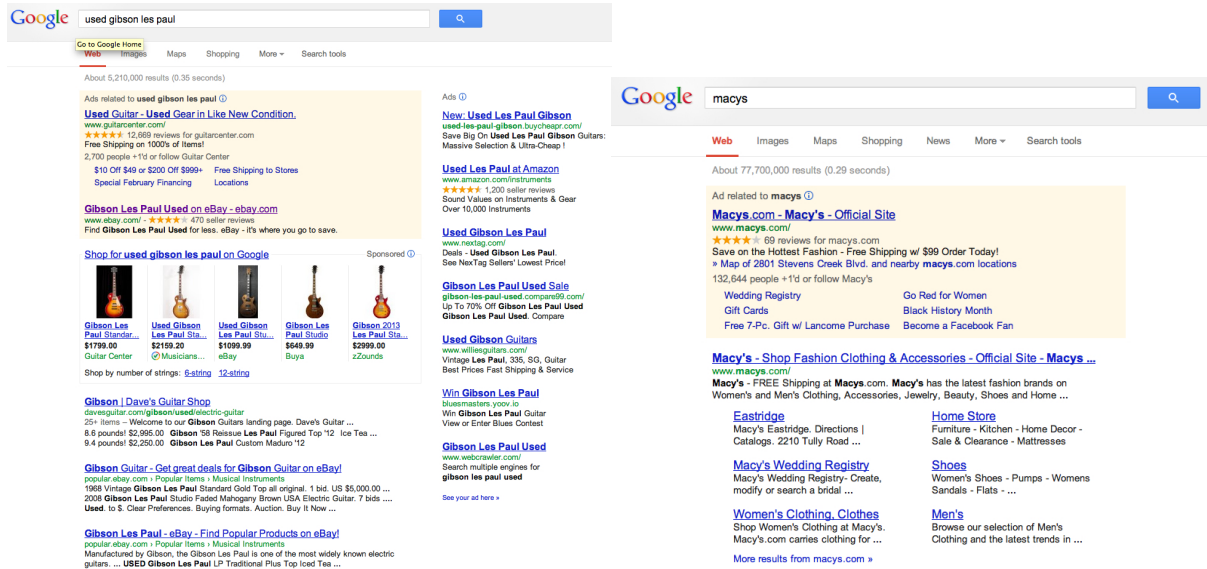
Figure 1a shows a Google search results page for the query “used gibson les paul”. The results fall into two categories: paid (or sponsored) search ads that appear in the shaded upper area (two ads) and on the right (seven ads), and unpaid (also called “natural” or “organic”) search results that appear below the shaded area.

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<sup>11</sup>These include, in order of dollars spent, IAC/Interactive Group; Experian Group; GM; AT&T; Progressive; Verizon; Comcast; Capital One; Amazon; and eBay. See the press release by Kantar Media on 3/12/2012, [http://kantarmediana.com/sites/default/files/kantareditor/Kantar\\_Media\\_2011\\_Full\\_Year\\_US\\_Ad\\_Spend.pdf](http://kantarmediana.com/sites/default/files/kantareditor/Kantar_Media_2011_Full_Year_US_Ad_Spend.pdf)

<sup>12</sup>These differ from Display (or banner) ads that appear on websites that the consumer is browsing, and are not a response to a search query entered by the consumer. We focus most of our discussion on Google primarily because it is the leading search platform.

Figure 1: Google Ad Examples



(a) Used Gibson Les Paul

(b) Macys

The ranking of the unpaid results is determined by Google’s “PageRank” algorithm, which ranks the results based on relevance, while the ranking of the paid search ads depend on the bids made by advertisers for appearing when the particular query is typed by a user, and on a proprietary “quality score” that depends on the click-through rate of the bidder’s previous ads. For a more detailed explanation of the bidding and scoring process of SEM, see Edelman et al. (2007) and Varian (2007).

Advertisers pay only when a user clicks on the paid search ad, implying that ad expenses are only made on consumers who respond to the ad. Furthermore, because firms pay when a consumer clicks on their ad, and because they must bid higher in order to appear more prominently above other paid listings, it has been argued that these “position auctions” align advertiser incentives with consumer preferences. Namely, lower-quality firms that expect clicks on their ads not to convert will not bid for positions, while higher-quality firms will submit higher bids and receive higher positions, expecting more satisfied users who will convert their clicks to purchases.<sup>13</sup>

<sup>13</sup>Indeed, Athey and Ellison (2011) suggest that, sponsored link auctions create surplus by providing consumers with information about the quality of sponsored links which allows consumers to search more efficiently.



The example in Figure 1a describes what is referred to as a non-brand keyword search, despite the fact that a particular branded product (Gibson Les Paul) is part of the query. The reason is that many retailers with their own brand names will offer this guitar for sale as the search results clearly show. This is in contrast to a branded keyword such as “macys”. Figure 1b shows the results page from searching for “macys” on Google, and as the figure shows there is only one paid ad that links to Macy’s main webpage. Notice, however, that right below the paid ad is the natural search result that links to the same page. In this case, if a user clicks on the first paid search result then Macy’s will have to pay Google for this referral, while if the user clicks on the link below then Macy’s will attract this user without paying Google.

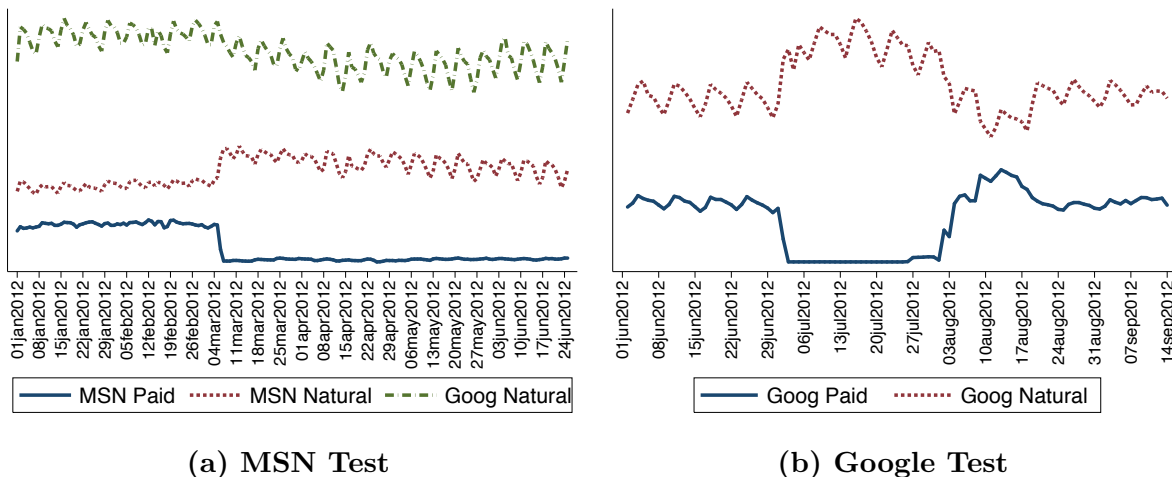
### 3 Brand Search Advertising - A Natural Experiment

In March of 2012, eBay conducted a test to study the returns of brand keyword search advertising. Brand terms are any queries that *include* the term eBay such as “ebay shoes.” It is our hypothesis that users searching for “eBay” are in fact using Google as a navigational tool with the intent to go to ebay.com. If so, there would be little need to advertise for these terms and “intercept” those searches because the natural search results provided by Google will serve as a perfect substitute. To test this hypothesis, eBay halted advertising for its brand related terms on a smaller search advertising platform (MSN). As suspected, almost all of the forgone click traffic from turning off brand keyword paid search was immediately captured by natural search traffic from the platform, in this case Bing. That is, substitution between paid and unpaid traffic was nearly complete.<sup>14</sup> Figure 2a plots the paid and natural clicks originating from the search platform. By design, paid clicks were driven to zero when advertising spending was suspended. At the same time, there was a noticeable uptake in natural clicks. This is strong evidence that the removal of the advertisement raises the prominence of the eBay natural search result. Since users’ intent is to find eBay, it is not surprising that shutting down the paid search path to their desired destination simply diverts traffic to the next easiest path, natural search, which is free to the advertiser.

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<sup>14</sup>In a recent paper, Yang and Ghose (2010) similarly switched off and back on paid search advertising for a random set of 90 keywords. We find much smaller differences in total traffic, most likely because we experimented with a brand term where the substitution effect is much larger.

**Figure 2: Brand Keyword Click Substitution**



MSN and Google click traffic is shown for two events where paid search was suspended (Left) and suspended and resumed (Right).

To quantify this substitution, Table 1 shows estimates from a simple pre-post comparison as well as a simple difference-in-differences across search platforms. In the pre-post analysis we regress the log of total daily clicks from MSN to eBay on an indicator for whether days were in the period with ads turned off. Column 1 shows the results which suggest that click volume was only 5.6 percent lower in the period after advertising was suspended.

This approach lacks any reasonable control group. It is apparent from Figure 2a that traffic increases in daily volatility and begins to decline after the advertising is turned off. Both of these can be attributed to the seasonal nature of e-commerce. We look to another search platform which serves as a source for eBay traffic, Google, as a control group to account for seasonal factors. During the test period on MSN, eBay continued to purchase brand keyword advertising on Google which can serve as a control group. With this data, we calculate the impact of brand keyword advertising on total click traffic. In the difference-in-differences approach, we add observations of daily traffic from Google and Yahoo! and include in the specification search engine dummies and trends.<sup>15</sup> The variable of interest is thus the interaction between a dummy for the MSN platform and a dummy for treatment (ad off) period. Column 2 of Table 1 show a much smaller impact

<sup>15</sup>The estimates presented include date fixed effects and platform specific trends but the results are very similar without these controls.

**Table 1: Quantifying Brand Keyword Substitution**

	MSN		Google
	(1) Log Clicks	(2) Log Clicks	(3) Log Clicks
Period	-0.0560*** (0.00861)		-0.0321* (0.0124)
Interaction		-0.00529 (0.0177)	
Google		5.088 (10.06)	
Yahoo		1.375 (5.660)	
Constant	12.82*** (0.00583)	11.33* (5.664)	14.34*** (0.00630)
Date FE		Yes	
Platform Trends		Yes	
N	118	180	120

Standard errors in parentheses

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$ 

once the seasonality is accounted for. Only 0.529 percent of the click traffic is lost so 99.5 percent is retained.

These results inspired a follow-up test on the larger Google platform that was executed in July of 2012 which yielded similar results. Figure 2b shows both the substitution to natural traffic when search advertising was suspended and the substitution back to paid traffic when advertising resumed. Column 3 of Table 1 show the estimated impacts: total traffic referred by Google dropped by three percent. It is likely that a well constructed control group would reduce this estimate as was evident in the MSN test. During this test, there was no viable control group available because there was no other contemporaneous paid search brand advertising campaign. In the Appendix, we describe a test we designed and executed that preserved a control group in a European market which confirms the results described here.

In summary, the evidence strongly supports the intuitive notion that for brand keywords, natural search is close to a perfect substitute for paid search, making brand keyword SEM ineffective for short-term sales. After all, the users who type the brand keyword in the search query intend to reach the company's website, and most likely will execute on their

intent regardless of the appearance of a paid search ad. This substitution is less likely to happen for non-brand keywords, which we explore in the next section.

## 4 Non-Brand Terms Controlled Experiment

When typing queries for non-brand terms, users may be searching for information on goods and services that they wish to explore further, or even to purchase. If ads appear for users who do not know these products are available at the advertiser’s website, then there is greater potential to bring these users to the site, which in turn might generate additional sales that would not have occurred without the ads.

Because eBay bids on a universe of over 170 million keywords, it provides an ideal environment to test the effectiveness of paid search ads for non-brand keywords. The broad set of keywords place ads in front of a wider set of users: anyone searching for queries related to millions of products and not just those searching specifically for eBay. Measuring the effects of the full keyword set more directly addresses the value of informative advertising because we can examine how consumers with different levels of familiarity with the site respond to advertising. In particular, we have past purchase behavior for users who visit and purchase items on eBay, and we can use measures of past activity to segment users into groups that would be more or less familiar with eBay’s offerings. Non-brand ads have the ability to attract users that are not directly searching for eBay but the endogeneity remains because the ads may attract users who are already familiar with eBay for which the ad provided little or no information. In short, these users may have visited eBay eventually if the ad were not present.

### 4.1 Experimental Design and Basic Results

To determine the impact of advertising on the broader set of search queries we designed and implemented a large scale field experiment that exposes a random subset of users to ads and preserves a control group of users who did not see ads.<sup>16</sup> This was accomplished by leveraging Google’s relatively new technology that allows advertisers to target their ads to the geography of the user. We use Google’s geographic bid feature that can determine,

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<sup>16</sup>Whereas the previous section referred to a test of advertising for branded keywords and their variants, this test specifically excluded brand terms. That is, eBay continued to purchase brand ads nationally until roughly 6 weeks into the geographic test when the brand ads were halted nationwide.

with a reasonable degree of accuracy, the Nielsen Designated Market Area (DMA) of the user conducting each query. There are 210 DMAs in the United States, which typically correspond to large metropolitan areas. For example, Google’s home market includes the San Francisco, Oakland, and San Jose metropolitan areas.

For the test, advertising was suspended in roughly 30 percent of DMAs. This was done simply to reduce the scope of the test and minimize the potential cost and impact to the business (in the event that the ads created considerable profits). To select these markets, a purely random sub sample of DMAs were chosen as candidates for the test. Next, candidate DMAs were divided into test and control DMAs using an algorithm that matched historical serial correlation in sales between the two regions. This was done to create a control group that mirrored the test group in seasonality. This procedure implies that the test group is not a purely random sample, but it is certainly an arbitrary sample that does not exhibit any historical (or, ex post) difference in sales trends. The test design therefore lends itself neatly to a standard difference-in-differences estimation of the effect of paid search on sales.

The execution can be seen in Figure 3a which plots total *attributed* sales for the three regions of the U.S.: the 65 test DMAs where advertising ceased, 68 matched control DMAs, and the remaining 77 control DMAs. As before, attributed sales is the total sales of all purchases to users within 24 hours of that user clicking on a Google paid search link.<sup>17</sup> Note that attributed sales do not completely zero out in the test DMAs after the test was launched in late May. The remaining ad sales from test DMAs is an artifact of the error both in Google’s ability to determine a user’s location and our determination of the user’s location. We use the user’s shipping zip code registered with eBay to determine the user’s DMA and whether or not the user was exposed to ads. If a user makes a purchase while traveling to a region exposed to ads but still has the product shipped to her home, we would assign the associated sales to the off region. Attributed sales falls by over 72 percent.<sup>18</sup>

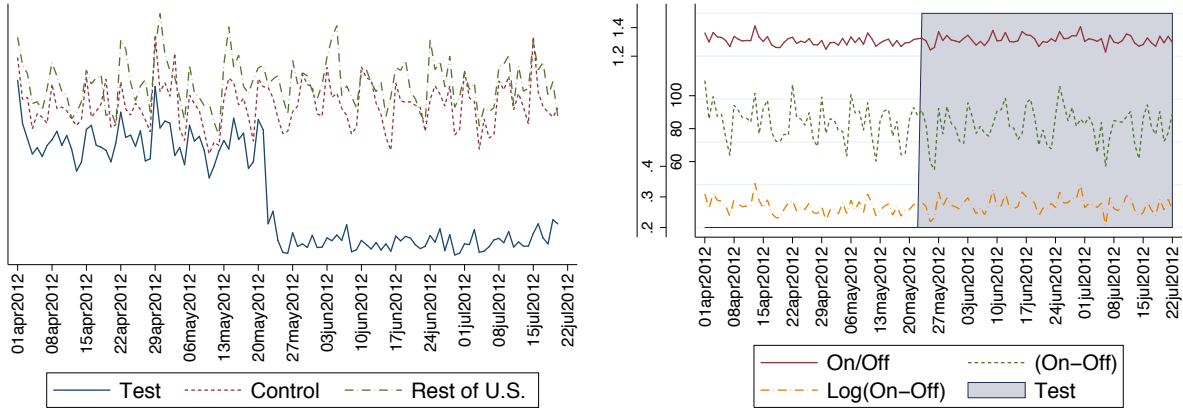
A very simple assessment of the difference-in-differences results is plotted in Figure 3b. We plot the simple difference, ratio, and log difference between daily average sales in the designated control regions where search remained on and the test regions where search is off. As is apparent, the regions where search remained on are larger (about 30

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<sup>17</sup>The y-axis is suppressed to protect proprietary sales data. It is in units of dollars per DMA, per day.

<sup>18</sup>This classification error will attenuate the estimated effect towards zero.

**Figure 3: Non-Brand Keyword Region Test**



(a) Attributed Sales by Region

(b) Differences in Total Sales

percent) than the regions switched off.<sup>19</sup> This is an artifact of the selection algorithm

**Table 2: Diff-in-Diff Regression Estimates**

	(1)	(2)
	Log Sales	Log Sales
Interaction	0.00440 (0.00628)	0.00440 (0.00629)
Experiment Period	-0.0579*** (0.00531)	
Search Group	-0.0130 (0.169)	
Constant	11.75*** (0.133)	11.77*** (0.00856)
Date Fixed Effects		Yes
DMA Fixed Effects		Yes
N	23730	23730

Standard errors, clustered on the DMA, in parentheses

\*  $p < .1$ , \*\*  $p < .05$ , \*\*\*  $p < .01$

that optimized for historical trends. This difference is constant through the pre and post experimental period demonstrating the muted overall impact of paid search. To quantify the impact of paid search, we perform a difference-in-differences calculation using the period of April through July and the full national set of DMAs. The entire regime of paid search adds only 0.44 percent to sales. The regression equivalent estimates are shown

<sup>19</sup>The Y-axis is shown for the ratio, the log difference, and in differences in thousands of dollars per day, per DMA.

in Table 2. A regression setting allows us to add precision to the estimates because we can control for inter-DMA variation with DMA clustered standard errors and DMA fixed effects. The point estimates are robust to different specifications, and adding additional controls substantially reduces the standard error of the estimator.<sup>20</sup>

We examine the effects of the endogeneity on estimates of returns in Table 3. Columns 1 and 2 show the estimates of a regression of log revenue on log spending during period prior to our test. As is evident, a simple OLS yields unrealistic returns suggesting that every 10 percent increase in spending raises revenues by 9 percent. The inclusion of controls lowers this estimate but still suggests that paid search contributes a substantial portion of revenues. Our discussions with industry practitioners suggest that most firms similarly use a number of controls, which reduce the bias but still yield large positive returns. However, as we explain in the introduction, the amount spent on ads depends on the search behavior of users, which is correlated with their intent to purchase. It is this endogeneity problem that our experiment overcomes.

**Table 3: Instrument for Return, Dep Var: Log Revenue**

	OLS		IV
	(1)	(2)	(3)
Log Spending	0.895*** (0.0136)	0.102*** (0.0325)	0.00563 (0.0411)
DMA Fixed Effects		Yes	
Date Fixed Effects		Yes	
N	10500	10500	23730

Standard errors in parentheses

\*  $p < .1$ , \*\*  $p < .05$ , \*\*\*  $p < .01$

Column 3 of Table 3 shows an estimation of spending’s impact on revenue using the difference-in-differences indicators as excluded instruments. The instruments isolate the exogenous experimental variation in spending to estimate the causal impact of spending on changes in revenue. True returns are an order of magnitude smaller and no longer statistically different from zero suggesting that even eBay’s large spending may have no return at all.

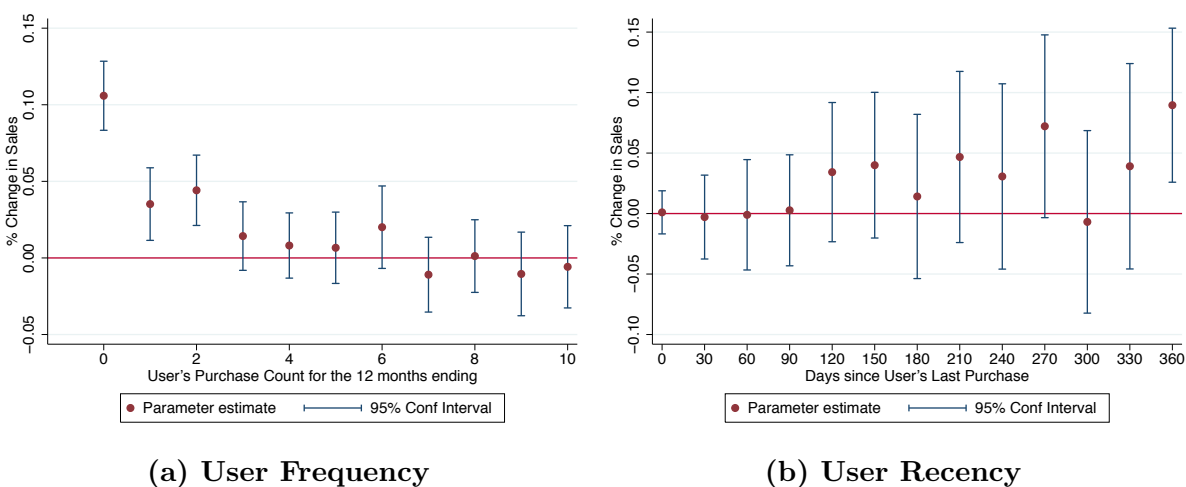
<sup>20</sup>The weekly cycle of e-commerce purchase behavior produces a sizable negative intra-DMA correlation. Thus, panel variable clustered standard errors are substantially smaller than simple standard errors. The inclusion of DMA fixed effects increases precision for the same reason.

## 4.2 Consumer Response Heterogeneity

The advantage of an experimental design that varies treatments across geographic markets is that we can now compare many outcome metrics between markets. This allows us to separate outcomes by observable user characteristics because each subset of the user base will now be observed in markets that are experimentally exposed to advertising. Econometrically, this can be accomplished by interacting the treatment dummy with dummies for each subgroup which produces a set of coefficients representing the total average effect from the advertising regime on that subgroup.

We examine user characteristics that are common in the literature: recency and frequency of a user’s prior purchase history. First, we interact the treatment dummy with indicators for the number of purchases by that user in the year leading up to the experiment window.<sup>21</sup> Figure 4a plots the point estimates of the treatment interactions. The experiment generated the largest effect on sales for users that had not purchased before. Interestingly, the treatment effect diminishes quickly with purchase frequency - causal returns to revenue are largest for new and infrequent customers. Estimates are consistently near zero for users who buy regularly (e.g. more than 3 times per year).

Figure 4: Paid Search Impact by User Segment



Second, Figure 4b plots the interactions by time since last purchase. Estimates become noisier as we look at longer periods of inactivity because there are fewer observations

<sup>21</sup>Transaction counts exclude the pre-test period used for the difference-in-differences analysis.

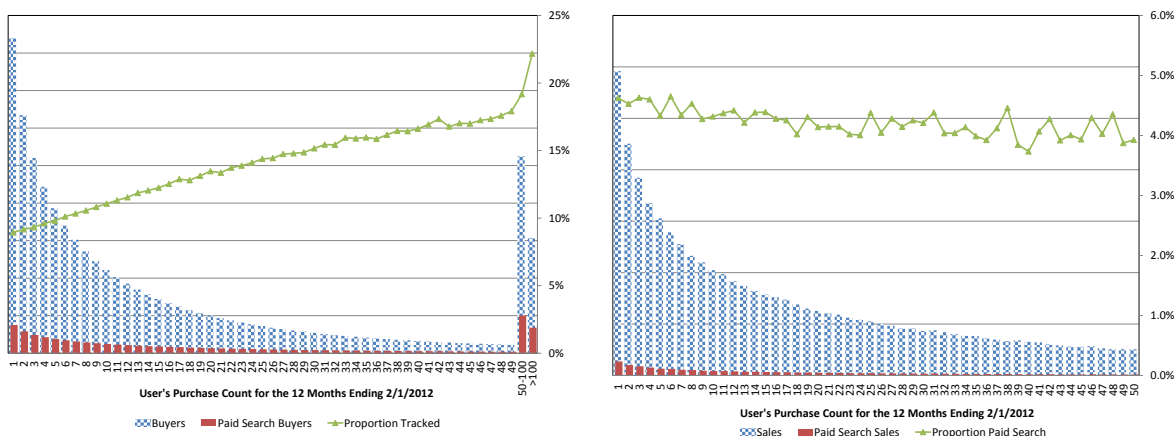


that return after longer absences. The estimates are tightly estimated zero impacts for 0, 30, 60 and even 90 day absences, suggesting that advertising has little impact on active and moderately active customer. However, the effect then steadily rises with absence and impacts are once again large and statistically significant when looking at customers who have not purchased in over a year.

The implication of Figure 4 is clear: search advertising works only on a firm’s least active customers. These are traditionally considered a firms “worst” customers, and advertising is often aimed a high value repeat consumers (Fader et al., 2005). This evidence supports an advertising model that affects consumption choice only when the advertising updates a consumer’s information set. Bluntly, search advertising only works if the consumer has no idea that the firm has the desired product. Large firms like eBay with powerful brands will see little benefit from paid search advertising because most consumers already know that they exist, as well as what they have to offer. The modest returns on infrequent users likely come from informing them that eBay has products they did not think were available on eBay. Active consumers already know this and hence are not effectively influenced.

While the least active customers are the most desirable targets for search advertising, we find that most paid search traffic and attributed sales are high volume, frequent purchasers. Figure 5 demonstrates the relationship between attribution and user purchase frequency. Figure 5a plots the count of buyers by how many purchases buyers make in a year. The

**Figure 5: Paid Search Attribution by User Segment**



**(a) Buyer Count Mix**

**(b) Transaction Count Mix**

counts are shown separately for all buyers and for that subset of buyers that buy, at any point in the year, after clicking on a paid search ad. The ratio of the two rises with purchase frequency because frequent purchasers are more likely to use paid search at some point. Figure 5b shows the same plot for shares of transaction counts. Even users who buy more than 50 times in a year (i.e. once a week) still use paid search clicks for 4 percent of their purchases. The large share of heavy users suggests that most of paid search spending is wasted because the majority of spending on Google is related to clicks by those users that would purchase anyway. This explains the large negative ROI computed in Section 4.

We have searched for other indicators of consumer’s propensity to respond in localized demographic data. Although randomization was done at the DMA level, we can measure outcomes at the zip code level, and so we estimate a zip code level regression where we interact zip code demographic data with our treatment indicator. We find no differential response across several demographic measures that is statistically significant: income, population size, unemployment rates, household size, and eBay user penetration. The coefficient on user eBay penetration (the proportion of registered eBay users per DMA) is negative, which complements the finding that uninformed and potential customers are more responsive than regular users.

### 4.3 Product Response Heterogeneity

As argued above, a consumer’s susceptibility to internet search ads depends on how well informed they are about where such products are available. Given that the availability of products varies widely, the effectiveness of paid search may vary by product type. As a large e-commerce platform, eBay’s paid search advertising campaigns present an opportunity to test the returns to advertising across product categories which vary in competitiveness, market thickness and general desirability. To our surprise, different product attributes did not offer any significant variation in paid search effectiveness.

As in Section 4.2, we decompose the response by interacting the treatment indicator with dummies for sub-groupings of revenue using the category of sales. We found no systematic relationship between returns and category. The estimates center around zero and are generally not statistically significant. At the highest level, only one category is significant, but with 38 coefficients, at least one will be significant by chance.

We explored multiple layers of categorization, ranging from the broadest groupings of hundreds of categories. The extensive inventory eBay offers suggests that some categories

would generate returns because customers would be unaware of their availability on eBay. However, we have looked for differential responses in very granular product categories and found no consistent pattern of response. Moreover, less than 5 percent of categories are statistically significant at the 5 percent confidence level. Moreover, in an examination of the estimates at finer levels of categorization, we found no connection between ordinal ranking of treatment impact product features like sales volume or availability. It is thus evident that for a well known company like eBay, product attributes are less important in search advertising than user intent and, more importantly, user information.

## 5 Channel Substitution

The brand query tests demonstrated that causal (incremental) returns were small because users easily substituted paid search clicks for natural search clicks. Metaphorically, we closed one door and users simply switched to the next easiest door. This substitution was expected because users were using brand queries as simple navigational tools. Unbranded queries are not simply navigational because users are using the search platform to find *any* destination that has the desired product. Only experimental variation can quantify the number of users who are actually informed by the presence of search advertising.

Such experimentation can also measure the extent to which paid and natural search are substitutes for non-brand terms. This substitution exists because non-brand searches for many products that eBay sells should produce some amount of natural search traffic. For example, in Figure 1a we showed Google’s search results page for the query “used gibson les paul”. Notice that the second ad from the top, as well as the center image of the guitar below it, are both paid ads that link to eBay. At the same time, the two bottom results of the natural search part of the page also link to eBay. Hence, some substitution from paid to natural search may occur for non-brand keywords as well.

We measure this potential substitution by regressing natural search attributed sales on paid search attributed sales. The two are naturally highly correlated because shocks to purchase intent are common to both channels. We again use the experimental treatment dummies as excluded instruments to measure the causal impact of increases in paid search sales on natural search sales. The experimental dummies are correlated with paid search sales because paid search spending, which was turned off in the experiment is a driver of

attributed sales, and the dummies are random by design so they are otherwise uncorrelated with natural search sales.

**Table 4: Natural Search Substitution**

Dep Var: Log Non-Brand SEO Tracked Sales				
	(1)	(2)	(3)	(4)
	OLS	OLS-FE	IV	IV-FE
Log Paid Search Sales	0.699*** (0.0223)	0.00560 (0.00433)	-0.182 (0.126)	-0.0391*** (0.0110)
Constant	3.724*** (0.174)	9.038*** (0.0439)	10.41*** (0.932)	
DMA,Date Fixed Effects		YES		YES
Observations	23178	23178	14706	14706

Table 4 shows the OLS and IV estimates with and without date and DMA fixed effects. Fixed effects greatly reduce the bias but still leave the estimates wrongly positive. The IV estimates show that paid and natural search are in fact substitutes but the estimates are remarkably small with an an elasticity of -.039.

This leaves open the question about traffic substitution. To extend the metaphor, we closed the paid search door, saw no increase in traffic through the natural search door, but still saw the same number of total purchases as evidenced by the unaffected total sales. Where did the additional take up come from? A decrease in the use of the search platform without a corresponding drop in sales suggests a more complex relationship between paid traffic origination and user purchase behavior. A natural hypothesis may again be the sheer name recognition of eBay. Most people who are searching for goods may already have eBay in their consideration set, and plan to visit the site directly unless they are guided to the site with a convenient paid search ad. In lieu of this ad, therefore, the user may just open a browser and type “www.ebay.com” directly into the address bar. We hope to explore this hypothesis in future work.

## 6 Deriving Returns on Investment

To make the importance of our results clear and interpret their implications for business decisions, we compute the implied return on investment (ROI) associated with spending on paid search. To derive the ROI from the estimates of impacts on revenue we need to

add information on spending. Imagine that initially the amount spent on paid search was  $S^0$  associated with revenues equal to  $R^0$ . Let  $\Delta R = R^1 - R^0$  be the difference in revenues as a consequence of a difference in spending,  $\Delta S = S^1 - S^0$ , and by definition,  $ROI = \frac{\Delta R}{\Delta S} - 1$ .

Let  $\beta = \Delta \ln(R) \approx \frac{\Delta R}{R^0}$  be our estimated coefficient on paid search effectiveness, that is, the effect of an increase in spend on revenues as estimated in tables 2 and 3.<sup>22</sup> After some simple algebra on this approximation we have,  $\Delta R \approx \frac{\beta}{(1+\beta)} * R'$ . Using the definition of ROI and setting  $S^0 = 0$  (no spending on paid search), we have,

$$ROI \approx \frac{\beta}{(1+\beta)} \frac{R'}{S'} - 1 \quad (1)$$

It should be noted that this calculation of ROI considers only short term, immediate revenues. The long term benefits of adding customers or informing customers of new product holdings that leads to future returns are not accounted for. We discuss this further in Section 7.

In order to actually calculate the ROI from paid search we would need to use actual revenues and costs from the DMAs used for the experiment (or total revenues and costs of paid search), but these are proprietary information that we cannot reveal due to company policy. Instead, we use revenues and costs from public sources regarding eBay's operations. Revenue in the U.S. is derived from eBay's financial disclosures using Marketplaces net revenue prorated to U.S. levels using the ratio of gross market volume (sales) in the U.S. to global levels, which results in U.S. gross revenues of \$2,880.64 (in millions).<sup>23</sup> We obtain paid search spending from the release of information about the expenditures of several top advertising spenders on Google. Our estimate of eBay's yearly paid search spending for the U.S. is \$51 million.<sup>24</sup>

Table 5 presents the ROI estimates using our experimental results, coefficients from Tables 2 and 3, and the publicly available reports on revenue and spending as described above.

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<sup>22</sup>Recall that  $\beta = \ln(R^1) - \ln(R^0) = \ln(1 + \frac{\Delta R}{R^0})$  which for small values of  $\frac{\Delta R}{R^0}$  equals approximately  $\frac{\Delta R}{R^0}$ .

<sup>23</sup>Total revenues for 2012 were \$7,398 and the share of eBay's activity in the U.S. was \$26,424/\$67,763. See [http://files.shareholder.com/downloads/ebay/2352190750x0x628825/e8f7de32-e10a-4442-addb-3fad813d0e58/EBAY\\_News\\_2013\\_1\\_16\\_Earnings.pdf](http://files.shareholder.com/downloads/ebay/2352190750x0x628825/e8f7de32-e10a-4442-addb-3fad813d0e58/EBAY_News_2013_1_16_Earnings.pdf)

<sup>24</sup>The information reports a monthly spend of \$4.25 million, which we impute to be \$51 million. See <http://mashable.com/2010/09/06/brand-spending-google/>

**Table 5: Return on Investment**

	OLS		IV	DnD	
	(1)	(2)	(3)	(4)	
$\beta$	0.895	0.102	0.00563	0.0044	A
Spend (Millions of \$)	\$ 51.00	\$ 51.00	\$ 51.00	\$ 51.00	B
Gross Revenue ( $R^1$ )	2,880.64	2,880.64	2,880.64	2,880.64	C
Net Revenue ( $R^0$ )	1,520.13	2,614.01	2,864.51	2,868.02	D=C/(1+A)
$\Delta R$	1,360.51	266.63	16.13	12.62	E=C-D
ROI	2568%	423%	-68%	-75%	F=E/A-1

As is evident, simple OLS estimation yields unrealistic returns of over 2500 percent and even accounting for daily and geographic effects implies returns that are greater than 400 percent, as shown in Column 2. The IV estimation reduces the ROI estimate significantly below zero to negative 68 percent and our best estimate of average ROI using the direct difference-in-differences estimation is negative 75 percent as shown in Column 4.<sup>25</sup>

## 7 Discussion

The results of our study show that for a well-known brand like eBay, the efficacy of SEM is limited at best. For the most part, paid-search expenditures are concentrated on consumers who would shop on eBay regardless of whether they were shown paid search ads. As we outline in the introduction, of the \$31.7 billion that was spent in the U.S. in 2011 on internet advertising, the top 10 spenders in this channel account for about \$2.36 billion. These companies generally use the same methods and the same consulting firms to design their ad campaigns and there are many reasons to think that the results we presented above would generalize to these large and well known corporations. This would most likely not be true for small and new entities that have no brand recognition, which must pay in order to appear at the top of a search page for any given query.<sup>26</sup>

<sup>25</sup>As described above, this calculation is done for revenue and spending obtained from public sources about the U.S. portion of eBay. We can instead use reported global revenue from eBay’s 10K together with spending estimates from Kantar Media as a robustness calculation ([http://kantarmediana.com/sites/default/files/kantareditor/Kantar\\_Media\\_2011\\_Full\\_Year\\_US\\_Ad\\_Spend.pdf](http://kantarmediana.com/sites/default/files/kantareditor/Kantar_Media_2011_Full_Year_US_Ad_Spend.pdf)). Since they report total internet marketing expenditures globally, we can pro-rate the amount spent on paid search using the IAB report, which states that paid search is about 46.5% of total internet marketing spend. This places ROI at negative 60 percent, which is close to the negative 75 percent reported above in column 4. Columns 1 through 3 use a coefficient that is log-log and hence requires a slightly different derivation.

<sup>26</sup>If you were to start a new online presence selling a high quality and low-priced widget, someone querying the word “widget” would still most likely not see your site. This is a consequence of the PageRank

This begs the question: why do well-known branded companies spend such large amounts of money on what seems to be a rather ineffective marketing channel? We believe that the reason is the challenges that these companies face in generating causal measures of the returns to advertising. As the results in Table 5 demonstrate, a naive regression of sales on advertising spend would result in an ROI estimate of 2500 percent, while a more thoughtful regression that accounts for seasonal and geographic variation would drop that number to about 400 percent. Still, this vastly overestimates the negative 75 percent that we estimate using the experiments. This is in line with other experimental results obtained recently by Lewis et al. (2011) regarding the effectiveness of display ads.<sup>27</sup>

Of course, this overstated effect from using regressions on observational data should not be a surprise. It is precisely for this reason that scholars resort to natural experiments (e.g., Goldfarb and Tucker (2011b)) or controlled experiments (e.g., Lewis et al. (2011)), in order to correctly assess a variety of effects related to internet marketing. This is, however, not the norm in industry. Not only do most consulting firms who provide marketing analytics services use observational data, recommendations from Google offer analytical advice that is not consistent with true causal estimates of ad effectiveness. As an example, consider the advice that Google offers its customers to calculate ROI:

“Determining your AdWords ROI can be a very straightforward process if your business goal is web-based sales. You’ll already have the advertising costs for a specific time period for your AdWords account in the statistics from your Campaigns tab. The net profit for your business can then be calculated based on your company’s revenue from sales made via your AdWords advertising, minus the cost of your advertising. Divide your net profit by the advertising costs to get your AdWords ROI for that time period.”<sup>28</sup>

This advice is very much akin to running a regression of sales on adwords expenditures, which is not too different from the approach that result in the inflated ROIs that we report in columns 1 and 2 of Table 5. It does not, however account for the endogeneity concern

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algorithm that relies on established links to webpages. Only after many websites link to your site, related to the word widget, will you stand a chance of rising to the top of the organic search results.

<sup>27</sup>Using a controlled experiment they demonstrated that displaying a certain brand ad resulted in an increase of 5.4 percent in the number of users performing searches on a set of keywords related to that brand. They then compared the experimental estimate to an observational regression estimate, which resulted in an increase ranging from 871 percent to 1198 percent.

<sup>28</sup>See <http://support.google.com/adwords/answer/1722066>

that our study highlights where consumers who use paid search advertising on their way to a purchase may have completed that purchase even without the paid search ads. The only way to circumvent this measurement concern is to adopt a controlled test that is able to distinguish between the behavior of consumers who see ads and those who don't. As we have shown, once this is done correctly, estimates of ROI shrink dramatically, and for our case become very negative.<sup>29</sup>

The experimental design that we use exploits the ability of an advertiser to geographically control the ad expenses across DMAs, thus yielding a large-scale test-bed for ad effectiveness. The idealized experiment would have been conducted on a more refined user-level randomization, which would allow us to control for a host of observable user-level characteristics.<sup>30</sup> Still, given the magnitude of our experiment and our ability to aggregate users by measures of recency, frequency, and other characteristics, we are able to detect heterogeneous responses that shed light on the way users respond to ads. As targeting technology is developed further in the near future, individual-level experiments can be performed and more insights will surely be uncovered.

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<sup>29</sup>As mentioned earlier, this is only a short term estimate. Still, to overcome the short-term negative ROI of 75% it is possible to calculate the lifetime value of a customer acquired that would be required to make the investment worthwhile. This is beyond the scope of our current research.

<sup>30</sup>For example, Anderson and Simester (2010) analyze results from experiments using direct mailing catalogs which are addressed to specific individuals for which the company has lots of demographic information. This level of targeting is not currently feasible with online ads.



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