A couple of years ago, the Wall Street Journal ran a story (no doubt by a small female reporter) about the secret phenomenon of small women buying their clothes in the kids’ department. The clothes were sturdier, better-fitting, less fashion-extreme...and cheaper.

In much the same way, small businesses have been buying their IT in the consumers’ department. While vendors note the difficulty of reaching the small-business market, those customers have been happily buying their hosting and access from Yahoo!, their accounting from consumer-turned-small-business vendor Intuit and now their advertising from Google and sponsored-search pioneer Overture/Yahoo!.

The dot-com bust told us that the consumer market was a tough one: Consumers don’t pay. Attention turned to the enterprise market: They are slow to buy and pay, but at least they have money. But now, out of that gloom is emerging a new market of empowered small businesses willing to pay — a little — for reliable, robust, easy-to-use capabilities that have been tested by millions of consumers who don’t have IT departments either. It’s as if the vendors were talking about streamlining government, but all the little businesses want is genuine power to the people.

The small-business market is tough to define. Some vendors go by company size — under 100, under 50 employees. But what’s small in one industry may be mid-sized in another. Others say it’s anyone without an IT department, or a company not worth selling to directly because its budget is too small. The best definition — but one not readily usable by a market-research firm — is any company where the owner still manages directly: When he decides whether to
sit down with the salesman who invites him to play golf or to search for a cheaper alternative online, he knows he can use the money saved to pay for a family vacation. . .and choose his own golf partner.

Whatever the answer, most small businesses don’t worry about the question. They are too busy running the business. Over the last few years, many of them have discovered the IT tools they need for themselves, as consumers. They get e-mail from their airlines; they start to send mail to their own customers and prospects. They keep their checking accounts with Quicken; they start to use it for their business books, sometimes upgrading to QuickBooks. They buy a used lawnmower or sell an unused exercise machine on eBay; they start to procure and sell online. They respond to ads on Yahoo! and now, with the advent of consumer-style almost-one-click-purchase advertising, they are advertising on the Web with Google's AdWords and Overture.

In short, the small-business market is a producer-side version of the consumer market, rather than a mini version of the big-business market. Companies such as Yahoo! and Google are well-positioned to sell into it, and their business customers - all of them consumers in their private lives - know these portals already. (see Release 1.0, January 2003.) For broad, generic functions, small businesses will look to these mass-market vendors; for customization, trust, and outsourcing of many tasks, they will look to one another. . .and find one another through those same mass-market platforms and services. The real intermediaries that will empower small businesses are not fancy vertical exchanges or slumming business-IT vendors, but the same intermediaries they already use in their daily lives.

We started researching this issue of Release 1.0 expecting to look at small-business accounting packages and the like, but we discovered that the real action in small business is online communications with the outside world. Whereas large businesses have gained productivity by automating internal processes and now are looking to IT for greater flexibility, small businesses have different needs and opportunities, and typically devote relatively more of their resources to external communications than to internal processes. (They have a higher ratio of surface to volume than do large organizations.)
Mass-market, Net-based services promise to support them in improving those communication processes.

(The underlying technologies are many that we have previously covered in these pages: Web services, the service grid, RSS feeds, CRM, reputation systems and all the wonderful tools that enable people to communicate and keep track of things online. But the way they are sold has little to do with understanding the technology, and everything to do with explaining the results.)

. . . and big business

A few years ago, the question of missing productivity was all the rage. Where were the benefits of all the IT stuff everyone was buying? What about the Internet’s vaunted effect on the economy? Now, with the so-called jobless recovery, we are beginning to see the effects. Productivity grew about 1 or 2 percent per year in the ‘90s; since 2000, it has grown at 4 percent per year. However, we believe, that’s just the swelling of the wave, with its impact mostly within large companies. Smaller companies, as they scale up, have also benefited from economics of scale and automation. The small companies grown big we cover here – Yahoo!, Google, eBay – are cases in point.

The big gains in productivity in the next few years are likely to come in small business. Those won’t be in internal processes; in the real world, it doesn’t make much difference if the owner has to spend an extra half hour on Saturday. From the point of view of a small business, the key is generally to raise revenues rather than to lower costs (and besides, the owner can’t fire anyone just because she outsources the payroll). The impact of the Net is to help these companies increase their revenues, and to turn more moonlighters and part-timers into small businesses.

But the phenomenon we describe below is not just people in small businesses using “consumer” tools for business purposes. Many entrepreneurial individuals in large organizations are starting to do the same. It’s everyone from the employee who uses SurveyMonkey to assess customer needs instead of asking IT to build a custom application, to the “Internet group” at BMW of Austin who sell mostly used, high-end BMWs to customers around the country who go to eBay not for price but to find rare models they can’t find any other way, says BMW salesman William Weekley. “Every
time we have an Alpina or a Z8 [two popular used models] we put it on eBay, because that’s where people will be looking for it.” Meanwhile, the big-three online travel companies are all fielding direct sales forces to sign up corporate customers.

Big business often finds that the best way to overcome the inefficiencies and friction of operating the old way is not to call on IT, but to outsource to the same pay-by-the-unit services that small businesses have discovered.

**Macro business**

Small business’s discovery of the Net will eventually affect the entire US economy – which is already propelled by the drive and flexibility of its entrepreneurial class plus the lightweight regulatory environment that allows them to flourish (at least as compared to most other countries, some hampered by too much regulation and others by corrupt regulators). Aside from dynamism and the rapid spread of good ideas (and death of bad ones), the Internet is bringing transparency both to sources of supply and to pricing. Things will change for people who had a vested interest in high prices – both suppliers and the buying agents (rarely owners) who accepted those prices in exchange for, say, a round of golf or fancy lunches or even actual bribes.

On the other side, discarded but still useful goods can now find customers to pay for what may have been written off as worthless – creating new value out of what seemed to be nothing.

But it’s a dynamic economy, after all. After a time, the presence of those “found” goods and the ability of customers to find perfectly useful second-hand products will depress prices of new goods. It will likely force vendors to look for new markets...
overseas, where those goods can produce more value. Inventory turns are likely to increase as visibility increases. Everything will move faster. It will become harder to make obscene profits, as everyone competes with everyone. Small businesses will find it easier to expand – or to stay small and profitable. And meanwhile, giant companies that mass-produce goods or services are likely to become somewhat easier to deal with as they too face a more competitive, transparent business environment.

In short, it will be easier to create value instead of anti-competitive friction.

**The market: Step by step**

Although the marketplaces in which small businesses operate are overwhelmingly vertical, many horizontal tools and platforms can support them effectively. Hundreds of micromarkets – mostly invisible to anyone but their participants – happily co-exist on eBay and Google. Third parties resell generic tools and services to specific markets, often with little customization, but with an understanding of how a particular kind of business may use the tools or which customer segments to go after. Do you need the hourly-employees module, or the follow-up service database add-on? Do you need scheduling for your dental clinic, or scheduling, with different terminology, for your truck repair shop? Do you need point-of-sale or invoicing?

Says one market researcher who wants to remain unidentified: “As an intellectual exercise, we took a look at possible clustering of IT dealer customers. From our data at least, it is substantial. For each dealer, we counted the number of customers in each major Standard Industrial Classification [SIC]. We defined the dealer as clustered if more than 50 percent of the dealer’s customers were concentrated in one or two major SIC categories. We examined several hundred dealers and several thousand customers. Most dealers were clustered.”

But interestingly, the clustering is more about culture and trading partners than about specific functionality. The salespeople need to know the lingo and the community, and internal processes do differ; they may require customization or specific workflows (and of course product-specific tools or IP/service-specific contracts). But you don’t need a formal, domain-specific ontology or transaction module to find your trading partners or the things you need online; all you need is a few keywords that are intelligible to other buyers and sellers in your industry.
Aside from hardware sales, there are four major functional markets in IT for small businesses, plus a variety of intersecting vertical markets: Internet infrastructure (connectivity, Web-hosting, e-mail, domain names and the like), marketing online (advertising, search/find, and direct marketing or “power e-mail”), trading online (transactions), and operating online (linking internal operations to external data sources or processing facilities).

**INTERNET INFRASTRUCTURE** is an extremely fragmented market: Over the last four years small businesses have shifted away from AOL to buying access from local ISPs or telcos, including Yahoo!’s co-branded service with SBC; AOL has withdrawn from the broadband market and is offering the small-business market online content and services only. According to Tier1 Research, Yahoo!, with about 295,000 customers, is the largest player in the so-called mass-market hosting market for website hosting, with about a 10-percent share.

**MARKETING ONLINE** can be divided into outbound marketing – sending mail or posting ads – and inbound marketing – making it easy to be found through search engine optimization and other means. There’s a standard waiting to be born – some kind of metadata format – but for now the market inefficiencies have created a thriving business segment. Companies in this market are looking eagerly at the roughly $200 billion spent on advertising, direct mail and classifieds/yellow pages in the US – and also at the $100 billion of telesales, much of which has now been rendered illegal and despised by the Do-Not-Call list. Various visions of much of it moving online dance in the eyes of marketers, but they have to contend also with the Can Spam Act, anti-spam tools and pop-up blockers. This new atmosphere works to the advantage of more relevant, less intrusive search-oriented ads, and third-party, professionally managed mailings.

**TRADING ONLINE** is where the ability to scale up and outsource IT has been key. This has been the most visible part of the market. Most of the promised exchanges of the dot-com boom have morphed into something else, but the concept does live on in a variety of vertical marketplaces, most notably on eBay. Currently, online trading accounts for only a fraction of a percent of US general merchandise sales, but eBay is already used by many companies to price goods if not to buy them.

And finally, **OPERATING ONLINE**, where Web applications can talk directly to internal accounting and inventory systems, and most basic processes are automated. Because the kinds of services and products sold vary so much, and because the communities involved are so different, this is where vertical solutions matter most. A restaurant
simply operates differently from a dental clinic, even though both have hourly employees and some do business only by appointment (or reservation). And a dressmaker is a whole other story. . . However, many of the solutions use the same underlying technology, customized by a local or domain-specific reseller.

These are somewhat arbitrary distinctions and one flows into another, but they serve to arrange the diversity of online offerings into some kind of structure.

**Why now? Why not yet?**

It’s not as if the small-business market is undiscovered. In the late ‘90s, BigStep, NetLedger and a host of competitors such as SmartAge raised over $1 billion to address the small-business market. Some of them failed because of overdoses of money, but they were also addressing a market that just wasn’t ready. “Ninety percent of our customers were still on dial-up,” recalls BigStep co-founder Andrew Beebe, now CEO of Energy Innovations in Pasadena, CA. (The company was sold to Affinity in 2002; two other co-founders are now running small-business services at Yahoo!) Few small businesses had much computer expertise, and their customers weren’t online either.

Now that situation has changed. Broadband is becoming prevalent, especially in businesses, and their customers are online. It’s possible to outsource almost any non-core function, and small companies can get purchasing economies of scale, not by joining some specialized exchange, but simply by searching online (see box, page 29).

Of course, the set of small businesses is amazingly diverse, comprising around 8 million units. . .or maybe it’s more than 20 million units, if you include all of the home offices and freelancers, as does Lonier. Statistics in the small business market are notoriously squishy (see box, page 10). Once you get below, say, five employees, there’s disagreement on whom to count, and how. One person may own five S-corporations (for tax and other reasons); is that one business or five? Should you count the person who sells on eBay but doesn’t pay taxes? What about the kid who does Web design—formerly for the neighbors, and now for a worldwide market? (By the way, he lives in Romania, and his older brother buys on eBay.) The top of the pyramid is clear, but the bottom slides out into a mass market indistinguishable from “regular” consumers.

For our purposes we have segmented small businesses into four broad categories not by size or industry, but by where and what they sell and deliver.
GOODS that can be described in a catalogue and shipped to someone. Businesses selling goods who want to extend operations outside their home communities have benefited hugely from the example of Amazon and the trading platform provided by eBay. eBay’s 430,000 business users - about 5 percent of the 8 million small businesses counted by the Small Business Administration (SBA) – are in the vanguard. Yahoo! hosts 295,000 small-business websites. Both these companies are leaders in a fragmented marketplace. More recently, Overture and Google AdWords have enabled these companies – and also online service firms - to reach a huge market that was previously unreachable. And FedEx and UPS have enabled them to ship and manage inventories. We estimate that such businesses constitute about a quarter to a third of the number of small businesses counted by the SBA, but a smaller proportion of the broader, 20-million market. Many of these businesses start out in the local-services category (below) as physical retailers – but ones whose edge is sourcing goods rather than delivering them locally (i.e. vendors of fine pates or makers of fancy chocolates rather than local supermarkets).

ONLINE SERVICES that can be both described and delivered online – a small but fast-growing category. The businesses in this category include everything from accountants, travel agencies and tax preparation services to outsourcing of IT operations – and ironically, they increasingly supply their services to other small businesses. These companies tend to be the most technologically sophisticated of the small businesses since their activities are usually computerized, if not necessarily online. They tend to be big users of online promotion tools, including e-mail, websites and online advertising. One of the hottest such mostly-online services is “search engine optimization” – gaining fast with 3 million hits on Google, vs. 7 million for “Web design.” (It’s also worth noting that Google’s AdSense - allowing small businesses to host ads (sold by Google) on their own sites - has enabled some small online content providers that previously might have been unsustainable, to cover their costs or even make a profit.)

LOCAL, PHYSICAL SERVICES, the laggards in getting online, include everything from retailers, health clubs and restaurants, and performing services such as nursing, delivering pizza, cleaning teeth and cleaning or building houses. So far, online advertisers in this category tend to be youth-oriented services such as restaurants and movie houses selling through online entertainment listings, including both local services and others such as AOL’s nationwide Moviefone, which have local ad reps and telesales. But in general, local service firms tend not to be very computerized, let alone visible online. They don’t have much reason to be: No one would know where to look for them anyway. But that’s about to change, with Google and Yahoo! getting
serious about local search. This category is by far the largest, at two-thirds or more of the total, especially if you include the millions of unregistered businesses.

**FRANCHISE OPERATIONS** are typically small, local service businesses, but we don’t include them in our discussion. You could say that they have outsourced just about everything other than local operations, usually including branding, business processes, procurement…and online presence. Yet they compete in the small-business space. In past years, they have had the powerful competitive weapons of their franchisor’s market visibility; now, perhaps, the balance will shift in favor of the local players.

Note that until recently the vast majority were in category three – local services. The first category was called “mail-order,” and there was no such thing as “online services.” And of course some businesses are in more than one category; local service businesses often add an online component without abandoning their local presence.

**Getting to the heart of small business**

The story of small business online is hard to tell because its players are so diverse. Few small businesses actually identify themselves as small businesses, nor do they read the small-business magazines beloved of (and sponsored by) IT vendors. They subscribe to *Professional Heating and Plumbing Installer* or *Gator Dentist* magazine or *Progressive Grocer* or *Hotel and Motel Management*. (Like Dave Barry, I am not making these up!) But they probably don’t have time to read them. They are too busy working to spend the time to learn much about IT, and too small to take big risks.

Over the past few years, things have become better for them – and also for their competitors. The advent of all the wonders we describe below is giving small businesses new possibilities, but it is also eliminating the possibility of not changing.

Small businesses are run by individuals, notes Dan Bricklin, who recently left Interland, an online infrastructure provider to small businesses: “They see themselves as unique. They don’t want to pay you $100 to change a word [on a Web page]. They want to know they could do it themselves, but they would spend hundreds easily to make something look good if they thought it would bring in business. And they themselves are becoming online customers, so they’re beginning to understand the value of online presence.”

Small businesses demand respect. Because they know that as individuals they lack market power and can’t get the attention of a manufacturer’s sales force, they prefer
to work with resellers they know and can hold accountable. That argues against online sales among strangers, and for communities such as eBay or Tribe Networks. Reputation systems (see Release 1.0, October 2003) are important for small businesses, both as buyers and sellers, because they generally don’t have strong brands (other than franchisees).

By and large, small businesses buy IT on word-of-mouth, relying on peers and colleagues and family for advice. They can’t afford to buy Gartner surveys or to spend much time on research. Once a vendor sells to one clay-pot company or one soccer league, it’s easy to get to the rest. But unfortunately, these niches are small.

Finally, there’s a strong generation gap. Old-line jobbers and distributors of “hard lines” (hardware, industrial parts and the like) tend to be second-generation family businesses run by a 50-year-old male, while many of the newer online businesses skew younger, more female and above all, more tech-savvy. But there’s management succession within this base as well as a rising crowd of younger small-business owners, as about 10 percent of small businesses die and another 10 percent are born each year. (Many probably fail before they can even be counted.) This newer generation is much more comfortable buying and selling online.

In the Beginning: Small Business Starts Offline

Two suppliers have 80-plus market share in their small-business markets: Intuit and Microsoft. Yet both entered the market and gained their positions before the Internet was a big factor, and neither has been particularly forceful in helping small businesses to get online. That may change, but it’s a change that will be led by other vendors.
**Intuit: Quicker and quicker**

In the past, companies often got acquainted with IT by buying QuickBooks (or even Quicken), in order to keep their accounts. Just about everyone who sells to small businesses interfaces with QuickBooks in one way or another. Most notably, accountants and bookkeepers for small businesses have almost all standardized on Quicken and QuickBooks. “They just say, ‘Send me the QuickBooks files,’” says Lonier of Working Solo. “I haven’t seen my accountant [face-to-face] for years.”

Currently, QuickBooks has an 83 percent share of accounting software retail units sold and 90 percent of the dollars, according to a survey by NPD Techworld, and has about 2.5 million installations. Moreover, nearly a third of Quicken’s 16 million users use that product to manage their business finances in some way. In short, Intuit’s two products are the software other small-business software talks to. Although Intuit’s dominance makes life tough for competitors trying to sell accounting to small business, it makes life much easier for anyone trying to sell complementary software and services: There’s really only one standard to worry about.

Scott Cook and Tom Proulx founded Intuit in 1983 to sell Quicken, a consumer tool that was intended not to enrich the process of managing a household’s checkbooks and banking but simply to “quicken” it. The company launched QuickBooks as the business version of Quicken in 1992, after learning that nearly half of Quicken users were using it to run small businesses. “Bookkeepers in small businesses generally don’t like debits and credits any more than individuals do,” says Scott Cook.

In one month after its launch, he recalls, QuickBooks became the market leader, beating out the fuller-featured DAC Easy and Pacholi, even though it had fewer features and twice the price. “Yes, we had debits and credits,” Cook says, “but you couldn’t see them. We just let people fill in familiar forms, such as checks and invoices, and did all the accounting in the background.” Among the QuickBooks users it has won over the years was CommerceOne, which, he notes, was keeping its accounts in QuickBooks when it went public in 1999.

Over time, Intuit has extended its line to include QuickBooks Premier at $499 and Enterprise at $3500, in addition to the Basic and Pro versions priced between $200 and $300. There are also complementary products for payroll, point-of-sale and the like, and a program that helps small businesses to sign up for credit-card merchant accounts (so that they can accept payment by credit card). But Intuit’s success also blinded it to its evolving market. “We had a very simple attitude to third-party developers,” says Cook. “We told them to go away.”
But a little more than two years ago, everything changed. The market slowed and the company caught its breath, even as some of its customers were growing larger and demanding more specific functionality. In 2002, Intuit launched a new strategy (and attitude) called “Right for My Business,” on the premise that one size or shape does not fit all. “The role of developers became much clearer to us,” says Dan Levin, senior VP of the QuickBooks Group. “We knew we couldn’t solve for all the needs in each niche market. For example, while Intuit now has a QuickBooks product specifically for contractors, a landscaper still has different needs from a concrete-pouring contractor, even though both fall within the contractor segment.” Developers can add functionality at that “micro-vertical” level, while Intuit continues to focus on the “mega-vertical” segments. Scott Cook and Paul English (since-departed VP of technology for small business and personal finance) drove this strategy throughout Intuit. The company started talking to third-party developers, and discovered a whole new market and distribution channel. Now it has published APIs and a developer conference that attracted 460 people last December, and can refer customers to 300-plus third-party products (including some that connect to eBay) and to 27,000 fellow members of the Intuit Developers’ Network. But in fact, it’s more often the other way around: There are tens of thousands of developers and IT consultants who resell QuickBooks, often in conjunction with their own custom add-ons.

Intuit continued is foray into vertical markets with the 2002 purchase of Eclipse, a turnkey provider of business management software to the wholesale distribution industry founded in 1991. It has about 35,000 active users in market segments ranging from plumbing, HVAC, electric and building materials to industrial, janitorial and other durable goods supplies. It generates approximately $40 million in annual sales, according to industry sources. That same year Intuit also acquired business management software companies Management Reports, Inc., for commercial and residential property managers; OMware, for construction companies; American Fundware, for public sector organizations; and CBS Payroll, which provides a full-service outsourced payroll solution.

“Most of these verticals are served by dozens of small, under-capitalized, no-name companies,” Levin pointed out. “The combination of a good team that knows their industry with Intuit’s brand, access to capital, and strategic and operational rigor, will create industry-leading solutions and crowd out the smaller players.” But these vertical markets are notoriously hard to capture.
Microsoft: Well, its first name is micro!

Microsoft probably covers 90 percent of the small-business computer market, and that market accounts for more than $6 billion, or about 20 percent of the company’s $32-billion total revenues, says Steven Guggenheimer, worldwide VP for small business within the Small, Midmarket Solutions and Partners group. For Microsoft, with its international operations, the current market is about 40 million small businesses with fewer than 50 employees. Yet the company doesn’t have much specific visibility in this market, even though it stands to gain a lot from a new generation of small businesses going online.

Microsoft is just now beginning to “re-focus” on small business, says Guggenheimer. “Over the last five years, we’ve proved we’re an enterprise supplier. But our voice in small business is lower. We have to reinvigorate our voice” – since the company doesn’t deal with small-business customers directly. It has also retailed the products, arranging existing options in ways to meet small-business needs better.

“We’ve tried to simplify the message,” he says. “We need to have easy offers that small businesses can understand. Most of the time the owner/manager makes purchase decisions, and you can’t reach them with a sales force. In Microsoft’s case, you reach them through dealers, VARs and OEMs [which serve the small-business market]. So from our point of view, it’s all marketing – no sales.” Microsoft is also increasingly
looking at ISPs such as KPN in the Netherlands, and other suppliers who touch small businesses directly, as potential resellers.

To reach through those resellers, Microsoft has created a small-business version of Office. Office Small Business Edition has the core set of functions, including Word, Excel and PowerPoint. “But we took out Access and put in Publisher,” says Guggenheimer. “It’s more valuable for a small business. And we have a version of contact manager that lets you keep business contacts separate from personal.”

The small-business version of Windows Server includes Windows Server 2003 plus Exchange, and Windows Sharepoint services, and the premium version also includes SQL server and Internet Security and Acceleration Server. (However, making robust security a default rather than a scenario, as it is now, could be an easy win for the world as well as for Microsoft.)

“It’s not a user interface meant for an IT pro,” says Guggenheimer. “It’s scenario-oriented: We ask the user what they want – remote access, automated backup, shared calendar – and then there are standard configurations for those. Simple scenarios like online information-sharing with customers can really make a difference.” He cites one memorable example, W&E Baum of Freehold, NJ, a company that makes memorial plaques. It used to take orders by phone, and occasionally it would misspell a name on a memorial stone – an expensive, time-consuming mistake. Now the company takes orders online, and lets its clients spell the names for themselves.

Windows Server SB costs $700 to $1500. For $1000, you can get a “low-end version with hardware” – barely enough margin to encourage a dealer to provide support, but cheap enough to encourage a business to upgrade from a desktop.

Microsoft has also redesigned its small-business portal, bCentral, and related services. While the portal continues to expand to cover the topics small businesses care about and leverage the breadth and depth of the Microsoft website, the bCentral services have also expanded, adding Web hosting, list-building, search engine optimization and other tasks. “We’re making it a lot easier for small businesses to offer their services online, no matter what business they’re in,” says Guggenheimer.
As for accounting, Microsoft acknowledges Intuit as the leader in the US, though not globally. Its own accounting solutions, says Guggenheimer, are targeted higher up. As Intuit has illustrated so well, it makes more sense to sell small business owners new versions of the tools they use at home, than to repurpose and try to dumb down an enterprise solution.

**Infrastructure: Small Business Gets Online**

Despite the 7 to 8 million Quicken/QuickBooks business users, many small companies’ first experience with computers now starts with an Internet connection rather than accounting. But unlike the market for accounting, which converged on a single vendor, the market for online infrastructure services is extremely fragmented, and the range of services broad. Going online generally starts with an e-mail account – which may not even be paid if you get it from Yahoo! or Microsoft’s Hotmail.

Only 2 to 3 million small businesses in the US currently have a website, though that number is growing rapidly. But online businesses that survive at all typically grow up to buy services such as domain name registration and paid e-mail, and perhaps some Web design templates or other IT help. In the future, they may also host blogs, solicit customer feedback through forms and surveys, and run outbound e-mail marketing campaigns.

This market is just beginning, but it is likely to grow rapidly in the next couple of years. Companies such as Tucows, below, helped bring the vanguard of small businesses online through network of local providers. Now a second wave of online businesses, lured more by consumer-style advertising than by local dealers, is being helped online by companies such as Yahoo! and eBay. That trend is well underway.

The next phase will be the mass entry of local businesses into online marketing and presence. Yahoo!’s and Google’s new and improving capabilities in local search and marketing, with the two companies striving to best each other month by month, should attract both small merchants and consumers. The only loser will be classifieds and print listings: Already, almost 7 percent of the 16.2 billion yellow-pages style look-ups is performed online, according to Larry Small, director of research at the Yellow Pages Integrated Media Association. But the print yellow pages still get 98 percent of the revenues. Those revenues may drop slightly as merchants start to pay (only) for performance, but the total going to online media is likely to jump sharply.
Over time, as it’s worthwhile for both sides, local merchants are likely to start posting realtime information about everything from inventories in stock to sales, promotions and other events: “Come in this week to sample Juan’s quesadillas!”

**Tucows: Horizontal domain expertise**

Tucows is one of the largest suppliers of domain names, digital certificates and related services to small businesses through a network of about 6000 ISPs and Web-hosting companies, who in turn serve millions of small businesses. (It serves a few companies directly, including EDventure; it hosts Esther Dyson’s blog.) It also runs a software downloading service with about 30,000 shareware, freeware and trialware titles. It’s a wholesaler and exemplifies many of the issues around the small-business market – both as a vendor to it and as a small business itself.

Tucows is also a model of how small businesses used to get online, through a network of trusted, local providers who could make things work onsite. And it’s probably a model of the kind of services companies will graduate to once they have gotten started with mass-market providers such as Yahoo!. Tucows sells through service providers, themselves small, who act as retailers. Notes CEO and founder Elliot Noss, “With domain names, end-users are touching three suppliers at the same time: the registry that holds their name; us, the registrar who registers the name; and the resellers, who set the terms of service and prices and manage the payments. Each supplier maintains different data elements. Supply chains are about data, now, not just geography and logistics. This is a large-scale working example of what Web services are supposed to be.”

Tucows resellers, for their part, are generally either “vertical” by industry, or geographically specific. Some of them specialize in fields such as Internet services for real estate or for travel agents; they charge much higher retail prices than, say, GoDaddy, which is a horizontal competitor for Tucows and its resellers.

“Your job is to make your customers not feel stupid,” says Noss. “If you think your job is just to run a mail server, you’ll fail.” Overall, Noss is high on the potential of his business. “Look at a simple WiFi network. Setting up an access point and putting cards in desktops is a complete black art, yet it’s very simple for anyone who knows how. A restaurant, for example, would happily pay $500 for someone to buy an access card and set them up. The provider could do it in 60 minutes, with a nice
profit – but it’s not worth the restaurant’s time to learn how. That’s an example where geography is key: You can just walk up and down a mall or a street and knock on all the doors. Or you can go visit the landlord.”

And as a small business, Tucows also benefits from Google’s AdSense. “We generate incremental revenue from the most remote nooks and crannies on our website. Google has increased the yield of our most difficult-to-sell Web pages by five to eight times; it’s incredibly well targeted. Each time we do something like this, it exceeds our expectations. It’s like magic, something from nothing.”

Noss has run Tucows for the last seven years, although the Tucows website was originally launched in 1994. It is celebrating its tenth anniversary this year. One of its early successes was in providing all the initial downloads for ICQ. ICQ founder Yossi Vardi put together an investor group that bought the company from its previous owners in 1999; the company went public in 2001 through a reverse merger. The company launched wholesale domain registration services in 2000, when ICANN brought competition to domain names. It now also offers digital certificates, e-mail, spam-filtering and blogging tools with more services on the way. And this month it announced the $4-million acquisition of Boardtown, a Starkville, MS-based online wholesaler of billing and subscriber-management software to about 700 customers in the US and 40 other countries; those customers are mostly ISPs and wireless providers, with some overlap in Tucows’ reseller base.

**Yahoo!: Overture wags small-business dog**

Yahoo! is the leader in the new small-business services market. For a consumer just getting started with business online, the friendly small-business pages of this familiar portal provides a natural place to start.

Yahoo! started consolidating its variety of properties and offerings into a discrete, coherent small-business offering in 2002 (shortly after Terry Semel’s arrival). “It’s truly night and day from two years ago,” says Richard Riley, VP & general manager of Yahoo! Small Business. Now they are all offered through a single page on the Yahoo! portal dedicated to small business with a simple set of pitches: “Get a domain, Build a Website, Market online, Open an online store.” For customers, this leads to a single dashboard where the user can check the health of all these functions at a glance.

The base of Yahoo!’s small-business services is its hosting business; it is the leader in this $3-billion (and growing) market, with analysts estimating its customer count at
300,000. Its service, which starts at $11.95 per month, includes everything a small business needs to get online: domain name, business e-mail, website hosting and the SiteBuilder tool.

Yahoo’s small-business efforts grew out of and now comprise a variety of mostly acquired services, including Geocities, Viaweb (a more business-oriented website hosting service), SimpleNet for domain names, co-branded online access from SBC, and the like. Riley himself joined Yahoo! back in 1999, when it acquired his small business Log-Me-On.com and its product, the early iteration of Yahoo!’s persistent Companion toolbar.

Other than broadband access, most of the other services are Yahoo!-owned and operated. The most recent addition to the array is Overture (founded as GoTo.com by Idealab in 1997), which it acquired last October and which is already being lauded for its significant contribution to Yahoo!’s earnings. So far, Overture has more than 100,000 clients, many of them bigger firms, but it is attracting an increasing number of smaller firms.

 Shortly after the acquisition, Yahoo!’s existing small-business services were placed under Overture’s management, still based in Pasadena, CA. The company now has three major revenue-generating units, Overture (which includes search advertising and small-business services), headed by former Overture CEO Ted Meisel; its traditional direct-sales oriented business group, headed by Wenda Millard; and consumer services, headed by Jim Brock.

However, some parts of the Yahoo! offering for small business remain unconsolidated. Yahoo! has a substantial local-directory business; listings in that are separate from listings in the main directory (although small businesses can purchase them through the Small Business pages). Its HotJobs subsidiary is also linked to but operated separately; that service too has benefited from Yahoo!’s strength in small-business advertisers, and has held revenues steady at a time when Monster.com (for one) showed a drop in revenues. “We’re a stable company in an unstable business,” says Riley.

*Yahoo! local - local, but a moving target*

Yahoo!’s local offerings are strong and growing, though sales of advertising on those properties have not shown the explosive growth of Overture. According to Nielsen NetRatings, Yahoo! is the number-one destination for people looking for local...
information (maps, yellow pages and city guides), reaching 19 million unique users last February.

Indeed, Yahoo! is a powerful force on the directory side that is its heritage; its entire range of local properties includes Yahoo! Yellow Pages, Maps, Real Estate, CityGuides (entertainment, events, dining, spas and the like) and Classifieds. But under Paul Levine, general manager of Yahoo! local services and formerly with e-Trade, its local services are getting better at searching the Web and integrating local directory search results within Yahoo! search. However, there is still a profusion of different places to look, both for the advertiser and for the consumer in search of something. The seams are still showing.

Yahoo!’s most recent local offering, SmartView, is a case in point. It’s not unique: Travel sites have been doing this for a while with hotels, for example. It displays a variety of different items on a map: You can find spas, Greek restaurants, post offices (but not FedEx), ATMs or movie houses for your preferred Zip Code or near a street address. But in addition, SmartView links each icon to data; click on any item for relevant details. Its limited array of properties and categories betrays Yahoo!’s directory heritage, but we were delighted to see such location-specific picks as New York City subway stations.

For now, Overture does not yet offer local targeting for paid search results, other than matching a “local” search term; in part, that’s because it distributes ads to other sites and can’t check users’ IP addresses the way Google can when users visit the Google site. However, Overture promises it will have local targeting within a few months. And, because of Yahoo!’s particular strengths in directory and hosting, Overture “local” advertisers won’t even need to have their own website; users who see a listing will be able to click into a page of information supplied by the advertiser and hosted by Yahoo!.

**America Online: You’ve got business?**
AOL also offers a variety of services for small business and an existing consumer market presence, but it hasn’t made the same push into small business as Yahoo! – although it certainly attracts a similar audience of consumers who could turn into producers (or at least merchants). For now, it seems to see small businesses as a (paying) audience of potential leads for marketing partners rather than as active users of services. Most of its own small-business offerings are content rather than services. In addition, it links to partners for everything from broadband (a variety of telcos),
website building and hosting (from Affinity) to e-mail marketing (Constant Contact) and domain-name registration. Small businesses can make use of AOL’s aggregation of their purchasing power: “So long as there are aggregators of small businesses, it’s a good place for marketers to go to find them,” says Sarah Bernard, VP & general manager of AOL for Small Business. “If AOL can come in and negotiate 5 percent off this and that, it’s a win all around.” Some big vendors that have offered discounts and other bennies to AOL’s small-business customers include FedEx (5 percent off shipping costs), Gateway and Dell (for printers and various upgrades) and Monster.com (a free job posting).

The company has more than a million such customers, most of them local, physical businesses, says Bernard. A recent sample broke down as 54 percent selling to local customers only, 18 percent regional, 23 national and the rest don’t-know. On a different spectrum, 33 percent said they sell through a website, 14 percent place online ads on other sites, 11 percent advertise in online yellow pages, 11 percent in an online marketplace, while 54 percent said they do not sell or market online at all.

However, though AOL provides a variety of services to small businesses, its own advertising services still have a big-company mentality, based on the large and visible marketing deals of three to four years ago. It is now unwinding many of those and sees a good opportunity in serving smaller advertisers. “There’s a lot of opportunity in local,” says Jim Riesenbach, VP of search and directional media. “We have a whole variety of models. We can offer targeting within a radius of 10 to 15 miles.”

On the geography side, AOL has AOL Cityguide (formerly Digital City) and Moviefone, as well as MapQuest, which integrates well with a variety of offerings and has some good geographical analytics under the covers. It also has data on 13 million businesses from InfoUSA, events from Eventsource, and its own editorial additions. “Local search is not just Yellow Pages and the other listings AOL has assembled,” says Riesenbach, who previously worked at Digital City and has been working in local advertising for eight years. “People come to AOL for weather, news and driving directions,” and then AOL can serve them geographically targeted ads. . . all in line with its recent efforts to better integrate its variety of offerings (see RELEASE 1.0, MARCH 2004). Note that many of the search results are just that, search results powered by Google but also including these other, more formatted data sources; they provide a context around which AOL can sell ads.

Nonetheless, Riesenbach says, “We think it’s going to be driven initially by national advertisers that have local presence and see increased conversion by local targeting.
Right now you see Gap or Target or Wal-Mart – they are selling online and also trying to generate foot traffic. Our focus is to go after the big guys. We have a self-serve capability, but it’s relatively limited for now."

**Small Business Stays Local - Online**

As noted, businesses who provide services to local customers are the last group to go online. They couldn’t easily expand beyond their current markets even if they could reach them, because they supply their services in person. Obviously, any business could grow, but these businesses find it tougher to benefit from the Internet-based economies of scale and reach that sellers of goods and of online services can enjoy.

Currently, local businesses spend a substantial amount of money on various kinds of advertising. Although the share of local vs. national is unclear, they probably control a fair amount of the total spent on direct mail ($48 billion), radio ($20 billion) and cable TV ($16 billion), and a majority of spending on newspaper classifieds ($15 billion) and yellow pages ($14 billion). (These totals are from Morgan Stanley, culled from a variety of sources.) Additionally, local businesses probably did a fair amount of telesales, an $83-billion market in 2003 that will shrink dramatically as more and more people put themselves on the Do-Not-Call list. Whatever local businesses’ current share of these media and how much will shift, we believe that the kind of supply Google and its competitors are creating will generate strong new demand for advertising online, about a $7-billion market in total last year.

Right now, consumers are just getting into the habit of looking for local things online. But when they do, they first need to search for the right place to look – city guide, classifieds, travel site, LocalCourierOnline.com. Ironically, local media are fragmenting even as national media are consolidating (viz. the recent acquisition of EDventure by CNET Networks ;). There are local search services. . .in fact, there may be too many of them. That’s why Google’s aggressive entry, with its ability to be local everywhere and its automated advertising sales model, is so interesting.

**Google: Now with locale inside**

Google became the leader in search with a single-minded dedication to simplicity and a devotion to algorithms. It eschewed content, and aside from software development almost everything it did was automated.
But Google was quick to follow Overture’s lead in sponsored search and improve on it – or at least provide a variation that some people preferred. AdWords (as is well-known by now) clearly identifies its ads as sponsored links, and it has a pricing algorithm (of course!) that ranks, prices and sequences ads in part according to their click-through rate. (The impact is that popular ads, rather than expensive ones, show up higher in the list. In essence, it means that advertisers can’t easily pay to be first on the list. It also encourages advertisers to improve their ads. By contrast, Overture relies more on human editors; it has about 100 of them. That slows down the process of placing ads, acknowledges Overture, but it improves quality.)

Google has also overcome its earlier distaste for content, starting with Froogle (the shopping service, which accepts data feeds from online merchants). Its new local service goes even further, using data licensed from a variety of yellow pages.

**Granular geography**

Google Local has been around in early-beta form for a while, but it was awkward and unreliable, though improving over time. Now Google has dramatically improved its geographical search and advertising capabilities, with extensive new features that a more overtly commercial company might call a breakthrough.

There are two sides to Google’s local initiatives. Google Local serves both the consumer with a new set of usefully formatted results pages, and the advertiser with the ability to target locations with great precision. It’s interesting to gauge the resources that went into this new service, which include nationwide deals with undisclosed “Yellow Pages-like” data sources for the structured data behind most of the searches.

On the user side, the system initially captures what you might call a “location intention” when the user types in a query that includes a location – for example, “Palo Alto hotel.” The results page starts with three “local results,” hotels near Palo Alto (indicated by what looks like a squashed bug but is actually a “compass intention”). These are not traditional Web search results, which begin with Starwood Hotels in this case, but they are not ads. Rather, they are “local” search results derived by a different set of algorithms that crawl two sources of data. One new algorithm set extracts information that matches both the search term and the geographic term; another executes a search/crawl over a set of structured and licensed databases with data on all [registered] US businesses. Says Sukhinder Singh, general manager of local search: “Our database from the structured providers is almost 13 million [small businesses and other organizations]. We also look at a few million more businesses we could find only online.”
On the right are “standard” AdWords ads. But if you click on the “local results” link, you go to a new page that contains more extensive, formatted local results listing hotels and addresses (as well as the top Web link or page about each business), ordered not by Google’s traditional relevance rankings, but by other algorithms that include distance and the like. If you click on either the hotel name or a link entitled “more related pages,” you get an algorithmically constructed page showing the hotel (or whatever) on a MapQuest map, along with name, address, phone number and driving directions, plus the full list of related Web pages that mention the establishment – potentially including reviews or lawsuits. You can also see a map showing the locations of all the results; it includes a much greater variety of establishments than Yahoo! – although not all of them may be relevant. All this is part of Google’s basic (but extended) service; the results, even though Google pays license fees for some of the data, are free both to the user and to whatever site the user may click on.

Of course, the assumption is that this will drive consumer traffic and lure more local businesses onto the Web, providing more data for Google to search and of course more paid advertising.

...for the advertiser

The search results described above are generated when the user types in some kind of geographical reference. Google also offers geo-targeted advertising (but does not alter the search results) based on the user’s IP address. The company asserts that its testing shows it can produce remarkably accurate results based on this method.

But Google has now refined its geographic targeting for advertising. When an advertiser buys an AdWord, it can specify geography, not just by region as it can now, but by a radius around a specific address or by specific geographic boundaries. (Google links to a couple of services that can help advertisers specify the precise polygon they want to cover by latitude and longitude. That’s far more precise than any other mass-market service...and perhaps more precise than most advertisers might want, but it’s an interesting technical feat.)

The first, more immediate implication is to make AdWords much more targetable, in essence dividing them up in a way that maximizes their value both to local advertisers and to Google – and of course to hungry, weary or otherwise locally-needy consumers. Google’s click-rate-dependent pricing model makes online advertising
affordable – and effective – in a way it wasn’t before for local advertisers. But we expect Yahoo!/Overture will soon offer locally targeted search ads, too.

Google Local isn’t going to unleash an immediate flood of newbies onto the Net, but over time it will make being online more and more lucrative for small, local businesses. And it will make not being online more and more disadvantageous. (There was a time when having a telephone distinguished a business from its competition. For now, it’s having a Net presence...)

Google’s experience so far with AdWords, and its ability to automate the advertising process for small businesses, portend a sea change in the accessibility of the Net to local advertisers. Obviously, businesses catering to young customers and run by young, tech-savvy owners will be the first to show up in force. Pizza, anyone? Or a café latte?

More metadata
But there’s more. Consider Google’s AdWords system a subtle mechanism for metadata collection.

Indeed, just as Google is quietly collecting huge amounts of e-mail through its Gmail service, it’s also beginning to collect metadata about businesses. Right now, it is simply adding geotargeting, but it could easily add other kinds of metadata. And there’s no reason it couldn’t start using increasingly complex data for formatted display as well, as it already does in Froogle.

For better or worse, Google has the market power to make such a collection interesting and to foster some standardization of metadata if it so chooses. To start, it is building an interesting database; someday, perhaps it could offer an open API. Some companies could send formal data feeds, while smaller businesses might fill in more complex data when they advertise. Then hotels could compete on the basis of, say, their swimming-pool hours.

Beyond that, most “e-commerce” searches today are for products or for the establishments that sell them. But unless you’re ordering online, those two searches are generally separate. As Google’s director of product management Salar Kamangar says, “There are few listings for what’s on sale at an individual local store. There was no point. But soon, it could make sense for a store to make [limited] access to its inventories available online, so that people could know exactly where to buy things.” And,
Even though Google can find reviews and other material about local companies, it still lacks the kind of community feel that means a lot to small businesses and their customers. Two companies are trying to make headway here: Insider Pages, an alpha-stage start-up funded by Idealab (the outfit that gave the world Overture), and Tribe Networks, which we covered last November as a social networking platform.

**Insider Pages: Local communities**

“I stupidly got my hair cut at SuperCuts and was really thrilled to share the information of how unhappy I was!”

So says Stuart MacFarlane, founder and early, thrilled user of InsiderPages.

Basically, it’s a local reputation system where users are encouraged to rate local businesses and share those ratings with friends. That content, so the business plan assumes, will draw traffic that attracts local advertisers. MacFarlane says, “It connects people together to share information. Prospective members understand the value of finding an electrician or caterer or beauty salon or bathroom-remodeler through friends. A referral, especially from someone you know, is the most important driver in choosing a service provider, and it’s something you can’t get through the Yellow Pages.”

To reduce the need for people to type in a lot of information themselves, it will start with firm data from Yellow-Pages style directories, and to reduce the need for them to name their friends, it will form partnerships with organizations such as mothers’ groups, PTAs and other neighborhood associations. In fact, says MacFarlane, early testing (no doubt reflecting early targeting) shows that the users skew female and older than your typical online social networker.

The goal is to attract advertisers, who will not be allowed to change or eliminate their rankings. (Presumably, it will be mostly the favored businesses who will advertise.) “We’ll be leveraging the local business’s relationship with our members to show value of advertising. I know this sounds a little cryptic, but it’s part of a proprietary strategy to create a trusted relationship with the advertiser,” says MacFarlane, who previously ran MXG Media, a retail/entertainment company, backed by USA Interactive. His team also includes two former employees from Citysearch.

**Tribe Networks: Classified connections**

Meanwhile, Tribe Networks, led by founder Mark Pincus, continues to grow as a kind of social network-cum-classified ads community. (See Release 1.0, December 2003.) Members can join tribes, link to friends, and provide or solicit recommendations for local businesses and services. Many of its members are local entrepreneurs and small business owners, though some work for larger companies.

While Insider Pages hopes to team up with various community organizations, Tribe Networks’ main edge is its relationships with Knight-Ridder and the Washington Post Company, who are lenders and investors. It is now trying to gain critical mass in a few key markets, starting with (of course) the Bay Area, where it is now up to about 145,000 registered members, of whom many are small businesses or freelancers.

of course, someone – say, Google – could sell anonymized data about those queries to merchants who wanted to stay in stock or pre-order based on what looks hot.

The best analogy, perhaps, is to Wal-Mart’s efforts to get its suppliers to use RFID, faltering though they are. In the long run, suppliers will adopt Wal-Mart’s standards, and other customers will likely start to use those standards too.
E-mail Marketing: Small Business Reaches Out

Kelsey Group estimates that 10 percent of small businesses, or about 800,000, participate in e-mail marketing at some level, while 30 percent (more than 2 million) are collecting e-mail addresses - and presumably have some plans for them.

Interestingly, in a world where the ability of companies such as Google to offer automated advertising services will be driving growth, effective e-mail marketing campaigns require something of a human touch and oversight. “As soon as it’s self-serve, someone can go and do some damage,” says Eric Melka, CEO of GotMarketing, an e-mail marketing services provider to more than 100,000 clients. (DISCLOSURE: ESTHER DYSON IS AN INVESTOR.)

For starters, e-mail is more intrusive than just ads, so it needs to appear to be welcome (whatever that may mean in any particular case). And unlike listings or search-related ads, they contain more information and need more personalization. Also, in the new legal and cultural environment created by spam and legislation (intended if inadequate) to stop it, leads, customer names and related records need to be managed carefully.

Outsourcing is key in this market, because most little guys will get shut down for spamming if they try to do it themselves. Online marketers such as GotMarketing and Constant Contact are a key intermediary, both teaching their clients how to behave online and also vouching for their good behavior to the ISPs and interceding so that their clients’ messages do not get blocked. (Spammers are a different market, though they often recruit home workers to do their work...and fragment it so as to escape the controls of the ISPs.)

Margaret Olson, CTO of Constant Contact, another such company with 150,000 clients over the years, says, “Small service businesses are coming online, following the lead of the product marketers. They’re getting solicited by mail themselves, and they see how easy it is to respond.” Constant Contact is AOL’s partner for e-mail marketing.

She notes that in the last year she has seen a shift among her clients from outbound prospecting to customer service: “They see the Net as a tool for retaining customers, to keep them and keep them buying. Small-business owners are viewing the Net practically. They don’t have dreams of being huge and global, but just to service existing customers and be more profitable.”
But the key, says Olson, is the underlying technology and automation: “We have better relationships with ISPs because we have a better feedback loop that lets us find out what our customers are doing without excessive cost. We can’t talk to every one of them because there are so many. The vast majority of people show up on our problem dashboard before they get into any real trouble. Ninety-nine percent of the time, it’s some kind of innocent mistake: They didn’t understand where a certain portion of their list had actually come from, or they mailed the same people three times in one day because they corrected misspellings. We tell them not to do that again and then life goes on! Education is a huge, huge piece of what we do. We give them information every step of the way. We have one customer who told a reporter, ‘They won’t let me do anything wrong!’”

GotMarketing, which is more oriented to marketing than technology, is focusing where it sees the growth, on marketing partnerships with Yahoo!, Microsoft and Salesforce.com, who together account for the majority of its revenues.

Trading: Small Business Buys and Sells

Despite the best efforts of BigStep, Geocities, the big exchanges and the like, with their business-focused pitches, eBay remains the platform of choice in small-business marketplaces. Among other things, it focused early on fostering trust through its reputation system and other mechanisms. Also, it did not pitch its members on the virtues of having their own websites: It focused on their immediate interest – selling or buying something. All the other stuff could come later...and in most cases, it did.

eBay: One platform; many markets

Jordan Glazier, general manager of eBay Business, joined eBay four years ago from GATX (where he was VP of its distribution centers) to build up its computers and networking business, which has grown from $100 million to roughly $1 billion over that period. Now he’s in charge of all of eBay’s initiatives directed at business. The company has an official estimate that 430,000 entrepreneurs and small businesses are selling on eBay, as a primary or secondary source of income, vs. about 150,000 the last time the company released a number in 2002. That approaches 5 percent of US small businesses, or perhaps 20 percent of those that are online. (As mentioned, these numbers are very squishy.)
Most of these entities are individuals or hobbyists; some of them eventually turn to selling on eBay fulltime. “It typically starts in the home and then moves out when the spouse gets upset with the clutter or needs the garage back,” quips Glazier. “Then they hire employees and deal with all the challenges of being a small business.”

Other eBay sellers are existing small businesses that use eBay to expand into new markets, often geographically. Glazier cites a second-generation restaurant equipment dealer in Atlanta who is now selling not just outside Georgia but also outside the US. A metalworking equipment dealer is now selling worldwide (see box, page 30). “Originally, such companies were constrained by the size of their parking lot or their ad budget or the local market,” he says. “Now they can sell anywhere.” He points out that shipping costs are usually minor for much expensive equipment; the majority of the cost is often packing and loading and unloading, independent of the distance shipped.

Over time, eBay has started various programs to help these amateurs-turned-pros as well as the experienced businesses. The programs include a co-op ad program that subsidizes their marketing efforts in print media. It also offers Seller Central, a mini-site with educational content from third parties such as the Small Business Administration and Entrepreneur magazine, online discussions and the like. It hosts (on a pay-your-own-way basis) seller summits, bringing its members together to share best practices. These tend to be events with 30 to 50 sellers gathering at a vertical trade show, but eBay’s last big conference, eBay Live, attracted 10,000 people to Orlando last June. (The next one is New Orleans, June 24 to 26.) In addition, eBay has used its members’ aggregated market power to bring in suppliers such as Direct Capital for lease financing of members’ sales and purchases.

Other examples of cooperation include a partnership with the American Machine Tool Dealers’ Association, which is rolling out a certified inspection program; its dealers will run inspections for items sold on eBay. Thus eBay is now increasingly a platform for services as well as for products, and becoming its own open ecosystem. (see release 1.0, december 2002.) Monster is offering hiring services and job postings through ads on eBay, attempting to reach its fast-growing members as they add new workers. A handful of software providers build programs through APIs that helps sellers sell into specific niches. Testmart is establishing specs by which sellers and buyers can specify test & measurement equipment.
And finally, there’s Paypal, which eBay acquired in October 2002. It supported $3.7 billion in gross merchandise sales last year, out of eBay’s $24 billion total, enabling transactions for merchants who could not get (or would not want to pay the fees for) credit-card merchant accounts.

In the other direction, increasing numbers of businesses large and small are using eBay as a procurement platform – not as a software tool, but as a market where they can find things. “That’s growing rapidly too,” says Glazier. In 2003, businesses bought $2 billion worth of general merchandise on eBay (up from $1 billion in 2002) – everything from networking and office equipment and PCs, to phones and peripherals. The proportion of used equipment rises with value, he adds, while smaller, disposable items tend to be bought and sold new. In addition he says, “Lots of merchants are coming to eBay to source inventory, to sell physically or through eBay.”

The tipping platform
The presence of all these players on eBay is significant enough to affect pricing of goods overall, though the effects are lumpy. That is, eBay is key in certain markets, many of them serendipitous accidents of history, such as metalworking machinery and restaurant equipment (need a 16-slot toaster?), test and measurement equipment, some segments of medical equipment, dental equipment, ophthalmology and radiology, vending machines, tractors, airplane parts, as well as broader markets such as PCs and networking equipment. (In others, eBay has made no real mark.)
Those untouched, inefficient markets include large-scale manufacturing where parts are often made to order within complex supply chains with few standards.

Many eBay markets follow a similar pattern, Glazier says. “Small businesses are accustomed to buying used equipment, but it was hard to find. Now, those markets are much more fluid. The savings are large for small companies. If you save $5000 on a dump truck, it’s a family vacation or a college tuition for your kid.”

He adds: “One of our members in metalworking equipment was posting all his items with an opening price of $1 with no reserve. All this stuff sells for $15,000 or $20,000, so I asked him what he was doing. He told me, ‘Your marketplace is so liquid that I don’t have to worry. I know I’ll get a fair price.’ These used to be very inefficient markets, but now you can find a selection of a couple hundred used 40-quart mixers on any given day.”

Moreover, the effect ripples through a market from used equipment to new. Because used equipment can be sold on eBay, the market for new items turns faster. Says Glazier: “Imagine an environment where there was no market for your used car; you just filled up your back yard with them. You’d try not to buy a new car. That’s what it was like in most of these markets. I have been to testing labs where they had closets full of old equipment: They were using old oscilloscopes as foot rests, and planks laid over stacks of spectrum analyzers as tables. I can’t quite point to it yet, but I think we’re going to see faster turns for folks upgrading their assets or turning idle assets into cash they can use.”

But he can point to one harbinger of such things: eBay has a new relationship with Agilent (the HP spinoff) which previously had eschewed the used equipment mar-
ket. Now, Agilent sells services and warranties for used Agilent products traded through eBay. Clearly, the company feels that practice enhances the marketability and value of its new products. Stay tuned. (Although in the long run, as markets get even more efficient, prices are likely to fall as used equipment becomes easier to find.)

Another macro trend, Glazier adds, is that secondary and tertiary brands find it easier to get distribution for their products, adding to competition for the major brands. “When I go to trade shows, a good number of the booths are from little-known vendors who are not looking for buyers but for distributors. A lot of those distributors are turning to eBay as well.“

And finally, a trickle of people are selling into US, but a lot of used stuff is sold from the US to customers abroad. That both keeps up prices in the US, and spreads the benefits of US markets to the rest of the world. What could be better than that?

And all this is based on a few billion dollars of sales, a tiny fraction of the US economy. But it’s the part where patterns are formed, of marginal prices and incremental costs. It’s the leading edge where inefficiencies previously were rampant. . . .

**EBay and third parties**

EBay has also recognized its role as a development platform, and has had an active developers’ program since 2002 – egged on in part by Tim O’Reilly, the open source and open-API proselytizer who will be speaking (along with founder Pierre Omidyar) at eBay’s developer conference this June in New Orleans.

The program now supports about 5000 developers, in three programs ranging from $500 to $5000 annually, depending on the level of support and other benefits. Developers get an SDK (Software Development Kit with use of the eBay APIs) and complementary access to an online site called Developer Zone; they also get access to the Sandbox, a test environment, and Member Forums, eBay’s developer community. And of course they can also use the eBay platform to reach their customers: They get listed in an eBay solutions directory, and eBay works with them to certify their applications, connect them to other third-party developers, and enable them to connect to eBay’s millions of buyers and sellers.
Coming full circle, eBay recognizes a natural affinity with Intuit: “About 40 percent of our business customers use QuickBooks,” estimates Randy Ching, eBay’s VP of platform solutions. “Most of the rest use paper and pencil or Post-It notes.” The two companies’ developer programs have good ties: Intuit’s SDK for QuickBooks developers includes a sample eBay application that illustrates how to extract pricing data from eBay; another one extracts inventory from QuickBooks in a format usable for listing on eBay. “Intuit just did this in January,” says Ching, “but I’m getting a sense developers are looking at following these models heavily.” Another partner is, amazingly, SAP, which will be including eBay as a module in its enterprise software suite; the module treats eBay as a sales channel, in the same category as, say, wholesale distributors or resellers.

EBay has also announced a partnership with Microsoft, using Office’s XML tools and Web services components. Bill Gates demoed an application linking Office and eBay at the Office launch last February. “That stirred the imagination of developers!” says Greg Isaacs, senior manager of platform and partner programs, who works closely with eBay’s 100-odd category managers. But most of eBay’s third-party developers are a lot smaller than Microsoft and SAP, and see room for all kinds of specific functionality.

Coda: If Small Businesses Are So Terrific, Why Did You Sell EDventure?

That’s a fair question. As we have described here, small businesses are about to gain powers and power they couldn’t hope for before. While it will take a long time for the trend to play out across the economy, businesses that make the effort to take advantage of the capabilities outlined here can lead the pack. Anyone can write a blog, buy a specific clickstream, and, without advance coordination, join forces with other small businesses to bring the forces of supply and demand to bear on large suppliers such as airlines and paper-clip vendors. Small businesses can be found online in their own communities without paying to reach people outside those communities; specific, local supply can meet specific, local demand.

Indeed, I loved having my own small business; it gave me great freedom and a wonderful platform for my activities and insights. Moreover, I had a longtime business partner and co-owner, Daphne Kis, who did all the work and kept things running smoothly. However, like many small businesses we were resource-constrained – not so much for funds, but for the resources to create an institution. So instead we
joined an institution – one that we hope will support us and leverage the insights and analysis we produce.

This issue of Release 1.0 is an excellent example. I’m proud of it; I think it’s a solid piece of analysis and leading-edge insight into an area that has been mostly unexplored and about which there are few figures.

But it’s “Release 1.0” – the first look at technology that matters. We’d like to be able to follow up with Release 1.1 or Release 1.2. Three or six months later, we’d like to ask: What has happened since? Did AOL follow Yahoo!’s lead? How are the marketplace clusters we noticed evolving? Have eBay’s numbers continued to grow? At what point will prices for used goods stop rising and start falling as markets become truly efficient? Will economists’ figures and studies – over time – bear out the trends we discern? We didn’t have the resources to follow up properly, because I was always chasing after the next Release 1.0, rather than following up on the previous one.

With CNET Networks, we hope to do that, turning Release 1.0 into a more persistent, interactive product. We’ll have the opportunity to flesh it out with audio and video interviews, more data and updates, and perhaps edited feedback from readers.

In many ways, of course, little will change. I’ll be writing some issues and editing others in the years ahead. And PC Forum will stay much the same – except for the kind of changes it has always made to reflect the dynamic market it embodies.

But we hope to reach a broader audience and to stay in closer touch with you . . . because in the end some things can’t be automated. Little businesses benefit from that, because they can stay close to their customers. We hope to stay close to you – and to the wonderful industry we cover – with a team of capable, insightful journalists and analysts that will grow over time.
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For further reading:
Main Street in the Digital Age, How Small and Medium-sized Businesses are Using the Tools of the New Economy,
U.S. Department of Commerce, Economics and Statistics Administration, February 2002,
Yahoo! Small Business portal: http://smallbusiness.yahoo.com
Calendar of High-Tech Events

MAY 9-14  **NetWorld + Interop** - Las Vegas, NV. Network with the networking community. For more information, call (888) 886-4057; fax, (650)372-7000. www.interop.com

MAY 10-11  **Location Technology & Business Intelligence Symposium** - Philadelphia, PA. How can you improve your business using location data and GIS? Come find out from the experts. Organized by the Wharton School and Directions Magazine. Register online or e-mail info@locationintelligence.net. www.locationintelligence.net

MAY 16-18  **AeA Micro Cap Financial Conference** - Monterey, CA. The American Electronics Association sponsors an opportunity for public technology companies to showcase themselves to the investment community. To register, contact Tina Morais, 1 (408) 987-4234; fax, 1 (408) 727-7057; tina_morais@aeanet.org. www.aeanet.org/microcap

MAY 16-18  **SIIA Education Technology Industry Summit** - San Francisco, CA. Learn all there is to know about how to use technology in education. For more information or to register, visit the website or contact James Kim, 1 (202) 289-7442 x1362; jkim@siia.net. www.siiia.net/etis2004

MAY 17-18  **SIIA Content Forum** - San Francisco, CA. The theme is "Show Me the Money." The speakers are online content creators, publishers and marketers. Need more info? Visit the website or contact James Kim, 1 (202) 289-7442 x1362; jkim@siia.net. www.siiia.net/cf2004

MAY 17-20  **GigaWorld IT Forum** - Orlando, FL. Forrester’s flagship event focuses on technology and IT management challenges, including creating business value with IT. Register online or call (888) 343-6786. www.gigaworldus.com

MAY 17-22  **Thirteenth International World Wide Web Conference** - New York, NY. Discuss the latest developments in Web technology and the issues and challenges facing the community. Visit the website or e-mail Mae Isaac at info@www2004.org. www2004.org

MAY 18-19  **SIIA Enterprise Software Summit** - San Francisco, CA. What is the “new” software industry: software-as-service, utility computing, grid computing, and open source? This is the place to find out. For more information or to register, visit the website or call James Kim, 1 (202) 289-7442 x1362; jkim@siia.net. www.siiia.net/ess2004

MAY 23-26  **iMedia Summit 2004** - Cambridge, MD The most important interactive media buyers are invited to meet with the top sellers at this semi-annual, invitation-only event. Esther Dyson keynotes. To request an invitation, visit their website. www.imediaconnection.com/summitspring

Events Esther plans to attend.

Lack of a symbol is no indication of lack of merit. The full, current calendar is available on our website, www.release1-0.com. Please contact Christina Koukkos (christina@edventure.com) to let us know about other events we should include.
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