The secondary market for domain names

This issue paper is intended for:

- **Companies that hold portfolios of domain names**, including those that are still largely unaware of the value that such portfolios can represent;
- **Companies that are involved in projects on the Internet** and are faced with domain names registered by third parties (to make them aware that if a domain name is not available, it is not necessarily inaccessible);
- **Anyone who**, for personal or professional reasons, **wants to learn more** about an aspect of the domain name market that they know little about.

With increasing frequency, there are stories repeated in the press about "record" selling prices for existing domain names, such as "credit.fr" and its associated website which were sold for nearly €600,000 at the beginning of 2010. These spectacular cases demonstrate a growing interest in domain names, but do not sufficiently reflect the market dynamics in terms of transaction volumes which have continued to grow in spite of the economic recession.

At a time when a growing number of companies and individuals hold domain names, it is useful to shed light on the mechanisms and players that underlie the operations of the still little-known "secondary market". This examination will serve to explain why domain names, which are usually perceived as an expense, deserve to be considered as an asset both for their holders and potential buyers.

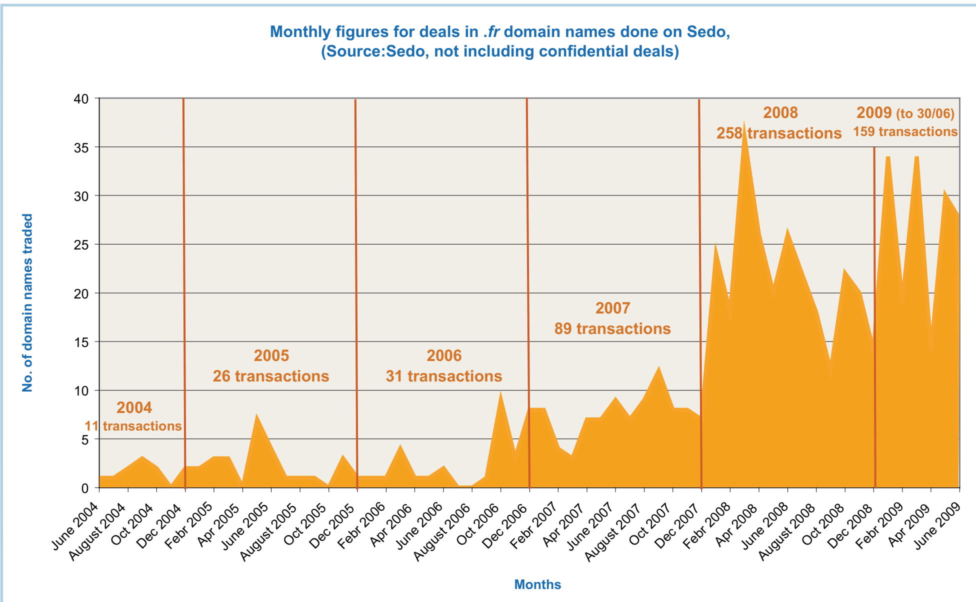
I The secondary market for domain names: A persistent and significant dynamic

In opposition to the "primary market" which involves the registration of heretofore unregistered domain names, the term "secondary market" refers to the market of mutually agreed transfers of previously registered domain names and "second-hand" domain names, as well as the ecosystem comprised of all the parties involved in these transactions.

The secondary market emerged as early as 1997 in the United States, taking the form of websites offering domain names sales listings. Before the dotcom bubble burst a few years later, there was still time for a few remarkable transactions to take place, such as the transfer of "business.com" for $7.5 million. However, this market remained confined to a small circle of experts, and the economic downturn that ran from 2000 to 2002 was sufficient, for a time, to make such high profile transactions disappear.

The secondary market regained some of its vigour in 2003 and started to accelerated sharply in 2005 with the introduction of the first "domain parking" platforms, along with the accelerated development of a few players who at the time were attaining the critical mass required to become real drivers in this market. In the mid to longer term, this expansionary phenomenon can be seen as the result of a lasting trend toward a growing need for domain names, as companies and individuals move onto the Internet on a massive scale.

Tightly focused on generic Top Level Domains (such as *.com*, *.net*, *.org*, etc.) until about 2008, the market has since broadened to include geographic TLDs which are considered by specialists as being rich in opportunities and both more accessible and attractive in terms of princing levels. The chart below illustrates this phenomenon with data provided by SEDO on the secondary market for *.fr* domain names. These figures reflect publicized transactions only. It is thus reasonable to think that the actual volume of transactions mutually agreed between parties is at least as large in both number and value.



Source: SEDO / AFNIC: French Domain Name Industry Report, 2009 edition

This exponential growth of the secondary market is tied to several factors:

- **A continuing increase in the need for domain names**, due to the growing number of Internet users;
- **The increasing scarcity of attractive domain names which are still available**, due in large part to the growth in needs. It is rare for these domain names to revert back to the public domain. When it does happen it is usually the result of an accident or negligence on the part of the registrant;
- **The emergence of intermediaries and tools** creating favourable conditions for transactions (transfer agreement between domain names holders and third parties interested in acquiring these domain names);
- **The regular appearance of new domainers of very different kinds**: from investment companies financed by venture capitalists, to individuals betting on domain names like they would on stocks in the stock market;
- **The emergence of a real awakening as to the value of domain names**, beyond the sensational figures sometimes found in the press. The economic crisis of 2007 – 2009 has led to a rationalization of prices, with the highest extremes being revised downward while the number of transactions has continued to grow regularly.

This market is legitimate inasmuch as it responds to a structural need for an adjustment between a supply and a demand of existing domain names, which are perceived, following the example of brand names, as true intangible assets. Moreover, large companies are increasingly likely to closely link their brand strategies to their naming strategies. For instance, some brands are trademarked only if the corresponding domain names are available in the most relevant Top Level Domains, or if these can be purchased from their owners at a reasonable price.

There is a virtuous dynamic between the growing value of domain names which stimulates the secondary market, and the development of that market, which, by making transactions more fluid, contributes to improved awareness of the value of domain names. However, as with all new markets, the secondary market for domain names lacks standards in terms of price setting due in large part to the fact that the numerous and often complex metrics used by the experts, when they exist at all, are not well known or understood by the other parties.

II The mechanisms of domain name valuation

The secondary domain name market is usually compared by insiders to the art market, for which valuation standards are difficult if not impossible to set. Insisting on the fact that prices result from the interaction of supply and demand, these specialists stress the principle of mutual agreement that governs the exchanges. This helps to explain the sometimes very high valuations achieved by some domain names. It nevertheless remains too vague and one might seek to set some benchmarks, while still acknowledging their limits.

Intrinsic value

The first factor in valuing a domain name is what might be called its "intrinsic value", which stems from the meaning it carries and certain features such as its length, its Top Level Domain, and the language of the term. These last two criteria are extremely important – the same term might sell for 10 times lesser value, if its TLD or language is of the less popular.

The standard domains are *.com* and the national domain of the target market's country (*.de* for Germany, *.fr* for France, etc.). TLDs such as *.net* and *.org* are often seen as second choices but may still hold a certain interest. The other generic TLDs are often neglected, after a few bad experiences resulting from euphoric launches that did not translate into sufficient success to install these domains in the habits of everyday web surfers. The ongoing relevance of a new TLD is tied to the faith that buyers have in its value, which can make it a must-have or a kind of fashionable item. But history has also shown that the effects of being "fashionable" fade quickly…

The approach developed in the early days with generic TLDs continues today with geographical TLDs, with an additional parameter bound to the appropriateness of the term's language and the TLD. A German term using *.co.uk*, for example, is not likely to be spontaneously typed by web surfers. Indeed it is both the intuitiveness and the meaning of the domain name that are responsible, to a large extent, for its ability to create value independently of its suitability for use as an original brand.

The uniqueness of the domain name must also be taken into account – a name with few close variations will be much more valuable. Unique words that do not have variations based either on number (singular/plural) or gender (masculine or feminine forms depending on the language) are more valuable than combinations of keywords that have multiple variations of these kinds, with and without hyphens.

Traffic value

Intuitiveness has long been the buzzword in the business of valuing domain names. It comes from the intrinsic value of the name, from its suitability for a possible intended target, and from the marketing value of its term considered as a keyword, as the search engine experts would think about it. In this perspective, the investor watches the search trends of web surfers and strives to register or acquire relevant domain names that include these high-potential terms.

The principle underlying this reasoning is that a fraction of web surfers who are interested in a given topic or product will tend to enter the domain name designating the topic directly into their browser's address bar, along with the Top Level Domain that seems the most relevant to them. According to this logic, the more a term is run in a search engine, the more the domain names that contain it are valuable, with the ideal being the term itself in the TLD that is most relevant for the targeted audience.

Although it is supported today by the growing number of web surfers, this approach based on "direct navigation" might one day be called into question as the address bar in some browsers is combined with the search bar. Moreover, it affects only a small number of domain names that are unusual enough to spontaneously capture a great deal of traffic. For others, this traffic is instead brought about by the SEO power of the website to which the domain name points, and of which the domain name is a key component, without being the only element. Search engines also take into account the title and content as well as the presence in the domain name of keywords corresponding to the search term. But if keywords are in the domain name, the search engines will naturally tend to improve the positioning of the sites concerned. As a result, part of the "traffic value" stems from the overall listing level already achieved by the web site, which creates traffic through the domain name, with some level of persistence over time.

Some players have specialized in re-registering domain names that have reverted back to the public domain, concentrating their efforts on names with a high level of residual traffic, in order to benefit from it at a lower cost. The number of backlinks (links from other sites pointing to the domain name) is an important element in evaluating the persistence of this traffic.

Valuation

The secondary market is still young and there is currently no valuation method which is stable and shared by all players, with which to judge the value of a given domain name. This makes this type of investment as risky as it can be lucrative, and some experts rely on their skills for identifying domain names that are destined to increase in value over time, and on their experience to find unique names abandoned by owners who are unaware of the value they hold.

It is also useful to distinguish the idea of investing in durable assets, which emphasizes intrinsic value, from the concept of "monetization" of traffic, which focuses attention on the value of the traffic.

Evaluation criteria will differ depending on the philosophy of the buyer, and can cover a broad spectrum ranging from traditional methods to techniques borrowed from the economic model of keywords purchasing.

Without seeking to be exhaustive, evaluation methods might include:

- **The so-called "comparables method"** which entails evaluating a domain name based on transactions that have already been completed involving domain names that are quite similar. But these estimates may be out of step with the dynamics of the market if they are based on data that is too old;

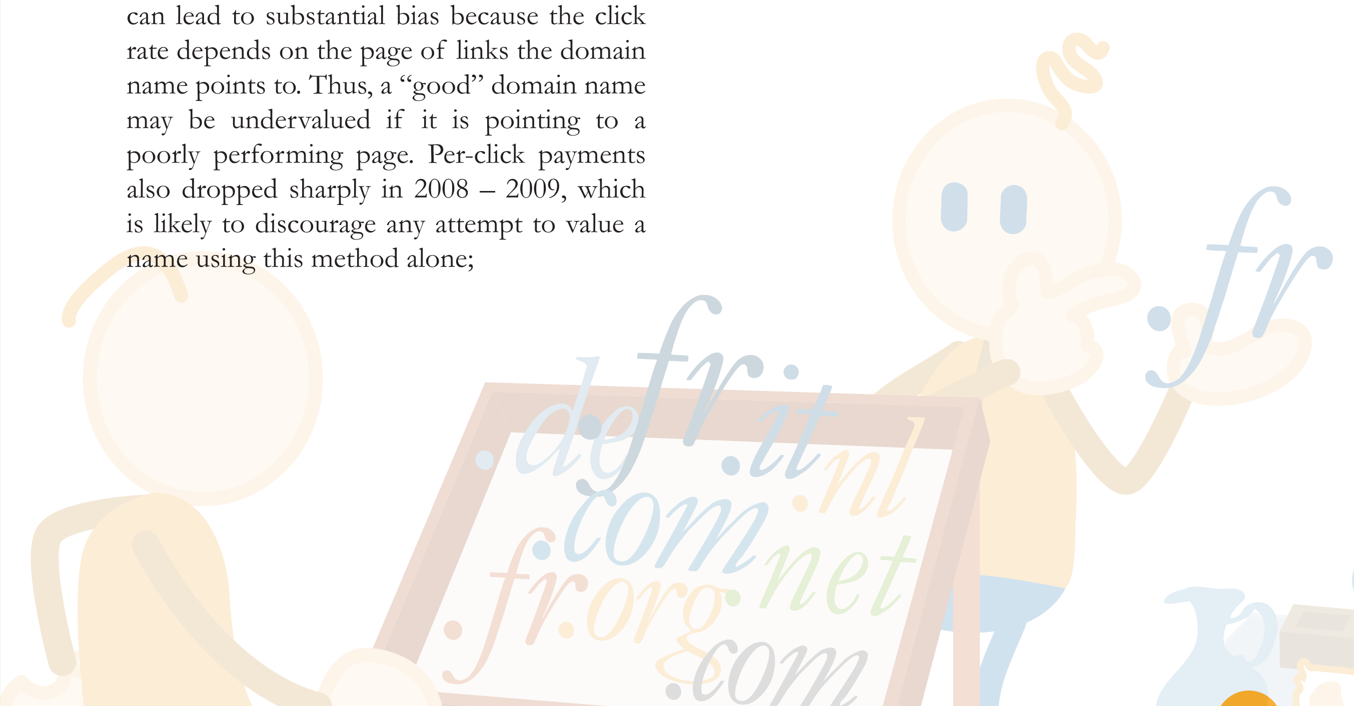
- **Evaluation of the "traffic value"** based on the principle of estimating the number of visits potentially generated by the domain name, and assessing the cost of acquiring the same number of visits through a major search engine and a system of paid inclusions. The benefit of this approach is reinforced by the fact that search engines are increasingly moving towards charging for traffic and applying a differentiated rate depending on the relevance of the domain name, in relation to the keywords purchased and depending on click rates as well. In this context, having a URL that includes the keyword will lead both to better positioning and better rates, in addition to the prospect of a higher conversion rate;

- **Valuation** on the basis of income actually generated through "parking" the name on a contextual links page, or a more elaborate scheme; regardless of the scheme, the holder of the domain name is paid based on the number of clicks on his page. This method can lead to substantial bias because the click rate depends on the page of links the domain name points to. Thus, a "good" domain name may be undervalued if it is pointing to a poorly performing page. Per-click payments also dropped sharply in 2008 – 2009, which is likely to discourage any attempt to value a name using this method alone;

- **The domain name's commercial added value** with respect to the sector of activity, in the sense that a single "lead" acquired via this name can sometimes mean an "average basket" worth thousands of dollars to the target site. Domain names as traffic generators are valuable assets for online marketing strategies;

- **The level of competition for the keyword** in the domain name can be considered as a factor in value of the name, but it might also actually reduce its impact, as competitors for a highly sought-after keyword will implement other means than just the domain name to attract traffic to their sites;

- **The value of the domain name's "branding"**, that is, the degree to which its owner can use it as an original and high-impact brand ("amazon.com" and "google.com" fit this profile at the time they were registered). Some particularly attractive generic names have a high "branding" value in and of themselves.



III The players

The secondary market is now driven by a growing number of players whose functions can be categorized according to their respective strategy.

These include:

- **The domainers,** or specialists in domain names investment. These are companies and individuals who possess a keen sense of the value of domain names and the trends where there is likely to be a profit. We exclude cybersquatters from this category, with which domainers are often confused. A domainer is an investor who does not infringe on the rights of third parties, while the action of the cybersquatter is based on that intent;

- **Domain name holders who are not specialists in the "business" of domain names**, but who may buy and sell names based on their personal or business needs. These days, this category appears to be both more numerous and less active. It will play an increasingly important role as it expands to include Internet newcomers and as people's understanding of the financial issues related to domain names matures;

- **The middlemen**, who act as marketplaces (buyers and sellers), as brokers and as negotiators between the parties. Their expertise is often reassuring to neophyte customers who may have concerns about the price of the transaction. The value added by these intermediaries is also based on their escrow services, guaranteeing that the buyer will actually get the domain name after the transaction, and that seller will be paid;

- **The parking platforms** that provide contextual links pages and share the revenue generated by clicks with their customers;

- **The organizations that sell advertising links**, who include in their ranks the major search engines;

- And finally, **the advertisers**, who finance this entire ecosystem. It is likely that, over time, these advertisers will themselves increasingly take on the issues related to the marketing value of domain names, and will more often become involved in the buying and selling of high-potential keywords or domain names, which are sustainable and can be renewed each year for a paltry sum compared to the value they provide to their holders.

Conclusion

The secondary market is currently experiencing an unusual situation where valuable assets are concentrated in the hands of a few experts, while a small number of third parties understands the dynamics of domain name valuation and the benefits domain names can deliver in terms of visibility on the Internet.

Equating domainers with cybersquatters has done much harm to the former, casting a shadow of suspicion on their activities, deeming them to be, if not illegal, at least of questionable morality. The market cannot really mature until these two are no longer confounded and it becomes as natural to buy and sell domain names as land, buildings or traded securities.

This development cannot occur until people have learned the difference that may exist between the nominal value of a domain name, that is to say, the price paid at registration, and its economic and market value.

Everyone now knows what domain names cost, but few know what they are worth.

Out of such biases arise practices that would seem surprising in other contexts: Practices such as abandonment of high-value names; names with high traffic potential that go unused; and not taking into account a company's portfolio of domain names in the valuation of its goodwill. Getting invaluable names "for nothing" is still possible, although it will almost certainly become less so over time.

Based on this fact, those who hold portfolios of domain names should move away from the kind of thinking that sees domain names as a cost centre and toward an approach based on their value, both in terms of immediate gains in visibility and the mid to long-term value of the asset. This trend can only be strengthened by the fact that domain names must already be taken into account as intangible assets in the IFRS and IAS 38 standards, to which listed companies are subject.

The contrast that persists between the different ways of understanding the value of a domain name may partly explain the fact that this rapidly growing market is still only emerging. The "big players" are in fact still very discreet, and the process of buying a domain name owned by a third party is far from being a casual everyday process. These are two factors that will profoundly shape the secondary domain name market in the coming years, if the various players are able to improve the fit between supply and demand through better information flow. Certain domain names are sometimes sold at prices which are objectively low simply because the sellers are acting in isolation, without always having sufficient credit, which prevents them from setting "correct" prices. In turn, prospective buyers struggle to identify the players and marketplaces where they might be able to find the right information at the right time. The operation of the secondary market is still perceived as somewhat opaque, complex and perhaps risky, thereby constraining its development.

As the market matures it will necessarily pass through a phase of redistribution of the most valuable names, from the "pioneers" who structurally are sellers to end users who structurally are buyers. We are already seeing a definite trend among some large accounts to purchase domain names that they feel are strategic from third parties. One might think that this phenomenon will intensify in the future, leading ultimately to a situation where the number of interesting domain names in circulation will shrink, their owners having acquired them with no intention to sell, except in specific cases related to divestments. All things otherwise being equal, if the new extensions planned by ICANN do not provide some nourishment to the system, the secondary market could enter into decline because of the scarcity of "good" names available for sale – even if that future still looks quite distant.

AFNIC would like to thank the secondary market experts who kindly read and amended this issue paper, to help make it into a reference document as objective and as fair as possible, given the constantly evolving subject matter.

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www.afnic.fr - afnic@afnic.fr