Case 16-3
A Network of Ideas

Spider-Web Corporation ("Spider") owns and operates various Web sites, including YourSpace, a social networking Web site, and Bling, a Web site search engine. Spider is a nonpublic U.S.-based company with headquarters in Silk Valley, CA, and it earns most of its revenue through advertising. Spider not only manages the advertisement space on its own Web sites, but it also assists other Web site owners with filling their ad space.

To generate revenue, Spider enters into agreements with various third-party advertisers (the "advertisers" or the "customers") whereby Spider agrees to place advertisers' ads on Web sites owned by Spider. Spider can also place these ads on Web sites owned by its network partners (the "partners"), for which it has agreements to do so (see discussion below). Spider gives the advertisers a list of Web sites to choose from; the advertisers specify which Web sites are suitable to reach their intended demographic. If the desired advertising space is not available, the advertiser and Spider must agree on an alternative Web site. The advertisers are not made aware of who owns the partner Web sites, and the fees charged to each advertiser are from Spider's standard list prices, which are specified in the agreement between the advertiser and Spider.

Spider offers the advertisers the option to have their ad displayed on a home page or linked to key search words. The pricing structure differs depending on which type of advertising is selected. For example, Spider will charge a fee each time an ad (also known as an impression) is displayed. Alternatively, if an advertiser selects its ad to be linked to key search words, Spider will charge a fee only when an end user clicks on the linked ad. The advertisers are invoiced the month after their ads are displayed, and payments are submitted directly to Spider.

To offer the advertisers a choice of Web sites on which to display their ads, Spider enters into agreements with the partners that own other Web sites. This expanded offering allows Spider to potentially increase its revenue from the advertisers; however, it comes with a cost to Spider. The partners charge a fee to Spider for use of their Web site ad spaces. The fee structure allows the partners to receive a minimum base fee that is equal to the cost to maintain the ad space (as predetermined on a quarterly basis) and up to 51 percent of the adjusted gross advertising revenue earned monthly. As defined in the agreement, the adjusted gross advertising revenue is equal to the amounts invoiced to the advertiser less chargebacks, credits, bad debt, refunds, and certain out-of-pocket expenses, including agency commissions and fees, sales commissions and fees, and creative services; however, the amount beyond the base fee is paid to the partner only after it is collected by Spider from the advertiser. The advertisers are not a party to any agreement with the partners; advertisers only have an agreement with Spider. Spider is solely responsible for fulfilling its contracts with the advertisers. Therefore, if suitable advertising space is not available on a partner's Web site or if the partner does not believe the ad is suitable for its Web site, Spider and the advertiser will agree on an alternative Web site.

Spider's agreement with the partners also specifies the space, size, and location on the partner's Web site that must be available for ads. During the term of the agreement, the partner is also required to keep Spider's network footer at the bottom of its home page because Spider is paying for the base fee. Since the advertisers are charged a fee either (1) for each time a user clicks their ad on a partner's Web site or (2) each time an ad is displayed, the partners are required to install and use the tracking software provided by Spider. This tracking software is given to the partner at no charge, and it gives Spider monthly usage reports; Spider uses these reports to determine the invoice for the customer.

Spider will identify ads or marketing messages from the advertisers, along with its own ads, to be placed on a partner's Web site. Spider will also pay the partner a nominal fee that is based on the number of times Spider's ad is displayed on the partner's Web site. Although Spider tries to identify ads that are best suited for the partner's Web site, it sometimes selects ads that are not a good fit for the partner's audience. The terms and conditions of the agreements between Spider and its partners allow the partners to request that Spider remove ads that are not suitable for their Web sites. If this situation occurs, Spider can find an alternative partner Web site to post the advertiser's ad.

Required:

- On the basis of the case facts, should Spider record the revenue it earns from placing ads for various third-party advertisers on Web sites owned by the partners on a gross or net basis? Provide an analysis supporting your conclusion.