To Pay or Not to Pay: Zagat's Dilemma
CASE STUDY

Founded by Tim and Nina Zagat, the Zagat Survey has collected and published ratings of restaurants by diners since 1979. Zagat publishes surveys for restaurants, hotels, and nightlife in 70 major cities. Zagat has come a long way from its roots in the early 1980s, when the food-loving Zagats started compiling lists of their favorite restaurants for personal use and to share with their closest friends. But with the rise of the Internet, e-commerce, and mobile technology, Zagat has struggled to find a business model that stayed true to the company's origins.

To generate their first survey, the Zagats polled 200 people, and increased that number over time. Executives, tourists, and New York foodies alike found the list to be indispensable. Spurred by this success, the Zagats decided to publish their survey themselves. The few booksellers that took a risk in stocking the book were rewarded with sales so robust that the Zagat Surveys became best sellers.

The pair also published similar lists for other major cities, including Chicago, San Francisco, and Washington, D.C. In addition to print books, Zagat opened a unit that creates custom guides for corporate clients, like the ones at Citibank. For a long time, this business model was sufficient to ensure that Zagat Survey was successful and profitable.

When the dot-com bubble came along, venture capitalists were attracted to Zagat for its brand recognition—the Zagat name is instantly recognizable to food-lovers, travelers, and restaurateurs alike. Zagat was one of the first companies to popularize user-generated content, collecting restaurant reviews from its readers, aggregating those reviews, and computing ratings. In addition to numeric rating scores, the survey also includes a short descriptive paragraph that incorporates selected quotations from several reviewers' comments about each restaurant or service. Venture capitalists saw that Zagat had a golden opportunity to migrate its content from offline to online, Web, and mobile.

Of the many decisions the Zagats faced in bringing their content to the Web, perhaps the most important- was how much to charge for various types of content. They ultimately decided to place all of their content behind a pay wall, relying on the Zagat brand to entice customers to purchase full online access. One of the most prominent members of the Zagat investment group was Nathan Myhrvold, formerly the chief technology officer at Microsoft. Myhrvold supported the Zagats' decision to use a pay wall for their content and maintained that putting all of their content online for free would have undermined their book sales.

Although Myhrvold and the Zagats themselves favored the pay wall, other Zagat investors argued that placing content online for free allowed companies like Yelp to get its results on the first page of Google search results, which is critical for maintaining the strength of a brand in today's advertising environment. By not taking this approach, Zagat left itself open to be surpassed by Yelp, Groupon, Google Places, and other similar services offering free content supported by advertising from local businesses. Sure enough, these companies soon began attracting numbers of online visitors that dwarfed Zagat's.

In 2008, the Zagats tried to sell their company. They failed to do so, partially due to Yelp's growing popularity. Prospective buyers were more intrigued by Yelp's much larger online audience and growth potential. The Zagats' failure to sell the company in 2008 highlighted their failure to effectively go digital. Food blogs and similar sites abound on the Web nowadays, but Zagat was in a unique position to get there first and establish itself as a market leader, and it failed to do so.

For much of 2011, Zagat continued to lag behind Yelp and other free review sites in the battle for eyeballs. Yelp drew much greater traffic than Zagat.com. From January to April 2012, Zagat.com had only 310,000 visitors, while Yelp had 31 million. The Zagat Web site claimed it has more users, but the disparity was still significant.

Zagat saw its fortunes change in September 2011, when Google paid $151 million to buy the company. Although the Zagats had sought $200 million in 2008, the deal was considered by analysts to be generous. Google was seeking to establish itself in the local search marketspace, and after failing to purchase Yelp for $500 million in 2009, Zagat was next on their shopping list. In fact, after the Yelp deal fell through, Google and Yelp have become heated rivals, and Yelp has alleged that Google is rigging its search results to favor its own services over those of its competitors.