With ex-Google exec, AOL seeks another fresh start

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Graphic shows AOLâ€™s revenues and online advertising for 2006-2008; includes Web site visitor totals for similar companies for 2008-

(AP) -- Shortly before taking over as head of AOL in April, Tim Armstrong ripped out some office doors.

The doors - made of glass and requiring a company key card to pass through - stood in AOL's New York headquarters, separating the offices of executives like former CEO Randy Falco and his No. 2, Ron Grant, from the rank and file.

The doors' departure is emblematic of a shift under way at AOL. Armstrong, 38, was recently hired away from Google Inc. and asked to give the long-suffering Internet unit of Time Warner Inc. yet another shot at salvaging its future after what seems like a lost decade.

If nothing else, Armstrong's arrival has thrilled employees who were unhappy under his predecessors, who were widely considered out of touch and out of place.

But Armstrong's more approachable style won't be enough to restore AOL's luster. AOL's legacy business, its dial-up Internet service, continues to dwindle while its newer online advertising service is not yet picking up all the slack. AOL's operations still make money, but that profit has been falling.

Armstrong's ability to find the right formula could be especially put to the test if Time Warner formally separates itself from AOL by spinning the Internet division off into a standalone business, as the company is exploring. That move would finally undo the $147 billion deal in which AOL bought Time Warner in 2001, which became one of the worst corporate combinations in history.

AOL would not make Armstrong available for comment. But current and former employees said his open management style, which he tried to show by taking out the doors, already has marked a stark change from Falco and Grant, who had snippy nicknames at AOL like "Rondy," a combination of their first names.

Falco and Grant joined AOL in late 2006 as part of a surprising management change by Time Warner that ousted AOL's then-CEO, Jonathan Miller. Falco had been president and chief operating officer at NBC Universal Television Group, while Grant came from Time Warner, where he was senior vice president of operations.

Falco was a terrific media executive but he didn't have Internet experience, and Grant was talented but had not managed large teams of people, said Ted Leonsis, an executive who retired from AOL in late 2006.

"You had two very good executives who were perhaps miscast at that time," Leonsis said.

In contrast, Armstrong is steeped in the Internet. At Google he was a senior vice president in charge of the company's North and South American advertising operations.

"For what they need going forward, I think that somebody from the Internet, with Internet credibility, was a good idea," Falco said in an interview.

Falco defended his tenure at AOL by noting that he had the tough job of cutting costs - $2 billion was slashed, with 2,500 layoffs, in his tenure - something that "never makes employees happy." He also refuted the idea that he wasn't communicative, saying he met weekly with employees in small and large groups.

Leonsis experienced the stir surrounding Armstrong's arrival firsthand. Shortly after his appointment was announced, Armstrong invited Leonsis and AOL co-founder Steve Case to join him at an all-hands meeting at AOL's former headquarters in Dulles, Va. The atmosphere at the meeting was "like a religious revival," Leonsis said.

This all may bode well for employee morale, but it doesn't mean AOL's business prospects have improved.

The dial-up Internet service was AOL's backbone when the company, then known as America Online, bought Time Warner in 2001. At its peak, in 2002, AOL had 26.7 million dial-up subscribers. Even as recently as 2006, dial-up was a $5.78 billion business for AOL.

But consumers have flocked to speedier offerings. Last year AOL's Internet access revenue was down to $1.93 billion, and now AOL counts

just 6.3 million dial-up subscribers.

Meanwhile, other Internet destinations have eclipsed AOL's free Web site, too.

In hopes of staunching the defection of users to competitors like Google and Yahoo Inc., in 2004 AOL began shifting from its origins as a "walled garden" with subscriber-only content to an online destination where most of its news, music videos and other features were free, and supported by ads. AOL beefed up the freebies in 2006 by giving away AOL.com e-mail accounts and software that consumers had previously paid for.

Along with this, AOL realigned itself around three core businesses meant to bring in revenue from online advertising: Platform-A, which sells ads for AOL sites like celebrity gossip blog TMZ and for third-party sites; MediaGlow, which includes numerous Web sites and blogs such as Moviefone and Engadget; and People Networks, which houses the AIM instant messaging service and other social media properties.

The transition has been bumpy. After several strong quarters early in the shift to free content, AOL's online advertising growth slowed and then reversed.

Advertising revenue totaled $1.89 billion in 2006 and rose to $2.23 billion in 2007, but dropped to $2.10 billion in 2008. And then ad revenue fell 20 percent in the first quarter of this year.

While the economy hasn't helped, Platform-A has suffered from lots of turnover in its short life span. The unit, which was formed in 2007 and includes several online ad companies AOL has acquired over the years, had three leaders under Falco and Grant. Now Armstrong has brought in a fourth person to oversee Platform-A: Jeff Levick, a longtime colleague

from Google.

Armstrong's challenge will be to figure out a better way to make money off the busy traffic AOL's Web sites gather.

AOL's various online properties averaged 106 million unique U.S. visitors each month during the first quarter, according to comScore Media Metrix. That ranked AOL fourth; Google, Yahoo and Microsoft Corp. were first, second and third.

"The fact that it has a large audience and makes money means wise leadership should be able to extract value from it," said John Buckley, who left as AOL's head of media relations shortly after former CEO Miller departed.

But AOL was the only member of this Web top four to see a year-over-year drop in traffic in the first three months of the year. It had averaged 110 million visitors in the first quarter of 2008.

And while AOL's operating income totaled $150 million in the first quarter, that was a 47 percent fall from the year-ago quarter.

Armstrong has "some serious work ahead of him," said Kevin Lee, CEO of search marketing firm Didit.

For now, Armstrong is concentrating on figuring out what, exactly, AOL's focus should be. He is spending his initial months visiting AOL's 7,000 employees around the world, scrutinizing AOL's products and garnering feedback that will be used to form a strategic plan.

AOL launched an internal survey in early May, hoping to get comments on what the company's goals should be. In an e-mail to the staff, Armstrong said AOL needed a mission that is reflected in its products.

"We have a huge advantage in this effort because we touch so many consumers each day, and they will take notice of our renewed focus and energy," he wrote.

Within a week, 1,000 people responded to the survey. If nothing else, Armstrong is finding out what happens when you take out doors.

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