



## **BRITISH SCREEN ADVISORY COUNCIL BRIEFING PAPER**

### **A PERFECT STORM? THE OUTLOOK FOR ADVERTISING**

**July 2009**

#### **Introduction**

This year will likely be the worst-ever year for advertising markets all over the world. The deep economic recession together with a number of industry-specific cyclical effects and local factors have combined to create a 'perfect storm' that has profoundly depressed advertising spending. And the signs are that this will continue.

Screen Digest is not forecasting any recovery for overall display advertising revenues – including television advertising – over the next five years. On the contrary, we believe advertising markets in Western Europe, including the UK, will underperform the overall economy in the next five years. Furthermore, we fear that the free-to-air television economy faces the prospect of long term decline as the symbiotic relationship between its three parts – large consumer brands, mass media, and advertising agencies – is increasingly disrupted.

However, we are certainly not predicting the end of television advertising. In relative terms, television is still a relatively healthy medium compared with press and radio, which are continuing to lose audiences – and revenues – year after year. Contrary to some press reports, in most markets, overall television viewing time is plateauing or even still rising, not decreasing. Consequently, over the longer term, television – along with digital media – may emerge as more indispensable than ever as a means to reach the mass market as audio and press continue to fade away as advertising branding media.

#### **The mechanics of decline**

Historically, it is well documented that advertising is always a casualty of economic recession. The mechanics of this are generally relatively simple. In tough times, when sales are falling or are expected to fall, corporations big and small tend to react by cutting marketing costs and reducing advertising spend in an attempt to maintain their operating margins. This process has been exacerbated by the increasing number of consumer brands that belong to publicly-listed companies, which are under even more pressure to cut variable costs in order to appease investors by supporting short-term

profitability goals. To cite just one example, advertising spend by automobile manufacturers is, not surprisingly, down by 29 per cent this year.

The net result is that advertising markets tend to reflect economic fluctuations, but in an amplified manner. On the positive side, when GDP grows by, say, three per cent, advertising spend can grow by 10 per cent or more. Conversely, when GDP is flat or down by a few points, advertising spending can fall by 5-10 per cent.

However, while economic fluctuations tend to have a magnified impact on advertising flows, the longer-term underlying trend has been for advertising to underperform the overall economy in developed markets. In part, this is because increasingly globalised multi-national corporations are shifting more of their marketing spend to emerging markets. For instance, between 2000 and 2008 – and despite the post-dot-com recovery of 2002-2007, the proportion of UK GDP spent on advertising fell from 1.12 per cent to 0.91 per cent. We anticipate it will continue to fall to 0.76 per cent by 2013. This reduction is even more acute when focusing only on the sub-category of display advertising (i.e. excluding online search): in the UK this was already down to 0.72 per cent last year and we expect it to further reduce to 0.53 per cent by 2013.

### **The economic storm clouds**

The global economic outlook for 2009-10 has darkened dramatically after the first three months of this year saw a further acceleration of the steep downward trend characteristic of last quarter 2008. This is despite major government initiatives across the world to re-instill health into the financial sector and trigger demand through new macroeconomic policies.

The International Monetary Fund (IMF) now believes that the global economy faces its worst crisis since World War II and will shrink by 1.3 per cent in 2009. Whilst the decline was deeper and faster than the IMF anticipated as recently as January 2009, recovery is likely to be only sluggish. This is evidence for an L-shaped recession where a fast and steep decline is followed by a period of flat growth.

The IMF significantly lowered its GDP growth forecasts again in April 2009, following a downward revision of its November 2008 outlook carried out only in January. Between January and April, the 2009 GDP growth forecast was downgraded by 1.3 points for the UK (from -2.8 per cent to -4.1 per cent) and for Spain (to -3.0 per cent). This is severe but still moderate compared with Germany, which saw a correction of 3.1 points from -2.5 per cent to a staggering -5.6 per cent.

Projections for 2010 were also downgraded in most markets. It is now expected that economic growth will be flat or negative (between +0.4 per cent and -1.0 per cent) in Europe's Big Five. While in January the IMF anticipated a return to growth in the US (+1.6 per cent), it now predicts a flat economy (+0.0 per cent).

In the first quarter of 2009, GDP fell off a cliff across Western Europe. It was down quarter-on-quarter between 1.2 per cent (France) and 3.8 per cent (Germany). It was down 1.9 per cent in the UK. Such a steep drop is unheard of in recent times and equivalent to a 4 to 15 per cent annual decrease in national wealth. In the light of all this, it is thus not surprising that advertising revenues fell, year-on-year by 15 to 20 per cent across Europe.

### **Trends across media**

The performance of television advertising has generally been consistent with the overall downward trends, maintaining its share within a declining overall spend. Television advertising sales in Europe have fallen by about 20 per cent on average this year so far. Europe's largest commercial broadcasters have suffered advertising revenue declines ranging from -8 per cent to -37 per cent. Other traditional media have fared even worse (especially press). Only internet advertising is performing better, but has still slowed to single-digit growth.

For the full year 2009, Screen Digest is forecasting that total West European advertising revenues will fall from between 8.4 per cent (Italy) to 15.5 per cent (Spain). We expect the decline in the UK to be 12.6 per cent.

For television advertising specifically, we forecast full year 2009 falls ranging from 10 per cent (Germany) to 17 per cent (Spain), with the UK forecast to drop 14.1 per cent. Screen Digest anticipates a *third* consecutive year of flat/negative growth in 2010, which will make it the longest advertising recession ever recorded. Indeed, only by 2012 do we envisage a rebound in television advertising (+5.1 per cent in the UK), driven by a combination of economic recovery and the major sports events that traditionally bless so-called 'quadrennial' years (the Olympics and European football championships).

On top of the consequences of economic recession, advertising markets are also currently being affected by a deadly combination of structural factors, market 'tipping points', and industry-specific problems. These include:

- Digital multi-channel television audience share, having reached 20 per cent in continental Europe and 40 per cent in the UK, is accelerating the trend towards fragmentation of television advertising inventory and increasing the deflationary pressures on airtime price.
- 2009 happens to be the lowest point of the traditional four-year event cycle, with no major sports events this year to boost advertising spending.
- The long-term erosion of press and magazine circulation has been accelerating.
- Television markets across Europe have been negatively impacted by a number of national market disruptions caused by regulatory uncertainty or crises in the local advertising trading systems. These local factors tend to have something

in common: they have all, temporarily or permanently, increased the bargaining power of the buying side and created disarray in the selling side. For instance, the partial termination of advertising on French public service broadcaster channels has encouraged advertisers simply to reduce their total spending rather than to transfer it to commercial channels – and the market is shrinking as a result; Spanish commercial television is in the deepest crisis in its history as collapse of an airtime cost bubble built throughout the 2000's has been combined with intensified competition; in the UK, the 'share deals' system for buying television advertising time has exacerbated deflationary trends (see below).

### **UK television advertising**

British commercial broadcasting's 'share deals' system has aggravated market conditions from a broadcaster perspective. This is the practice whereby media buying agencies commit to spend a certain proportion of their total annual television buying budget with a particular television advertising sales house in return for discounted prices.

The problem is that, if they anticipate that others will do the same, agencies/advertisers can *reduce* their total spending while still keeping their share commitments and thus their rate-card discounts. Assuming that other advertisers similarly react to adverse economic conditions by reducing their overall budgets, advertisers can maintain their 'share of voice' compared to competing brands whilst spending less on doing so. There is thus little disincentive to reduce their spending. When combined with weak demand from advertisers and a growing supply of television viewing – and hence available inventory, this buying system has helped create a deflationary 'vicious circle'.

In contrast, the practice in most of continental Europe is for every television advertising sales house to negotiate an annual deal with every media buying agency and/or large advertiser based on a certain volume of airtime rather than a percentage of budgets. Buyers typically commit to buy a particular volume of airtime at a certain price in return for a guaranteed level of discount on rate-card tariffs. Although these commitments are generally flexible and are not as structured as the practice of 'upfront sales' used in the US, they do provide a degree of visibility to the broadcaster.

Television is fundamentally a medium that is fragile in recessionary times due to its inflexible structure of costs and supply. Oil producers can reduce their output when they wish to push prices up, especially if they act in a coordinated fashion through an organization like OPEC; publishers can similarly elect to reduce the number of pages of advertising they offer, rather than cutting prices too much. By contrast, broadcasters typically have very little ability to constrain the amount of advertising inventory offered – and indeed, in some cases, are prevented by regulations from doing so.

Everywhere in Europe, the main terrestrial commercial broadcasters (ITV1, TF1, Telecinco, Mediaset) have always sold and scheduled the maximum volume of advertising allowed by national and European regulation, at least in peak time where the real value is. Buyers know that it is complex and risky for broadcasters to play with inventory, in part because the programme schedule would be affected by changing the duration of advertising spots. Moreover, since most broadcast costs are fixed, reducing the number of ads would generate no cost savings (contrary to publishers who may at least save a little on paper if they reduce pagination).

In fact, supply is actually *growing* in the UK as in most European markets. ‘Supply’ is not simply the volume of ad minutes delivered by broadcasters, but the volume of *viewing* – i.e. the number of minutes of ads multiplied by the number of viewers. And this supply is still growing as the growth of digital channels is driving overall viewing. In 2008, the volume of UK viewing increased by eight per cent and will increase again this year.

A combination of growing, inflexible supply, weak demand and no incentive to maintain previous levels of spending all leads to a downward spiral of discounting and ongoing deflation.

### **Prospects for recovery?**

With all these factors combining to make 2009 an ‘annus horribilis’ for advertising, it might be expected that things can only get better, as soon as the economy recovers.

However, the first problem with this assumption is that the economy is *not* predicted to pick up any time soon. With the economy in slow decline, only a sluggish return to growth is forecast from 2011. In April 2009, IMF forecasts suggested no return to growth in 2010 in Western Europe: it indicated France’s GDP would be very slightly up (+0.5 per cent) while GDP in the other big European markets would continue to shrink (between 0 per cent and -1 per cent).

More fundamentally, in the long term, Screen Digest foresees display advertising spending (i.e. excluding search) to continue to *underperform* a sluggish economy between 2010 and 2013. Put under increasing pressure by cost-controllers and procurement directors, we expect the marketing directors of big international brands will:

- continue to concentrate their marketing spending on *emerging* markets (at the expense of developed countries where they concentrate effort on ‘optimizing’ their spend);
- continue to concentrate on *digital* media at the expense of traditional media, following audience trends;
- continue to concentrate on direct marketing and sales support at the expense of spending on *branding*, thus favouring *direct* media, such as paid-for keyword search, at the expense of *branding* media (TV, magazines, etc).

Fundamentally, the television advertising ecosystem has thrived over the last 50 years through a symbiotic and mutually beneficial relationship between three parties: large consumer brands, mass media (free general-interest television channels with huge reach) and advertising agencies (responsible for creation, planning, and buying). There is a risk today that this relationship will increasingly break down as each party is focused on its own short-term survival, perhaps to the long-term detriment of all of them.

Advertising agencies, for example, are put under enormous pressure by their clients. To preserve global budgets when pitching every three years, they have to cut commission rates and thus the effort spent on creation and planning, research and innovation. While they have traditionally made their best margin on traditional media like television, they now have to exert pressure on television sales houses like never before. Agencies get much less commission when planning and buying online display advertising – and, of course, they are almost entirely excluded from the online search buying process. To remain cost-competitive and fight back against outsiders like Google, buying agencies are making efforts to commoditize airtime trading and reduce overhead and research. But, in so doing, they risk contributing to an impoverishment of their traditional trade and skills.

It is not only agencies that might lose out in the long term. Advertisers may be jeopardizing one of the pillars of their commercial success if they contribute to the decline of the mass media that can build and maintain brand awareness on a large scale. Gradually reducing the level of investment on brand equity would expose the FMCG and retail brand owners (Procter & Gamble, Unilever, L’Oreal, etc) to the mounting pressure of low-cost retail brands and hard discount retailers.

But of course, this is generally only perceived as a long-term risk. In the short to mid-term, brand owners are focused on maintaining their market share relative to other big brands and are generally not so concerned by the financial plight of broadcasters and agencies. They just want them sleeker and more cost-effective, and would cut out the middlemen if they are presented with a safe way to do it.

All this is exacerbated by the rise of younger marketing directors belonging to the digital generation who do not necessarily share traditional cultural affinities with media and agencies. Marketers are now preoccupied by measurable return on investment (ROI), but the ROI of branding communication will usually only be visible over a longer-term period.

### **The outlook for commercial television**

Despite the catalogue of woes hanging over its current performance, commercial television still has unique assets that should allow it to outperform all other traditional media in the mid and long term.

As discussed earlier, despite all the digital hype, television viewing is still growing slightly, or plateauing, in most of the Western World. Erosion of the younger demographic television audience is less than many forecast some years ago, as much online/mobile usage appears to be mostly complementary or simultaneous with television viewing. Moreover, research is increasingly showing that exposure to traditional display adverts, offline and online, plays a crucial role in prompting the 'last click' (e.g. viewers go direct from a television commercial to the associated website). And the younger demographic was never the mainstay of the broadcast business model anyway.

Another factor is that television will benefit from the woes of *others*. Other traditional media (daily press, magazines and radio in particular) have been losing circulation, audience and advertising revenues for some years and the situation is just getting worse. Some categories of press are losing audience share at an accelerating pace.

Of course, the advertising market is not a zero-sum game: if some media fade away, ad spend will *not* automatically be transferred to the survivors. But the seemingly terminal decline of popular daily press, for instance, may make national television channels the only viable large-scale branding medium left for big brand owners. As huge instant audiences are becoming scarcer and scarcer, they are becoming more valuable than ever. The 2009 Superbowl American football event, thriving in the midst of recession, is a great example of this. The commoditization of trading and simplification of media planning may also benefit television at the expense of all other smaller media, as television is typically the most accountable of traditional branding media.

Doomsters have also probably overstated the threat of the PVR to the television advertising business model – at least in the short term. The PVR's impact on advertising exposure has not been that dramatic in Europe so far and broadcasters have a range of tools at their disposal to prevent, combat or compensate for excessive time-shifting/ad-skipping behaviour (including live programming with interaction (voting, etc), '+1' feeds, ad-funded catch-up services, etc.).

An extreme scenario 10-20 years out would see the concentration of marketing communication on online/mobile search and the concentration of branding communication around television and online display (of course, with very blurred boundaries between the two by then), whilst press and radio would largely be marginalized as significant standalone advertising media.

Vincent Letang and Ben Keen, Screen Digest