

UK: Digital advertising market commentary

Market growth and evolution

Digital Insight Report

The switch to online continues to accelerate in Europe's lead digital media market. The internet's share of all advertising swelled to almost 15% in the first half of 2007, with further record-setting leaps in real growth. Boosted in particular by massive increases in the supply of media from social networks, and the continued switch of acquisition budgets into search, the wider media sector is hurting as budgets are displaced and advertisers follow their audiences. The big changes are now starting.

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Analyst's profile:
Danny Meadows-Klue

Danny has been a researcher and commentator in the digital networked industries since 1995. He managed the UK's first online newspaper and has helped run web businesses ranging from mass market portals and consumer magazines, to online stores, search and email services. He is the co-founder of the UK and European IABs, was their president for four years and has been lecturing on digital marketing for more than a decade.

“We’re still in the early stages of the transition to the digital networked society. The massive growth in online advertising may have fuelled web media, but the same migration of audiences and advertising is now hurting the classic channels deeply. In this decade of incredible social and technological transition, the major changes are yet to come. Firms who plan to survive transition need to become adept at reading the landscape, and adapt quickly based on what they learn.”

Introduction

Digital advertising: the switch accelerates

Every year we provide our commentary on the growth of the online advertising market in the UK, the related restructuring in the media industry, and the key trends in this segment of the digital networked economy. This Digital Insight Report examines some of the implications for classic media, reaffirms our predictions from a few years ago that online advertising spend will exceed television within three years, and explores the nature of some of these changes as audiences and ad budgets migrate from classic media channels.

With the professionally produced content sector founded on the advertising model, the continued leap in web ad spend has much wider implications for the future growth and diversity in online media and entertainment. Since 2002 the UK has emerged as an indicator market for much of Europe and the US, providing a rare laboratory into the future of media, so many of the trends explored here will be echoed across those markets.

Since 2000, we have been talking about the digital networked society and the implications for firms as their sectors make the transition. Digital Insight Reports explore patterns within these changes and provide some of the navigation to successfully make the transition.

Speed read

UK online adspend market share is now almost 15% of total adspend

The sector overtook direct mail in early 2007

The first half of the year was £1,334.3 million

The growth rate continues to be above 40%

These are record setting leaps in online advertising growth

Digital Strategy's forecast for the full year remains at £2.95bn

The growth in online is offset by dramatic changes in the market share of other channels as budgets are drained from classic media to fuel digital marketing

Search engine advertising continues to dominate, but all online formats are growing, with new waves of brand advertising entering the industry

Among client sectors, motoring is enjoying noteworthy growth in both classifieds and display, marking a transformation in the role the web plays in the sector

Context, overall growth and transition

Consistent pattern of growth and substitution

Although the first web advertising was sold in the UK fourteen years ago, the sector only became a mainstream advertising channel here in 2002. The marketing industry continues to be in the midst of a dramatic cultural and structural shift, and the 2007 data about the growth of online advertising spend provides a clear snapshot of the winners and losers. The data in this report is drawn from the recent audits by PricewaterhouseCoopers, in partnership with the IAB, and our commentary explains where we believe the sector is heading next.

The online ad industry has already enjoyed astonishing growth, but this high level of annual expansion will be maintained, as a large range of both supply side and demand side drivers encourage continued increases in advertising investment. Media substitution is an inherent by-product of this as clients reassess the mix of media they need to deliver campaign objectives, and there continues to be a wider discovery within agencies of the value the digital media channels bring to their clients in the digital networked society.

The reason the long term sector outlook remains extremely positive is because the UK is still in the early stages of transition into the digital networked society. As more elements of the socio-economic ecosystem are connected digitally, the importance of these channels in the communications mix continues to rise. With technical and social innovation permanently high within digital services, this trend will hold true well beyond the next five years, giving even the

seasoned online advertiser myriad reasons to invest further and giving their classic media partners the confidence to build online properties to support this migration.

This means the UK is still in the middle of a vast structural change in how its social and economic networks behave. Online advertising is only a tiny element of this, but consistently a massive beneficiary, with many of the trends within this change now clear to all actors. The switch to retailing through the web has become complemented by a blended process of online and offline channels working together to lead customers to a sale, fast access at home is being complemented by access on the move, the use of search marketing has changed customer acquisition models for good, and (finally) the effects of convergence are squeezing television and radio media through IP gateways to the point of delivery.

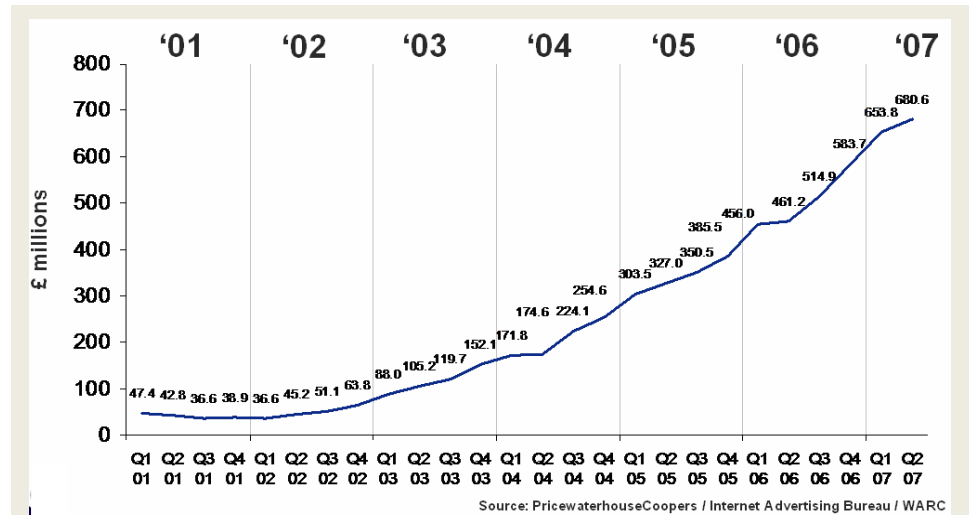
Once firms and consumers join the digital networked economy, they behave differently; permanently

The behaviour of the advertising market today is responding to these underlying changes, but it is still only a small token compared to what will unfold across Europe, the Far East and the US over the next decade. These changes affect firms in the offline world as much as those engaged directly in the digital channels, because the distinction in many ways emerges as arbitrary. Once firms and consumers join the digital networked economy, they behave differently; permanently. What happens between advertisers and consumers as a result of the internet is just one example of this, but it affects the behaviour of both groups across all the communication channels they use.



Digital Insight Reports

In times of huge economic, social and technical change, knowledge becomes a critical success factor. We created the Digital Insight Reports to bring you insights from a particular part of this fast changing industry. We read the patterns in the landscape and decode them for you to offer clear advice and an independent perspective. They cover key issues in the digital networked economy.

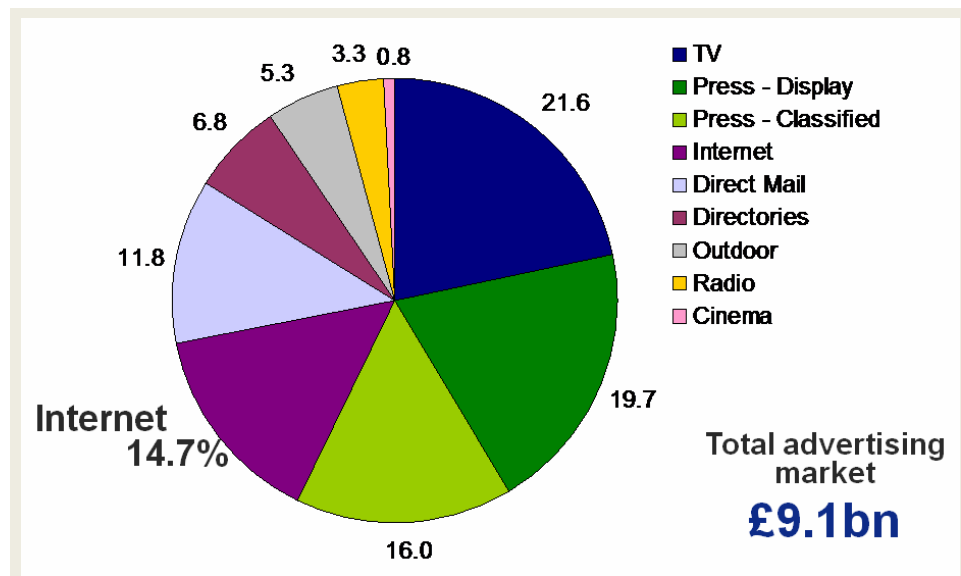


Online advertising growth since the dotcom boom: now nearly £700m in Q2
Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC

That's why the implications of online marketing run so deep: engage with it properly and marketers find themselves having to revisit the whole channel mix. The mass market adoption of the internet is triggering a fundamental substitution of media, but it is also creating new forms of media and communication. The sudden explosion of social networks, online communities and personal media during the last two years has unlocked a desire for self-expression and gives an outlet for the building and structuring of social relationships that is more efficient than the email and messenger models of the 90s. This sector, while still embryonic, is creating completely new advertising environments and its continued rapid growth is assured.

The speed of development within the digital marketing industry is daunting. It's incomparable to the way any media market has developed before. This sector behaves in a way that is both immediate and global, and where constant rapid product innovation and massive audience growth are the norm. Since the dotcom crash in 2000 there has been a huge resurgence in online advertising, fuelled by online media properties that are grounded in sound economic models and offering clear value propositions to both users and advertisers.

Online advertising's ascendancy is a product of its results rather than false promise, and its ability to straddle both brand building and direct response is now well documented and understood. Savvy marketers use digital touchpoints at many steps in their customer's journeys, and this positions online as the most comprehensive of marketing tools.



Online advertising: at 15% it's the most advanced market share in the world

Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC

Insight and analysis

UK online adspend: biggest leap yet

The latest figures confirm the rapid switch to online marketing is continuing in spite of the sector's existing size, challenging any suggestions that the market has matured and is slowing down. In Europe's lead media market, the internet's share of all advertising swelled to almost 15% in the first half of 2007, with further record-setting leaps in real growth. Boosted in particular by massive increases in the supply of media from social networks, and the continued switch of acquisition budgets into search engines, the wider media sector is starting to feel the real impact of the digital networked economy as the models that underpin many print and broadcast players get called into question.

As Digital's team had forecast, online ad spend growth held steady at above 40% year-on-year, giving the largest quarterly rises, and triggering further concerns across the TV and magazine industries about the profitability of classic media.

Key stats

- First half of 2007: £1,334.3 million
- First half of 2006: £917.2 million
- Year on year growth: 41.3%
- Online adspend market share of total UK adspend: 14.7%

With the UK market acting as a key indicator for European online adspend behaviour, the latest results will boost stock prices for continental firms looking for models of their own country's digital economy a few years down the line. The research is particularly accurate because it relies on publisher revenue declarations (under non-disclosure agreements to PricewaterhouseCoopers) and not rate card or sector estimates. It is also one of the only markets in the world to include a revenue declaration from the largest single player - Google.

Topline growth hides turmoil

Overall the UK ad market fared well, up 3.1% to £9.1bn in the first half of 2007, but this disguised the dramatic churn and channel switching between media that has made it the most turbulent and unpleasant of times for many media owners. In press classified advertising volumes continue to haemorrhage under the combined onslaught from the CraigsList free ad model, new pay-by-results engines such as Oodle, disintermediation as advertisers deal direct, the small business engines within eBay, and the inescapable Google effect. Television's increasingly shaky ground has become apparent, with many consumer brands we spoke to now talking frankly about switching campaign budgets to the web as audience reach stumbles but, worse, ad effectiveness falls faster. Media fragmentation, marketing savvy audiences, and massive changes in consumer behaviour are all impacting faster than most media groups can hope to adapt, paving the way for polarisation in profits and digital audiences. As Digital has been predicting since 2003, when the shake-out comes it will be larger and more brutal than most classic media (or their shareholders) predict.

Direct mail passes the crown

The statistics also confirm Digital Strategy's forecast that online would leap over direct mail in the Spring of 2007. Direct mail's market share continues to fall (currently 11.8%), and will suffer much deeper cuts as more customer acquisition budgets switch to Google and Yahoo. Remember that none of the cash invested in email relationship marketing (those billions of customer emails sent daily) is counted in the advertising figures because there's no media-buy involved. Add to that the massive investment most firms have now made, or at least begun, in their own web presence, and a much starker picture emerges; marketing has gone digital, and advertising is just part of that story.

The digital media mix

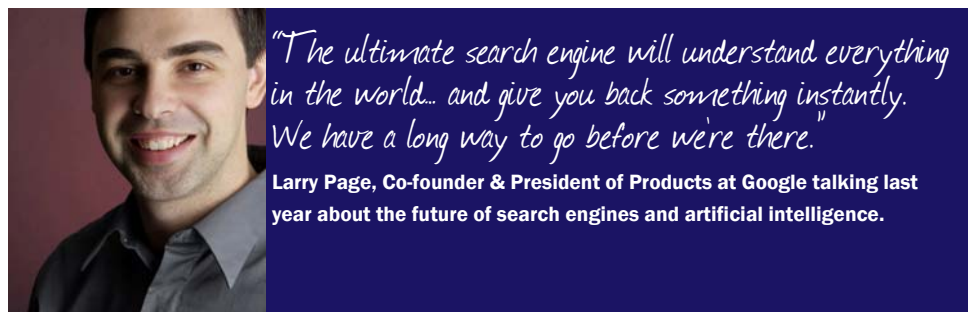
New patterns emerge within online adspend

Classifieds set to beat display

- Online classified advertising: up 72% year-on-year
- Market value for period: £277.7m
- Market share within online: 20.8%
- Online display advertising: up 33% year-on-year
- Market value for period: £287m
- Market share within online: 21.5%

As always, recruitment tops the classified charts, but the growth in automotive and property reflects a bitter impact felt in the regional press and magazine sectors as ad dollars follow the audience eyeballs.

Display's share may only be a fifth of all spend (21.5%), but embedded formats (such as banners and skyscrapers), all rose at a faster rate than any non-digital channel, with the interruptive out-of-banner formats (including an umbrella of rich media technologies) continuing to deliver strong performance for advertisers in the hands of a much larger digital creative community.



Search: unstoppable

- Search advertising: up 44% year-on-year
- Market value for period: £762.3m
- Market share within online: 57.1%

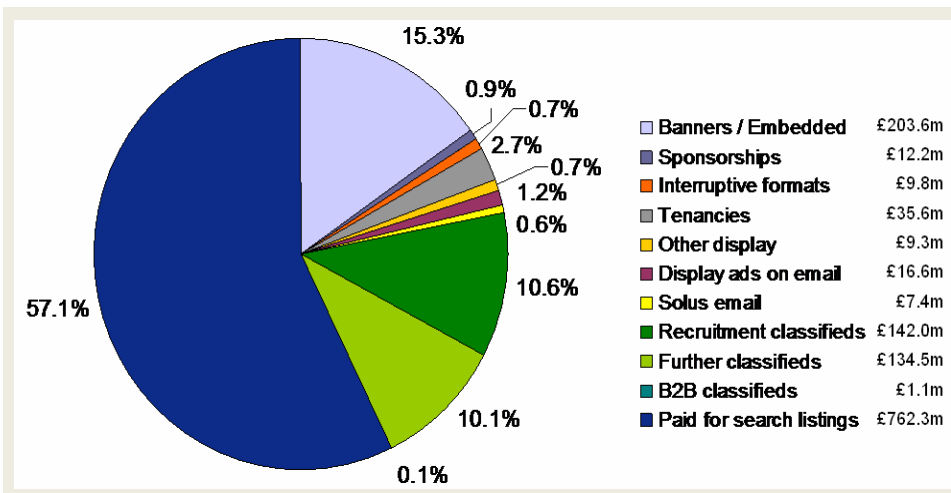
The advertising switch to search is now deep in a positive feedback loop that looks unbreakable. Massive search revenues from Google and Yahoo (and expected at MSN), are fuelling product development and acquisition on a scale never before seen in media. This is recasting the media landscape, with the search tools moving beyond the browser and onto the desktop and the mobile handset.

The combination of staggering profitability, market concentration, shareholder expectations and technical integration, have created a climate for sustainable, yet exceptional, product development. By giving customers the tools and applications they want, the mega-brands of digital are securing unstoppable growth in the supply of search advertising inventory, as well as its migration into new physical, geographic and sectoral markets.

Search isn't just riding high on the ecommerce sector, which itself swelled (to £32bn in 2006), it is now, finally, getting a window into brand spend as Google and Yahoo argue that the pay-per-click model is key in the brand activation that translates the awareness of a television campaign into website traffic for the TV advertiser: more slices carved out of TV budgets, and cut with precision and accountability.

The web? Just the job

Job advertising continues to be the lead category, among the ad revenues which can be pinned to certain industries. This time around, recruitment accounted for a quarter of all web



The digital media mix - % share of spend between formats shows how search dominates in the UK
 Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC (January to June 2007)

advertising spend (24.7%), up 5.3 points, and started to suggest that the main period of switch can be mapped out. Although volumes will continue to migrate, some spend will stay in both newspapers and magazines, but advertising form and structure will move towards brand messages about the recruiter (supported by their own recruitment websites as well as the myriad networks of third parties).

Finance sector matures

In contrast, while the finance sector was still up almost 40%, its share slipped down 3.9 points to 11.7% moving it into third place for the first time in many years. Hold back from thinking financial advertisers are losing their enthusiasm for the web: instead, much of their growing budgets and energies are being transferred into non-advertising strategies that focus on boosting customer acquisition through search engine optimisation (SEO), and boosting conversions through improved customer journey modelling within their own sites. Recent big spenders in finance that we surveyed focussed on the limits of online advertising in a saturated market and how they needed to fuel web customer acquisition with supporting tools.

Consumer goods: still missing a trick

As for consumer goods (CPG), adspend is making only slow progress in catching up to where audiences have migrated, but the switch to IPTV will see a step-change in CPG advertising.

Brand motoring budgets: another tipping point

Motoring firms get it. That's the conclusion you have to draw as automotive sector's spend swells further, placing it as the second largest single category of advertising brands. With a market share of 12.5%, the sector includes classified motoring listings as well as big budget video display formats. Smarter models of integrated marketing have placed the web at the heart of the mix for many motoring clients, and the media industry has responded, with rapid product innovation from motoring magazine brands, online pureplays, as well as vertical strategies from the likes of eBay and Google.

Outlook

Strong growth continues: web set to top TV

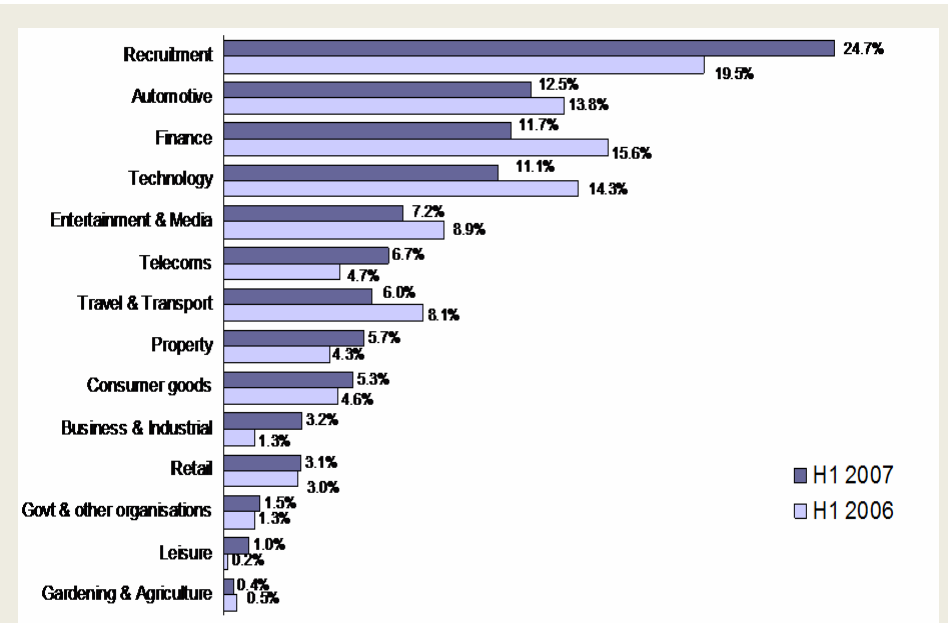
Where next?

Digital Strategy's forecast for the full year remains at £2.95bn, as does our forecast for online's share growing to over 22% and overtaking the television sector before the end of Q2 2010. If the share of television erodes disproportionately to the web during 2008, then the crossing point could happen even sooner.

The UK market continues to enjoy staggering growth, but this is part of a consistent pattern of annual increases above 40% every year since the dotcom recovery began. What's particularly interesting is the way search is continuing to hold its own, dominating all other formats and becoming a media channel in its own right. The UK online ad sector acts as an indicator market for the rest of Europe, and we are confident that once accurate numbers are available for the search sector, high market shares (30-40% of spend) will become apparent across Western Europe and Scandinavia.

The explosive growth of social media is finally being effectively monetised as media owners harness behavioural and contextual ad technologies, triggering a step-change in the profitability of consumer generated content.

At Digital, we're still bullish about the market, and see no signs of significant slowdown in the switch to online advertising, the use of search versus classic customer acquisition channels, or the switch to the web in business-to-business marketing. The looming correction in values among some of the internet stocks will have nothing like the same impact as it did in 2000 in advertiser confidence online because the business case is now proven and results are clear.



Sector market shares: Automotive overtakes Finance to rank #2. The data covers graphical advertising as well as search engines, but only includes paid-for media space, not websites or SEO.

Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC

Digital Thought Leaders
Thought Leader
Author and President of Capgemini

“You are the community you keep – or more importantly you are the community that keeps you.”

SEARCH INSIDE!
Life After the 30-Second Spot

DIGITAL STRATEGY CONSULTING

Meet the Digital Thought Leaders

Why do some firms get it so right, that their audiences and revenues explode? In periods of huge economic and social change, knowledge becomes the critical success factor, so we created the Digital Thought Leader interviews to bring you closer to people and brands shaping the digital networked economy. They are based on discussions we've had with them and are published monthly.

2008 will be the year when TV advertising supply finally gains traction on the web, and the explosion of online TV offerings - from content generators, TV networks and new aggregators this summer - will start to deliver material audiences. Alongside the standard slots, pre-roll IPTV and accompanying banner formats will provide the market with easy to use formats. This will help stimulate demand, just as the graphical formats in the Universal Ad Package did in 2003, and as budgets flow, they will create investment for new types of online programming from 2009 onwards.

Online advertising's ascendancy is a product of its results rather than false promise, and its ability to straddle both brand building and direct response is now well documented and understood.

Mobile marketing continues to swell, but for mobile advertising we still see early 2009 as the year the industry reaches its tipping point. The innovation in the use of SMS and digital outdoor advertising will continue to fuel marketers' enthusiasm for mobile, but only once the search, mapping and portal tools gain traction among the new generation of handsets, will we see the real arrival of mobile advertising.

Actions

Key takeouts; navigating change

Advertisers: Question whether your strategic media mix reflects where your audiences place their attention. There's likely to be a gap, and that means that the same marketing budgets could be working harder if deployed differently. Question whether the integrated marketing models you are deploying now are designed for 2008 or 2003. Invest in talent, with particular attention to training and retention of digital staff. Learn about the strategic models that can integrate your media more effectively, and heavily invest in data analysts to learn exactly what works and how: put the science into marketing and create a culture of optimisation of results.

Media owners: If not already in place, invest fast in building a digital strategy that helps protect your brand franchise, as well as manage revenue migration. Focus investment on building sustainable product rather than protecting short term ad markets. Train teams at every level, and invest in talent. Check your forecasts carefully to manage shareholder expectations as yields and volumes in classic media come under even greater pressure.

Offline agencies: Find strong digital partners and build integrated plans to protect your client relationships and continue delivering value. It's too late for many to migrate to digital and hire the teams needed, so by focussing on partnerships there's a way of managing change and retaining a role after the transition.

Digital agencies: Enjoy the continued switch into your market. Invest in building capacity to support growth, and invest heavily in talent, training and staff retention. To navigate the limitless choice of digital channels, build strategic models for media that can work across thousands of campaigns, and focus on analytics as a way of learning exactly what works and how: put the science into your client's marketing and optimise the results of the complete campaign rather than just the advertising delivery.

Investors: Continue to follow audiences and product development in selecting stock, rather than short term profits or revenues. Review portfolios against the Web 2.0 criteria and scrutinise evidence to look for sustainable rather than ad-hoc success from digital firms. Continue to anticipate the impact of disruptive technologies and shocks to the supply chain, as well as the effects of continued margin erosion within classic media. Be cautious about media firms that cannot transit away from the ad models of CPM and CPC when they melt into smarter currencies in the longer term. Pay particular attention to markets that will be pressured by wiki and search models, or firms with cultures that have not proved to be adaptable to change in the past. Anticipate the market correction we've been forecasting for late 2008 by focussing on firms with products and technologies that can be levered on a large scale by acquirers or partners.

Notes

Online adspend research methodology

The baseline definitions of advertising and the historic datasets are drawn from the PricewaterhouseCoopers study commissioned by the UK chapter of the IAB. This was established in 1997 and provides a data set that can be used as an indicator for the wider digital marketing sector, which is less effectively tracked.

Although there have been some changes to the methodology, and a modest amount of growth from new entrants to the research, it still seems reasonable to believe the survey now captures more than 90% of all online advertising. We are confident in these assumptions because Digital's founder was one of the original commissioners of the PWC research and helped run the study until early 2005.

However, the ad spend data includes no provision for online commerce or media space which is transacted in exchange for a slice of the revenues that result from a sale of a product. As a result this excludes affiliate networks such as Trade Doubler, consumer exchanges such as eBay and online shopping services such as Kelkoo or Tesco (except when advertising space is sold within those environments).

With many directory advertising products now becoming purely digital, there are definition issues that may lead to an understatement of the sector. Similarly print classified advertising can be understated because the online value of a cross media packaged deal is decided by the publisher, and that may not fully reflect the value of the online element.

Digital Training Academy programmes

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“Learning is like rowing upstream: not to advance is to drop back.”

Chinese proverb

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Our programme of training for media owners, consumer brands, agencies and business service firms covers more than 40 different disciplines within digital marketing and publishing. We cover everything from improving the effectiveness of search marketing to writing smarter email campaigns, from harnessing social networks and blogging, to strengthening media sales teams.

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If you have any questions about our approach to training, or the detailed content of the course then please email or call the team.



Making sense of a digital world

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