Profiling the world's leading digital ad economy
Market evaluation for UK online advertising

Digital Insight Report
April 2008

The switch to online advertising has not slowed down in Europe's largest digital media market. Online ad budgets continued to grow around 40% year-on-year, with the internet overtaking press classifieds for the first time and on course to overtake television in 2009. The sector now accounts for almost 16% of advertising spend and has risen by £2bn in three years. Half of this spend still goes into search engine advertising, but the breadth of brand building formats has broadened, and the arrival of video is triggering a new wave of growth. This Digital Insight Report draws upon data from the census of media owners managed by PricewaterhouseCoopers for the IAB, and provides our commentary on the market, both today and over the next three years.

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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.

"With web advertising set to overtake TV next year, the scale of shift has triggered a massive restructure in the media industry. It's not only the media mix that is changing, the core models of marketing have evolved. A new type of integration has emerged that blends digital and classic channels together, talking with engaged customers through their channel of choice. In the digital networked society, relationships between brands, media and customers are recrafted."

Introduction

Digital advertising: the switch accelerates

Every year we provide a commentary on the growth of the online advertising sector in our home market, the UK. We explore the related restructuring in the wider 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 that online advertising spend will exceed television, 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 advertising spend has much wider implications for the future growth and diversity in online media and entertainment. Since 2002, the UK has emerged as a trend-setting market for much of Europe and the US, providing a rare laboratory into the future of media; many of the trends explored here will be echoed across those markets over the next three years.

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 advertising market is the largest in Europe

The sector is now larger than all press classifieds and growing around 40% year-on-year

The share of advertising going into online is almost 16% and probably the largest anywhere in the world

The full year total for 2007 was £2.813bn - an increase of £797m year-on-year

Online spend broke £750m in a single quarter

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 growth

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

There is a three to five year timelag between where audiences place their attention and where advertisers place their budget

Regardless of the macro-economic conditions, the outlook for the online advertising sector over the next three years remains consistently strong

Context, overall growth and transition

Transition into the digital networked society

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 - the 2008 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 census conducted by PricewaterhouseCoopers, in partnership with the IAB, and our commentary explains where we believe the sector is heading next.

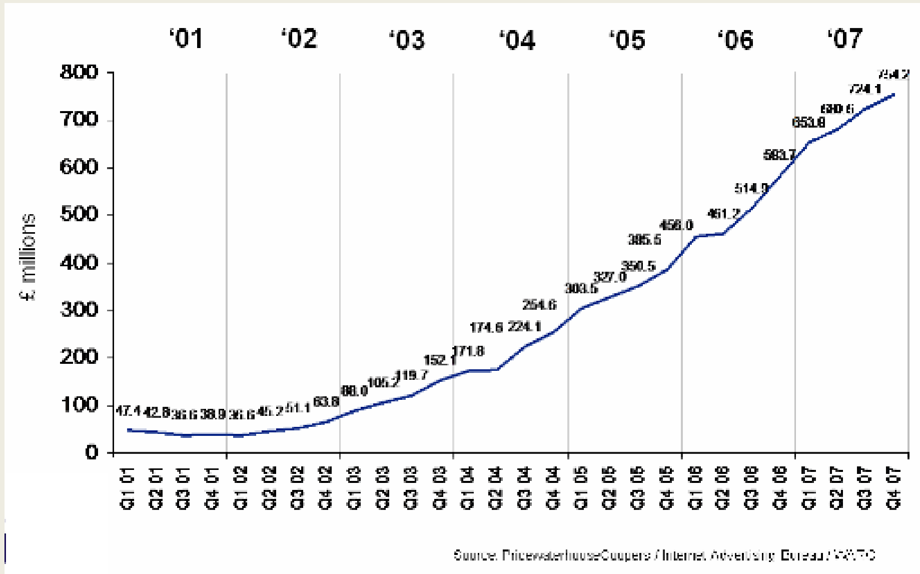
The online ad industry has already enjoyed astonishing growth, but this high level of annual expansion will be maintained, as a large range of both supply side and demand side drivers encourage continued increases in advertising investment. Media substitution is an inherent by-product of this as clients 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 in the middle of transition into the digital networked society. As more elements of the socio-economic ecosystem are connected digitally, and as the strength of those ties increases, the importance of these channels in the communications mix continue 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 digital media owners the confidence to build online properties to support this migration.

The UK is in the middle of a vast structural change in how its social and economic networks behave.

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 small part 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 finally being complemented by access on the move, the use of search marketing has changed customer acquisition models for good, and the effects of convergence are starting to squeeze 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 Americas 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 behaviour across all communication channels.



Online advertising reaches £750m in Q4 of 2007
Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC

Digital Insight Reports

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In times of huge economic 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. They are independent perspectives on key issues around business or marketing in the digital networked economy.

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 has triggered a fundamental substitution of media and communication channels, 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 three 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 instant messenger models of the 90s. This sector, while still embryonic in many areas, is continuing to create completely new advertising environments and that pace of innovation is part of the reason why continued rapid growth through 2010 is assured.

It's incomparable to the way any media market has developed before.

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. The dotcom crash of 2000 now looks like a trivial dent in the history of online advertising because the 22 quarter year segments that followed have each successively set and then broken adspend records. The initial resurgence in online advertising has turned into wholesale channel substitution, fuelled by online marketing strategies that deliver results, and enabled by web media properties that are grounded in sound economic models. The medium is the choice of the networked generation, and with clear value propositions to both users and advertisers, the pace of change will be maintained.

Supporting brand and direct response goals

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.

"There's a tremendous violence in traditional media as it continues to get displaced by digital."

Sir Martin Sorrell
CEO WPP Group

Insight and analysis

UK online adspend: set to overtake TV next year

The latest figures confirm there is no slowdown in the race to the web, with online recording its largest rise in a half year since records began. In spite of the high base the industry has already reached, the rapid switch to web marketing is continuing, challenging any suggestions that the market has matured. In Europe's lead media market, the internet's share of all advertising swelled to almost 16% in the second 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.

Key stats

- Full year 2007: £2.813bn - an increase of £797m year-on-year
- Year-on-year growth: 41.3% (first half year 2007 vs first half year 2006)
- Year-on-year growth: 38% (full year)
- First half of 2007: £1,334.3 million vs first half of 2006: £917.2 million
- Second half of 2007: £1.48bn
- Online breaks £750m in a single quarter
- Online adspend market share of UK total: first half 2007 14.7%, second half 2007 15.9%

As Digital's team had forecast, online adspend growth held steady at around 40% year-on-year – a 38% increase for the full year 2007 vs full year 2006 on a like-for-like basis. This makes for the largest quarterly rises, and triggers further concerns across the TV and print industries about the revenue pressures facing classic media.

Internet ad spend has increased by £2bn within just 3 years, the equivalent of the whole of the national newspaper sector

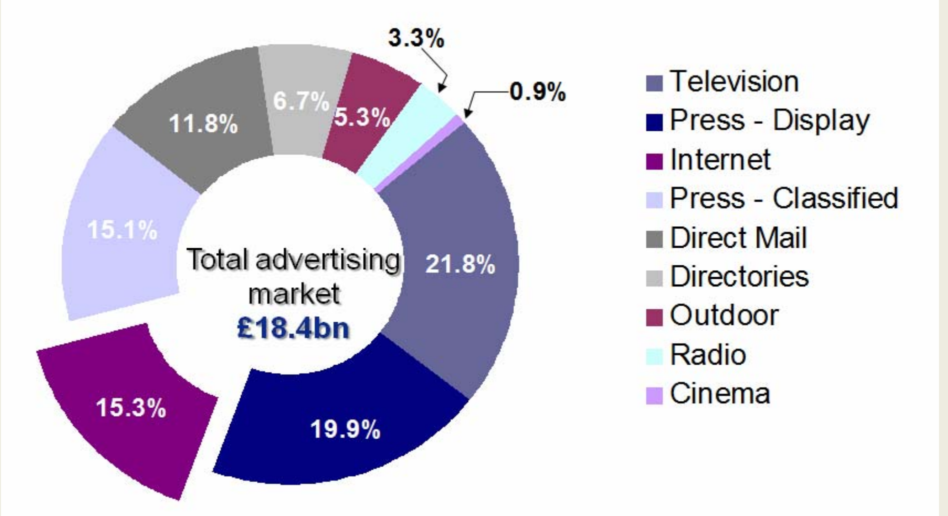
Massive leap in real terms

Internet ad spend has increased by £2bn within just 3 years, the equivalent of the whole of the national newspaper sector. The 2007 figures are actually over 38% up year-on-year because additional participating media sites joined the research, but to keep the data perfectly comparable, these firms are excluded from part of the analysis to provide a more accurate 'like-for-like' comparison.

Market share still rising at record levels
Across 2007 the web averaged 15.3% of total UK online adspend, up nearly three percentage points year-on-year. Online has just overtaken press classified (on 15.1%) and, with television accounting for 21% of spend, online should comfortably exceed the largest single media channel by the end of 2009. In contrast the radio sector has shrunk to just 3.3% of total spend. Direct mail continued to haemorrhage spend, with a loss of 6.5% year-on-year. The much larger press classified sector also sustained heavy losses, falling 3.2% year-on-year. By the last quarter of 2007, online was more than £100m ahead of press classified, which matched the direct mail sector for the first time in the same quarter.

Sluggish wider advertising market
The total ad sector rose 4.3% to £18.4bn, with outdoor and cinema the only channels outside the internet to rise above sector average. "There is no let up in the growth" explained IAB Chief Executive Guy Phillipson.

Minor seasonal trends
There are seasonal trends within the data, both in overall spend and within the market dynamics of the different sectors, however in aggregate these are masked by the complexity of a web advertising economy that draws from so many different sectors that these effects cancel themselves out.



With a market share of 15.3% online overtook press classifieds
Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC

International
The UK remains the largest online advertising market in the world in terms of spend per person and the market share online accounts for is 15.3% of the total media mix. The new data places the UK at roughly double the size of the US in terms of market share, and when comparable data for other European countries becomes available, the UK's position as Europe's largest online media market will remain clear, albeit reduced due to significant currency changes year-on-year.

The UK remains the largest online advertising market in the world - in terms of spend per person.

With the UK market acting as one of the world's trend setter digital economies for online adspend behaviour, the latest results will boost stock prices for internet firms across Europe and North America looking for models of their own country's digital economy a few years down the line.

Why the data can be trusted
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 revenue from the largest single player – Google. The data acts as a census of all online media owners and the consistent methodology since 1997 provides the most accurate of picture about how online media behaves. With 118 companies now participating, the census has swelled to include the largest number of firms so far. More details about the methodology are at the end of this paper.

The research forms the bedrock for analysing the online advertising sector. It was begun back in the middle of 1997 when a group of media owners came together to explore ways the market could better track growth and performance. In 1998 the online advertising sector was worth only £20m, however by the height of the dotcom boom the sector had reached £166m. After a modest contraction throughout 2001 and 2002, a resurgence began that would see it overtook radio, then national press, and direct mail, with the sector growing 41% to cross the £2bn barrier for the first time.

This research forms the bedrock for analysing the sector.

Topline growth hides turmoil
Overall the UK ad market may have fared well, up 4.3% to £18.4bn in 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 yields are under painful pressure and volumes continue to haemorrhage under the combined onslaught from the CraigsList free ad models, 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 the audience reach of TV stumbles and, worse, as ad effectiveness falls. When the Tivo effect of TV commercials being screened out altogether starts to really bite, the UK broadcasters will be in for a rough ride. 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 both profits and digital audiences. As Digital Strategy's team has been predicting since 2003, when the shake-out comes it will be larger and more brutal than most classic media (or many of their shareholders) predict.

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 is no media-buy involved.

Direct mail: losing to search and email

The statistics also confirm Digital Strategy's forecast that online marketing in many forms would draw budgets heavily from direct mail. Direct mail's market share will continue to fall across the next four years, and will suffer much more deeply as both customer acquisition budgets switch to search and retention budgets switch to email and then mobile. 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 is no media-buy involved. Add to that the massive investment most firms have now made in their own web presence, and a much starker picture emerges; marketing has gone digital, and advertising is just part of that story. The exceptionally high production and distribution costs of direct mail make it an increasingly less attractive option, even though sophisticated marketers have proven that strategies which combine DM with email can create a major overall uplift in effectiveness.

The digital media mix

The balance of advertising formats

Balance between the ad formats remains steady

Search engine advertising continued to hold market share at around 58% (57.8% 2006 vs 57.6% 2007) and display advertising held at comparable levels (21% vs 20.8%).

Search still takes the lion's share

The pay-per-click sector now weighs in at a staggering £1.62bn; with spend in the first half of 2007 accounting for£762m and swelling to £857m in the second half. By January 2008, 29m people were using search engines each month in the UK. The fact search spending is now rising in line with the total sector, growing 39% year-on-year rather than over 50%, reflects strong health but a slowdown in growth as advertisers broaden their online ad formats. The search sector has also completed the initial transition of budgets among early-mover advertisers which means growth of over 40% will be harder to achieve from here on. Figures for the search engine optimisation sector, now converging with the affiliate industry, are unavailable, so in terms of how marketers see the world there is a significant additional search spend that is not reported.

The advertising switch to search is now deep in a positive feedback loop that looks unbreakable. Massive search revenues from Google, who reported $2.5bn of revenues from the UK during 2007, 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.

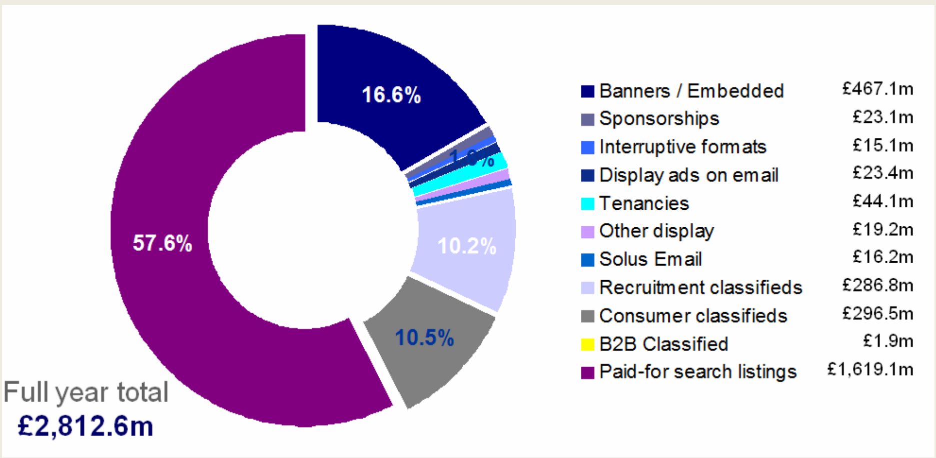
The combination of staggering profitability, market concentration, shareholder expectations and technical integration, have created a climate for sustainable, yet exceptional, product development. By giving customers the tools and applications they want, the mega-brands of digital are securing unstoppable 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, it is now getting a window into brand spend as Google and Yahoo successfully argue that the pay-per-click model is key in the brand activation that translates the awareness created through a television campaign into website traffic for the TV advertiser: more slices carved out of TV budgets, and delivered with precision and accountability.

Display shows strong performance by dynamics change

The display advertising sector crept close to £600m for the first time (£592 total for 2007), boosted by new formats and the broadband effect. Display includes banners, sponsorships, expandable and rich media formats, but with pre-roll video advertising buried inside the embedded advertising category, it's unclear what the size of the nascent video market truly is. The year 2007 was when television advertising started to become a real possibility for many media owners, and anecdotal evidence collated by Digital Strategy suggests many media owners are seeing revenues treble year-on-year, albeit from a low base. Although no figures exist that isolate video advertising, it is clear that web video is growing fast, although from a low starting point. Within the display sector, banners and rich media formats have risen 45% year-on-year while tenancies shrunk 40%, suggesting that the model which drove the tenancy explosion several years ago has now passed and that the rise of affiliates and email relationship building is successfully replacing the tenancy.

Classified growth masks turmoil offline
The classified sector changed a great deal with recruitment still enjoying the lion's share, but growth slowing. Until the start of 2005, recruitment had accounted for more than 75% of all online classified. Research by Digital Strategy with media owners across various UK advertising sectors has revealed continued pressure on yields that is unlikely to be removed. The market dynamics have changed, and although all media groups have not felt the full effects of this yet, we are confident they will by the end of 2008. The US market – where CraigsList had a greater impact much earlier – provides interesting insights, and only recently 26 newspaper groups in the US launched a strategic partnership with Yahoo to share the high yield recruitment advertising in the face of exceptional market pressures on the stand-alone print products. That ten year deal reflects the scale of change in the classified sector, and when viewed in the context of the Google Press Ads initiative, and the increasingly common local IP geo-targeting of display advertising, it is clear that the pressures on print have far to go before they level off.



The digital media mix - Search continues to dominate the UK online industry
Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC (full year 2007)

Industry structural change

Growing roles for networks

The role of sales networks has come of age, with some 40% of display advertising spend now channelled through them. The networks have tapped into the long tail by offering an immediate revenue stream to the smaller and mid-tier sites, while building in additional revenues – historically through low yield cost per acquisition (CPA) advertising – even to the largest online media owners. The acceleration of behavioural targeting in 2006 has delivered a step change in the advertising yields within networks, and although pioneers such as Yahoo have had behavioural mechanics in place for eight years, it is only now that media planners are ready to engage heavily with advertising budgets.

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Sales networks such as Tacoda, Advertising.com and BlueLithium have all enjoyed dramatic growth as the network sector accelerates, and all this, before any of the new generation of network services linked to the ISPs take off. Within the network sector there is no specific breakdown for behavioural targeting, but informal estimates suggest that 15-20% of display spend today probably goes through behavioural networks. A recent survey by the Association of Online Publishers flagged up 84% of media owners seeing key areas of opportunity in behavioural targeting, suggesting this sector will now accelerate well ahead of market average.

Advertiser sectors

Rapid growth as new sectors emerge

Job hunting shifts channels
Job advertising continues to be the lead category, among the ad revenues which can be pinned to certain industries (about 41% of total). Although volumes will continue to migrate, some spend will stay in both newspapers and magazines, but Digital Strategy sees advertising models in classic media move towards brand building messages about the recruiter, with online delivering the response. The changing nature of classified yields is a trend we have been tracking across Europe since 2003, and as large recruiters invest in their own sites (as well as the myriad networks of third parties), pressures on print yields continues to increase.

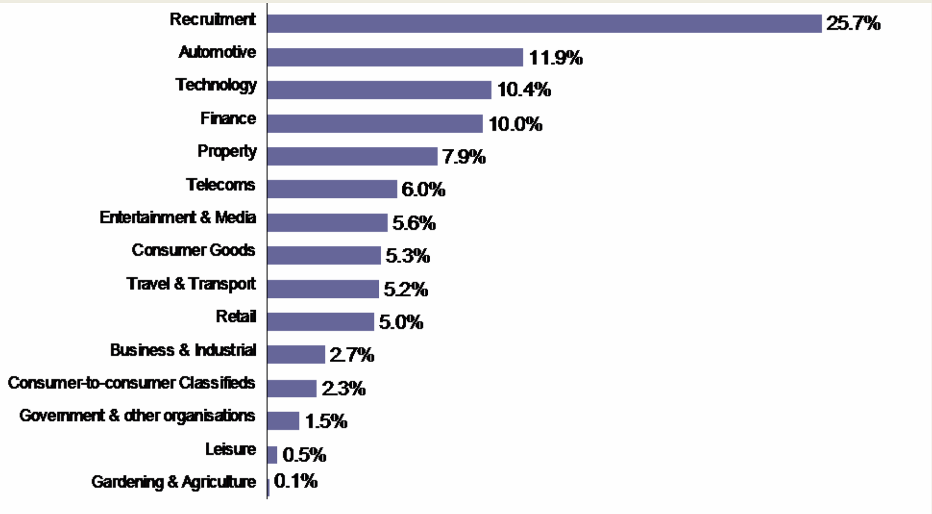
Key industry categories: motoring and property

The rapid growth in automotive and property reflects a fundamental and permanent channel shift and leaves a bitter impact in the regional press and magazine sectors as ad dollars follow the audience eyeballs. With motoring spend up into second place (accounting for 11.9% of total online adspend), it is clear that the transition of brand spend in the automotive sector is building on the shift in classifieds that took place several years ago. Property entered the group of top five sectors for the first time to reach 7.9% of online advertising.

With the conversion to online commerce still in its early stages, there is no question retail will continue to rise.

Retail accelerates

The retail sector swelled from 3.3% to 5%, propelled by a leap in ecommerce spending which jumped a massive 54% year-on-year to £46.6bn. With the conversion to online commerce still in its early stages, there is no question that retail will continue to rise. In retail, web advertising forms a vital link in product discovery as well as boosting retailer brand equity. Affiliate networks are clearly driving retail advertising sales online, and as the UK retail sector heads into a tough climate, the web looks set to be a strong beneficiary: “The affiliate model in particular is providing highly accountable and effective costs per acquisition” explains Phillipson.



Sector market shares: Recruitment continues to lead. 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

In retail, web advertising forms a vital link in product discovery as well as boosting retailer brand equity

Finance sector matures

The finance sector was still up significantly year-on-year, but with much financial marketing spend in search engine optimisation, website design and other techniques not covered in the research, projections of the finance sector based purely on online advertising will significantly understate the market. Hold back from thinking financial advertisers are losing their enthusiasm for the web: financial firms are among the most sophisticated of web advertisers, crafting advanced strategies that focus on customer acquisition techniques and refine every step in the conversion process.

However, much of their growing budgets and energies are being transferred into non-advertising strategies that focus on boosting customer acquisition through search engine optimisation, boosting conversions through improved customer journey modelling within their own sites, and boosting retention and loyalty with stronger electronic relationship management (eRM). Recent big spenders in finance 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.

Financial firms are among the most sophisticated of web advertisers, crafting advanced strategies that focus on customer acquisition techniques and refine every step in the conversion process

Consumer goods: still missing a trick

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

Limited data

The fact that only 41% of online advertising can be broken down into detailed industry sectors is frustrating, because in spite of the large sample size, it is not representative. The sample reflects the nature of classified and display advertising only, and does not represent the behaviour of the search sector which accounts for over half total spend.

Google and several other significant media owners are unable to provide market breakdowns, but if this were the case Digital’s team expect that the finance sector could be back in pole position, with retail also proving to be a disproportionate beneficiary of the search sector.

Sector outlook

Strong growth continues: web set to top TV

Audience growth swells the potential market
32.5m people are now online in the UK and over 90% of those connected are on broadband. With an acceleration in the speed of those connections, the scope for advertising has grown. The nature of broadband has changed dramatically in just the last 18 months: by November 2007, 54% of broadband access was faster than two megs per second and today the average speed of broadband is four megs.

This has created a step-change in the nature of consumer's experiences on the internet, but one that wireless access promises to continue advancing. According to BMRB, half the UK online audience has used wireless internet in the home within the last two months (survey date February 2007). "That means more eyeballs and more dwell time" explains Phillipson who sees the falling cost of access (both devices and bandwidth) as being a certainty for maintaining growth in adspend figures.

> There is a three to five year time-lag between where audiences are focussing their media attention and where brand owners focus their advertising budgets

With the gender balance now even, the range of potential advertisers has broadened. The scope for FMCG firms to use the web as a mainstream media channel is clearly in place, and women 25-34 now spend more time online than their male counterparts. Alongside the feminisation of the internet in the UK, there has also been a gradual swelling of the grey market, with one quarter of all Brits online now over fifty years old and collectively accounting for 30% of internet use.

The effects of these changes in demographics will see the broadening of the advertiser base over the next three years even if there were no further changes in audience time spent (something certain to rise). That is because most brands are still in the relatively early days of exploring their new advertising channel and the nature of their experimentation will predictably lead to more investment from each firm.

Since 2002, Digital Strategy has been aware that there is a three to five year time-lag between where audiences are focussing their media attention and where brand owners focus their advertising budgets.

Stronger strategies from media groups
There is also a cultural shift in the attitude of media groups to where digital channels fit and what the strategic framework should be. "The business models of all media companies have now embraced online" commented IAB UK chairman Richard Eyre. "Over the last 18 months the internet positioning of traditional media companies is now a cleverly worked compliment to classic channels."

Where next?
Digital Strategy's medium term forecast has been revised upwards. Four years ago we forecast online to overtake television advertising spend by the end of Q1 2010, now we are confident online will overtake television to become the lead media category in the UK towards the end of Q3 2009. By the end of 2010 there will be definitional challenges about the roles of different media because IPTV spend will be a significant category in its own right with both internet and TV sectors staking their claims to owning the data.

Our Q1 2010 forecast puts online's market share at over 22%, with television's share eroding further into the high teens.

> We are confident online will overtake television to become the lead media category in the UK towards the end of Q3 2009

The UK market continues to enjoy staggering growth, but this is part of a consistent pattern of annual increases of 40% or more every year since the dotcom recovery began. What is 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. Because the UK online ad sector acts as an indicator market for the rest of Western Europe and Scandinavia, we are confident that once accurate numbers are available for the search sector, high market shares (30-40% of spend) will become apparent across the region.

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.

Recession or not, online emerges on top

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 stock values among some internet firms will have nothing like the same impact as it did in 2000 in advertiser confidence on the web because the business case is now proven and results are clear.

The weakness in the North American economy that has spread throughout world financial markets is likely to have a minimal impact within online. As with previous economic cycles, the measurability of search, website customer acquisition, email and online lead generation are likely to see an acceleration in the shift of advertising budgets to web media as marketing directors tighten their purse strings. In the classified sectors this will benefit web media properties in part, but much of the classified volume is likely to move into new formats and payment models, further pressuring advertising rates, and including business models that disintermediate some media from their role in the value chain.

"Online is 'direct response heavy' as a channel," explains Phillipson. "85-90% of web advertising is direct response so if you're a marketing director faced with the challenge of cutting budgets, you're less likely to look to online."

Television advertising set to flood onto the web

For three years Digital Strategy has argued that 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 – is now delivering material audiences. With 90% of connections now broadband, the average broadband speed now 4 megs, and media owners unleashing large volumes of high quality video content, the conditions for video advertising to accelerate are now right.

> 2008 will be the year when TV advertising supply finally gains traction on the web

The Association of Online Publishers recently discovered that 70% of media owners see key areas of opportunity in streaming media, suggesting this sector will accelerate well ahead of market average. Given that most participants did not have a broadcast media heritage, it also underscores the determination of the print sector to acquire broadcast assets.

Media brands have experimented with video for years, YouTube democratised access to video from 2006, but brands can now have the assurance that audience volumes and programming quality have crossed a critical threshold. This will unlock new budgets, and in particular, the sudden arrival of in-stream video advertising formats will draw investment out of television plans and into online. Alongside the standard slots, pre-rolls and companion banner formats are providing the market with easy to use tools. 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 which will flow properly from the start of the 2009 financial year.

> With 90% of connections now broadband, the average broadband speed now 4 megs, and media owners unleashing large volumes of quality video, conditions for video advertising to accelerate are now right.

Mobile marketing continues to swell, but for mobile advertising, outside of Japan and Scandinavia, Digital Strategy 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 higher rates of adoption by iPhone generation handsets are needed before the mobile experience matches up to consumer expectations. Search, mapping and portal tools will then quickly gain traction among those connected, and creates the right precursors for the real arrival of mobile advertising.

> 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.

Overall growth: topping TV within 18 months

In terms of where the sector heads next, it looks set to draw level with press display during 2008 and comfortably edge above television in the fourth quarter of 2009. With economic factors likely to hit the TV market from late 2008, the position of internet looks even stronger and after 22 record-setting quarters, even a slower growth rate will comfortably push online into pole position.

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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.

Appendix

Online adspend research: methodology notes

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 95% 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.

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