

Digital advertising futures **Three year online advertising spend forecast**

Digital Insight Report
April 2005

This report tracks the take-off of online advertising since the mid nineties and forecasts its rise to become one of the dominant media channels for marketers within the next three years. It predicts online will exceed £2bn in 2007 and quickly consolidate a market share comparable to national newspapers. It outlines some of the key drivers and suggests the role of search will become even greater.

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Speed read

Total market to top £2bn in 2007. The real shift in marketing focus is now emerging.

The total value of the market will continue to grow rapidly with the rate of growth accelerating in 2005 as search is discovered by more clients and general online spend increases among existing clients. Total spend will cross the £1bn threshold in 2005 and £2bn in 2007.

Within this pattern there is clear seasonality and annual marketing cycles.

Search engine advertising comes of age, becoming understood by the mainstream marketing community. Its growth is unstoppable and unmatched by any advertising format in the UK's history of marketing.

Innovation in advertising products - particularly search - will continue with the arrival of local search, mapping and pay-per-call models.

As well as increases in connectivity, key drivers include the effect of the broadband boom, the rising use of the web in people's lives, the switch into online shopping, the changing customer journey, growing creativity, and how direct marketers and small firms have discovered the power of search.

Digital advertising futures

Although the first web advertising was sold in the UK eleven years ago, it has only become a mainstream marketing tool in the UK since 2002. The marketing industry is in the midst of a dramatic cultural and structural shift as it embraces online and the other emerging digital channels and these forecasts reflect the scale of those changes.

The industry today 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. But there's also a wider issue of the value media channels bring to clients in a digital networked society.

The long term outlook remains extremely positive, because as more elements of our economy and society are connected to these digital networks, the importance of the channels in the communications mix continues to rise. With technical and social innovation consistently high within digital services, this will hold true for the long term as well, giving even the seasoned online advertiser a reason to invest further.

This means the UK is in the middle of a vast structural change in how its social and economic networks behave and online advertising is a net beneficiary of this. Many of the trends within this change are becoming clear (for example retailing through the web, fast access at home, access on the move, the use of search marketing), but the behaviour of the advertising market today only hints at what will unfold over the next decade. Although not discussed in this report, these changes affect firms in the 'offline' world as much as those engaged directly in the digital channels, because firms and consumers both behave differently as a result of exposure to the digital networked economy. What happens between advertisers and consumers as a result of the internet is an example of this, and it affects the behaviour of both groups across all the communication channels they use. The mass market adoption of the internet is triggering a fundamental substitution of media.

The speed of development within the digital marketing industry is 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 audience growth are the norm. Since the dotcom crash in 2000 there has been a huge resurgence fuelled by online media, 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, positions it as the most comprehensive tool for all marketers.

Total market to top £2bn

Total market growth

The total value of the market will continue to grow rapidly. The growth rate will accelerate in 2005 as search is discovered by more clients and general online spend increases among existing clients. Total spend will cross the £1bn threshold in 2005 and £2bn in 2007.

This period heralds a continuation of the consistently strong growth within search. Graphical and classified advertising will both enjoy growth rates well in excess of 50% year-on-year in 2005 and 2006, although as the payment models within classifieds start altering, this will become increasingly difficult to quantify.

The industry growth rates of more than 80% that characterised the resurgence after the market correction in 2000/2001 are unlikely to be repeated after the 2004-5 wave of growth. However, even though we believe growth will slow to levels below 40% before the end of 2008, the annual rises in real terms will be very high – more than the entire value of cinema advertising for example.

Seasonality and annual cycles

Within this pattern there is clear seasonality. The seasonal patterns of different client sectors

(Motoring, Travel, Finance) has been apparent online since 1999. What has now emerged is a seasonality in format selection, with search enjoying a significant boost in the Q4 Christmas marketing period. There is also evidence of consistent step changes in investment each year triggered as the annual cycles of marketing budgets reflect new thinking about the firm's media mix.

Complex patterns as marketing culture changes

Although headline growth remains high, this masks a more extreme pattern of the different experiences between firms. Growth will neither be even across all industry sectors that advertise, nor across the advertising products advertisers select. Online marketing is still being discovered by most firms, so while one business may be just testing the water, a competitor in the exact same sector may be investing more than 20% of its media budget into online.

Marketing culture is changing fast to acknowledge the importance of digital channels, but many firms are still aiming for a position drawn from their understanding of the scale of digital's impact in consumers lives three or more years ago. Firms who quickly feed their customer intelligence back into the market are able to respond to the continued rapid growth. This means that some sectors within the online industry will be disproportionately affected by the growth. As the general understanding of online marketing improves, firms that have lagged behind in their investment in certain techniques are likely to catch up more quickly.

	Actual							36 month forecast		
Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total online ad revenues (£m)	19	51	153	166	197	408	653	1150	1550	2150
Search (approximate % share of total online spend)	0	<-1	5 (estimate)	12 (estimate)	25 (estimate)	35	40	45	46	47
Industry milestones		Online becomes larger than cinema advertising	Dotcom boom: £50m in one single quarter	Capital market corrects, shaking confidence in online	Sector doubles in size, becoming larger than in boom	Six consecutive quarters of record-setting growth	Online becomes larger than radio advertising	Online becomes larger than outdoor & transport	Online becomes larger than directory advertising	Online matches or exceeds national press advertising

Online advertising spend growth forecast

Using data from the historic the industry audit of advertising spend, managed by PricewaterhouseCoopers since 1997, we map out what we believe are likely advertising spend scenarios for the next 36 months. This forecast data (shaded) for 2005-7 reflects a reasonably likely picture of the market's development.

Source: Digital Strategy Consulting – April 2005

Search comes of age

Compelling proposition

The compelling proposition of search marketing is finally becoming understood by the mainstream marketing community. It's growth is unstoppable and unmatched by any advertising format in the UK's history of marketing. It offers unparalleled accountability and control, and usually generates leads for a much lower price than other channels. While researching these forecasts we consistently heard from advertisers that search was saving them 50%-90% of their cost per lead (in some cases leads were being generated for less than 4% of what the client had traditionally paid in print media).

Strategically search is also one of the main drivers in bringing advertisers onto the web for the first time. Search engine advertising is the fastest growing advertising format in the history of media. The search advertising sector is already several times larger than the UK cinema industry and will become larger than the radio industry at the end of 2007.

Listings in online search navigation were among the very first advertising formats created on the web, but it was only in 1999 that the self service and pay-per-click models emerged. These simple to use tools acted as a release valve for the huge pent-up demand created to drive traffic to websites. Search engines made a compelling offer to advertisers and website owners: a guaranteed immediate stream of interested viewers that could be increased or decreased in a perfectly controlled way. This is the purest form of direct response advertising.

It is also one of the few advertising models truly native to the web. With the bid price set by the community of advertisers, and the value generated by the viewers, its growth in scale will track the wider growth of the internet in corporate life and the individual user's world.

Real shift in focus now emerging

Markets don't adopt innovations uniformly. In spite of the rapid take-up of search, its use is better characterized as a patchwork of adoption between different firms and different sectors. The picture is changing fast as more and more firms uncover the power of search engine listings. Financial services will remain the most dominant vertical sector throughout 2006 and 2007, but search will prove particularly successful in attracting the small local firm – micro-businesses – by creating a model that any proprietor can engage with providing they have a credit card and internet access. This means that even if the rapid innovation in search advertising products and technologies were to stop, the demand would continue increasing as more advertisers discovered the existing tools.

Innovation continues

The arrival of local search will raise the stakes of the proposition to local firms, tackling head-on the value proposition of local yellow pages directories. The geographic precision of local listings (combined with the ease of presentation for the viewer) will both undergo step changes within all the main search engines. Mapping tools will fuse the 'real' and 'virtual' worlds together, unlocking a new relevancy in both the advertiser's and customer's minds. These will be woven into the fabric of search results, with listings presented accurately in overlays onto local streetmaps to show where the firm is based. The next steps into satellite imagery and then local video will create new ways to navigate the data and new advertising opportunities for firms.

Search engines will fuse with telephones in two ways. The first is the simple migration onto mobile phone handsets as these devices become internet gateways. Search will be one of the most important internet applications phones are used for, and this will increase the time throughout the day people have access to search engines. This creates new advertising inventory as well as new audience needs (much of which will be at the expense of the 118 directory enquiry telephony services). The second link to telephony will be even more profound in its effects. Pay-per-click based search advertising will be joined by pay-per-call models that will link customers to advertisers by phone calls. This will be through dedicated advertiser telephone lines initially, and later will merge into the traditional systems of voice and email. What is clear is that as a user clicks on a button on the search pages, a message is triggered for the advertiser to call them.

Key players drive take up

The self-administered toolkits offered by the main engines and search agencies have created a step change in the ease of use, enfranchising tens of thousands of small organisations into the market. At the larger end of the client community, concerted efforts by the key search properties Overture/Yahoo and Google in 2005, and additionally MSN in 2006-7 will maintain the marketing momentum. Within the large agencies restructuring will continue to better position them to take advantage of search engine advertising. Meanwhile specialist search agencies such as The Search Works will continue to innovate within the market and redefine the role of an agency within an increasingly complex technological framework. The net result is that while the product offerings from search firms will become more complex, for advertisers it will become easier to plan and buy. Investment in search so far has not only been drawn from all other advertising media, but also from wider marketing, promotional and business development budgets within the client. The balance of this will adjust as search rises to become the dominant direct marketing customer acquisition tool by 2010.

Drivers of growth

What are the supply side drivers of growth?

There are more than twenty drivers behind the growth in online advertising that Digital Strategy Consulting is tracking. All of the demand side and supply side drivers remain strong (many extremely strong), even though growth in the total number of connected consumers has softened. The unique relationship between audience volumes and their creation of incremental advertising inventory is having a massive effect on the supply of potential media space – although this is not currently being tracked effectively by any of the commercial research providers. Some of the key supply side factors that have been consistently strong influencers during the last few years include:

The effect of the broadband boom – Although faster connections are opening up a whole new genre of video-based advertising, broadband take-up remains a key driver because it changes the nature of the at-home internet experience. Broadband users spend more time online, visiting more sites and using the web more heavily.

Rising use of the web in people's lives - The role the internet plays in people's lives continues to grow, and the continued expansion of what is possible online – blogs, music, search, shopping – this is just as true for experienced internet veterans as it is for newcomers. This raises both the supply of media, and then the demand by advertisers.

The switch to online shopping – The well-documented channel shift from the high street to online is generating a range of advertising needs that will grow steeply during the next five years. This includes advertising inventory within online stores, the use of affiliate networks, the brand building campaigns needed for online stores, and of course search advertising.

The changing customer journey – For big ticket purchases - cars, homes, holidays – the web has already emerged as being the first port of call for many customers. Although this reflects their use of the advertisers' own sites (which contain the information needed to research the purchase), this change in the customer journey will soon be followed by the associated advertising communications that have used (in particular) television and print in the past.

Growing creativity removes a barrier - Technology innovation has raised the scope of what is possible within a web advert. From banners to search engine listings, video to microsites, there has been a significant step forward in the functionality and process surrounding the advertising creative, removing a barrier that stopped many firms (and even some sectors such as motoring) from readily embracing online advertising.

Direct marketers and small firms discover the power of search – Search will continue to be the largest driver of growth within online advertising.

Crossing further milestones in market share

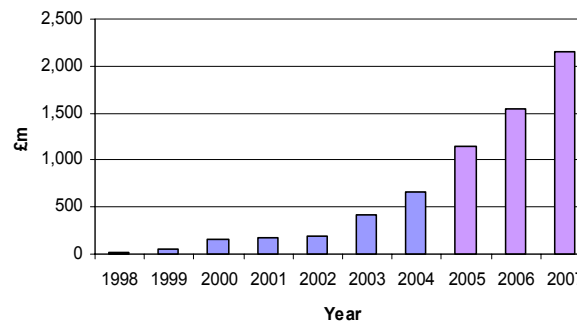
Overtaking radio

Since 1997 the online advertising industry has benchmarked its growth by tracking its market share of total UK advertising spend, making it more tangible to many marketers. In the Autumn of 2004 the online industry leapt over radio, a media channel with a relatively stable market share (ranging between 3.7%-4.1%). Even with the advent of new stations and the digital radio franchises, radio advertising is not exhibiting any fundamental change, making us confident that this 'overtaking' by online is permanent.

Overtaking outdoor and transport

Online will cross 6% market share of total UK advertising by the close of 2005. By this time it will have overtaken the Outdoor & Transport advertising sector, although if rates are slower than we predict then the seasonality in that sector could lead to it being overtaken early in the year and then overtaken again later in the year. Outdoor is the second fastest growing media channel after online, and although its growth rates are much smaller (less than 20% of online's), the growth is set to be consistent through 2006-8. This is being driven by a fundamental change in the advertising product as outdoor media starts to adopt digital (and even online) platforms and standards. Although as long as twenty years ago television screen advertising was being piloted on the London underground, digital media will now become a routine element within the outdoor industry. This is happening well in advance of the arrival of digital paper (probably around late 2008) which will then trigger a further growth phase. Further reasons for the growth in outdoor include the way the fragmentation of other media is

Total online advertising spend



Online: becoming one of the main marketing channels

UK online advertising spend growing to top £1.5bn in 2006 and £2bn in 2007. Search advertising accounts for nearly half the market.

Source: Digital Strategy Consulting – April 2005

making it a relatively more powerful awareness tool.

Overtaking directories

Growth in market share will continue at levels unseen by other media. The growth will continue to be very strong, although it will be at a slightly reduced rate for 2007 and 2008. Online will easily exceed the size of the directory advertising market in 2006, although this will take longer to quantify because of the reporting cycles of directories. If growth continues in line with our forecasts, then online will either match or exceed press classified advertising in the last quarter of 2007.

Beyond 2007

The longer term outlook for online remains extremely positive. Because the growth is being driven by such a range of drivers, and as part of this the supply of media continues to leap, we're confident of maintained annual growth rates in excess of 20% for 2008-10.

Notes

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. 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 captures more than 85% 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 it from 1999 until early 2005. However, neither it nor these figures include any 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 defining issues that may lead to an under-valuing of the market. Similarly print classified advertising, where the online value of a cross media packaged deal is decided by the publisher, may not fully reflect the value of the online element.

Actions

Reflect on the scale of the changes in these forecasts and consider their implications for your firm. How can you structure yourself to take advantage of them? What extra skills and resources do you need?

As media substitution continues, a new landscape of media is emerging. What are the wider implications for your firm as this new structure settles in? Map out the strategic options and review your own strategic plan.

Use this data to calculate your market share or investment in online against the industry averages to benchmark your performance. Devise a sector tracker that quantifies your addressable market.

Media agencies: review your media selection patterns every six months to check where your firm is in relation to these wider changes.

Advertisers: contact us about the latest thinking in your strategic media mix

Resources & Links

DigitalStrategyConsulting.com for further insight reports about marketing and commerce in the digital networked economy, including:

- **Winners and losers** (Planned December 2005)
Tracking digital media substitution and the shift in advertising spend
- **Digital Europe** (Planned February 2006)
Tracking the growth of online marketing spend
- **Search me** (Planned March 2006)
Key tricks for getting the most from search engine advertising
- **Digital Advertising Futures** (Planned April 2006)
Three year online advertising spend forecasts

Analyst's profile: Danny Meadows-Klue

Danny has been an international commentator on the digital networked industries since 1995 when he was appointed to manage the UK's first online newspaper (telegraph.co.uk) and has helped run web businesses ranging from mass market portals and consumer magazines, to online stores and search and email services. He has been cited by the DTI as being one of the 100 founders of the UK internet industry, and acknowledged by trade magazines for many years as being one of the most influential figures in his industry. He is the co-founder and former chairman of the UK and European Internet and Interactive Advertising Bureau trade associations, and has helped launch twenty further digital trade associations and initiatives around the world. He has been lecturing on digital marketing and publishing for more than a decade and set up Digital Strategy Consulting in 2000 to help firms make sense of the rapid changes brought about by the digital world, showing them how to harness the potential of the digital networked economy. He is an enthusiastic educationalist and continues to teach university students on Masters courses and senior executives on business courses. He is the inaugural chair of the examination board for the first Diploma in digital marketing, and a longstanding member of the journal of Interactive Marketing. Danny is a geography graduate of the University of Bristol and lives in London. Details of his current speaking engagements along with a full biography and recent articles are available on DigitalStrategyConsulting.com



About the Digital Insight Report series

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, and are published monthly. We also publish similar Digital Thought Leadership interviews and Digital Book Club reviews to share the ideas and thinking of some of the people and companies shaping the digital networked world. These often accompany our keynote talks and training workshops. Making sense of the digital world can be tough, but knowledge and training can unlock the potential of your team.

Our company support programmes includes

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Making sense of a digital world

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