Booz | Allen | Hamilton

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The Future of Advertising: Implications for Marketing and Media

Throughout 2005, Booz Allen Hamilton engaged in a dialogue on the *Future of Advertising* with Fortune 500 CMOs and senior media and entertainment executives. From these conversations, our client work, and research we've conducted with the Association of National Advertisers (ANA), it has become abundantly clear that shifts in consumer, marketer, and media behavior have passed a tipping point. We expect 2006 to open a widening gap between those marketers and media companies that know how to engage an increasingly "in-control" consumer—and those that do not.

Most companies have long since accepted that their world has changed and that they need to get more personal, digital, and interactive in their marketing and media mix. But the true leaders are those already taking action to ensure they are positioned to win in this new environment. They are investing today in assets and capabilities that will effectively reinvent brand marketing and ad sales as we know them. Who is the central catalyst in this transformation? An emerging class of "Super CMOs," who are building new integrated marketing models that are more ROI-focused, multi-platform, and targeted than ever before.

In this letter, we offer our perspective on how these developments will reshape media and marketing, and what companies can do today to prosper moving forward.

Why the Future of Advertising Is Now

I. *Momentum away from traditional media will accelerate:* As marketers follow their consumers and seek greater impact, they will shift spending away from traditional media at an ever-faster rate.

II. *Consumers: From captive to interactive:* As consumers opt for more personalized content, all media must determine how to become more "two-way."

III. *Digital video will usher in new advertising models:* Digital media will receive strikingly higher shares of marketers' budgets and attention as broadband video over fixed and wireless platforms begins to penetrate, shifting the value proposition of the Internet from information tool to entertainment vehicle and increasing both consumer media time and advertising inventory.

IV. *What matters will be what's measured:* Marketers are increasingly allocating their media buys based on how—and how well—they measurably influence purchase behavior.

V. *Marketers will go direct-to-consumer more and more:* Marketers are building their own "impact" and "insight" capabilities, raising the bar for agencies and media companies. Increasingly, marketers are working directly with media companies and, in some cases, bypassing them altogether.

I. Momentum Away From Traditional Media Will Accelerate

For more than a decade, leading marketers have registered growing displeasure with many traditional media—especially broadcast television—that continue to raise prices in the face of declining efficacy. Many leading marketers—Anheuser-Busch, Procter & Gamble, and DaimlerChrysler, to name a few—are actively rebalancing their media mix to emphasize more targeted platforms and messaging.

This shift reflects fundamental changes in consumer media habits, as more people spend more time accessing information and entertainment via digital media platforms—cable TV, mobile phones, video games, and, of course, the Internet. This shift in media consumption has fundamentally changed consumers' expectations of advertising as outlined below:

> *Two years ago, 10% of my advertising budget had an online component. Today it's 30%. Two years from now, it will be 50%. And overall budgets are* not *growing. It's all coming at the expense of television and print."*
>
> - CMO, Big Three Auto Company

Exhibit 1

From Impression...	...To Relevance
Consumers opting out of non-targeted broadcast advertising	Allow non-intrusive messaging (e.g., branded entertainment)
Annoyed with intrusive advertising	Prefer opting-in (e.g., e-mail newsletters)
Ignore non-relevant advertising (e.g., banner ads)	Demand targeting to <u>their</u> needs and profile (e.g., purchase history)

Nonetheless, many marketers' media budgets remain mired in a traditional, TV-centric model. Their ad spend allocations trail what increasingly influences consumer behavior (e.g., buying guides, the Internet, and targeted articles in the case of the auto industry).

This schism highlights both the challenges *and* opportunities for marketers. Marketers know that the role of advertising has morphed from an "after-the-fact" reflection of changing consumer tastes to a "before-the-fact" indicator and innovator. Yet organizational inertia, uneven levels of consumer insight, spotty effectiveness metrics, and the continued dominance of TV in the structure, processes, and promotional calendars of marketing departments have hampered progress in updating the media mix. Marketers' budget shifts have been incremental (i.e., last year +3%) rather than sweeping.

We do expect this mindset to evolve significantly in 2006 as more mainstream marketers adopt "zero-based" approaches to media buying and seek to emulate pacesetting brands such as Toyota Scion, Pepsi ONE, and Unilever Dove, which have innovated around non-traditional marketing platforms—dedicated Web sites, targeted print campaigns, unique live events, relationship marketing, mobile programming—and delivered strong results.

II. Consumers: From Captive to Interactive

As consumers gain greater access to information on brands and greater control over their media consumption (via the Internet, DVRs, iPods, etc.), the efficacy of broadcast linear media to shape brand preferences and drive purchase behavior is in decline. As marketers see the impact of traditional media—TV, radio, and print—ebb, they will gravitate to more "two-way" solutions, including relationship marketing, rich media, search-based advertising, and experiential marketing.

The market will confer even greater value on advertising vehicles that prompt the consumer to take action. Interactive appeals that compel audiences to vote via mobile phone, register their email address at a company Web site, or test drive at an event create opportunities to forge one-to-one relationships and create value that can be monetized well beyond the initial impression. That's meaningful currency to marketers. The insights gained from these "two-way" solutions can inform innovation priorities, provide real-time feedback on marketing programs, and, in some cases, even provide predictive input on the key products that will be in demand. The increasing ability of marketing to flow data upstream into supply chain decisions *before* the product hits retail will not only save consumer goods companies significant expense, but will also further raise the profile of the marketing function at these companies.

III. Digital Video Will Usher in New Advertising Models

Today, most major marketers allocate only about 4 to 10% of their measured media spending to online advertising. This percentage will increase substantially in 2006, as broadband penetration—now roughly 60% of all U.S. Internet households—enables video delivery over both fixed and wireless platforms. Broadcast and cable networks are already making more of their high-quality content available to consumers online. ESPN Motion and MTV Overdrive, as examples, achieve attractive sellout levels and CPMs at or exceeding what they get on TV.

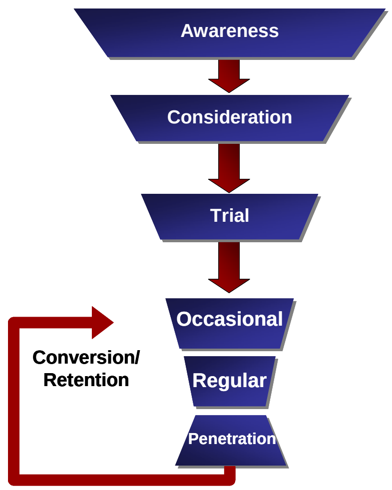
Broadband—because it accommodates previously unwieldy video files—shifts the primary focus of the Internet from information to entertainment, and that shift is profound from an advertising perspective. As consumers spend more time online and advertisers are able to showcase their products in the richer manner digital video enables, we expect to see leading marketers cluster around the most outstanding online communities and high-quality brand environments. This combination of more online consumer time and a richer advertising inventory represents the tipping point in online ad spending, in our view. As a result, we expect big-brand advertisers to significantly increase their online advertising budgets.

There is the view in the industry—given the tremendous publicity Apple's video iPod has received—that digital video will be a direct-to-retail consumer model where you pay per download. That's not our view. Because of broadband penetration reaching critical mass and the "network effect" we've just described, we expect digital video to be predominantly ad supported. From both the consumer's and advertiser's perspective, the digital video experience will be much like today's broadcast television, except consumers can now view these moving images on their laptops, mobile phones, iPods, TiVos, or Xboxes, as well as their television sets, and advertisers can deliver a much more targeted, measurable, and productive ad.

IV. What Matters Will Be What's Measured

Companies are realizing they need marketing that creates more consumer engagement *and* better communicates brand relevancy in ways that are measurable. Increasingly, marketers are moving their strategy and spending decisions down the "purchase funnel," de-emphasizing awareness-building media and favoring media that prompts consideration, trial, and, ultimately, conversion. Moreover, they are demonstrating a growing desire to innovate and invest around those platforms, products, and concepts that promise to deliver both traffic and sales impact.

Exhibit 2
Consumer Purchase Funnel



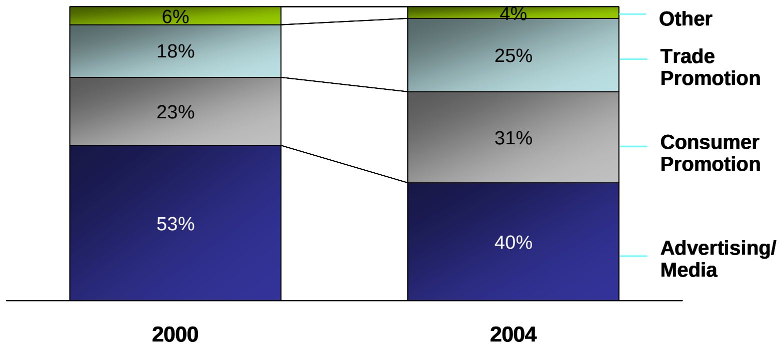
Source: Booz Allen analysis

As part of our 2005 research and client work on the *Future of Advertising*, we interviewed almost 50 senior marketing executives, analyzed data from two dozen media and industry research services (as well as from Booz Allen's proprietary Organizational DNA database of 50,000 surveys), and reviewed client work on marketing- and sales-organization effectiveness across a range of consumer-facing sectors. We were struck by the broad need expressed by marketers to develop more robust ROI analytics and consumer insights[*]. There was a nearly uniform desire among respondents to concentrate advertising resources on those consumers who are, as one CMO told us, "specifically in the market for *my* category, product, or brand."

Media companies and agencies used to dismiss the rise in "below-the-line" spending as a phenomenon largely driven by retailers' demands for trade promotions. But the spending shift from the major measured media (e.g., TV, radio, print) to "below-the-line" marketing expenditures (e.g., promotions, in-house Web sites, sponsorships, events, PR) owes more to the fact that you can more easily measure and prove the value of promotional spend. The chart below shows the pronounced reallocation of ad dollars from media advertising to promotions during the past five years:

[*] Booz Allen's ongoing study of marketing organizations with the ANA. 66% of senior marketers agreed they need to develop consumer insight and ROI analytics capabilities.

Exhibit 3
Trends in Marketing Mix (As a Percentage of Total Marketing Budget)



Source: Promo Industry Surveys

The emergence of online as *the* power vehicle to reach "in-the-market" consumers has accelerated these shifts. The trade-off between "brand building" and "moving the goods" that used to characterize advertising-versus-promotions decisions in the old days disappears online. Whether in heavy-consideration categories (e.g., automotive, travel, personal finance), or with impulse buys (e.g., specialty foods, packaged goods), marketers can now deliver contextually relevant messages and product information to only those consumers who are "interested in a Lexus," "planning a trip to France," or "searching for organic diapers." The result: greater accuracy and much less waste.

V. Marketers Will Go Direct-to-Consumer More and More

Much as in the early days of television, when P&G produced its own soap operas to showcase its products, marketers today are appealing to consumers directly by bringing capabilities in-house that once resided with their agencies and media partners. We expect these developments to alter the balance of power between these three constituents in three key ways:

1. *Marketers will create their own proprietary research networks to arm themselves with leading-edge insight into consumer behavior.* P&G's Tremor, an in-house unit that fosters brand trial and consideration via a network of some 280,000 trend-setting teens, has proven so successful that P&G now rents it to other, non-competing marketers, including Coca-Cola and Toyota. These interactive communities of "alpha consumers" offer marketers multiple benefits: they generate buzz for new products by reaching key influencers; they bypass traditional media to connect with hard-to-engage segments (such as multi-tasking teens); they communicate brand messages in ways that consumers interpret as more authentic; and they deliver deep customer insights.

2. *More marketers will appeal directly to target consumers through their own entertainment assets.* While we're not likely to see marketers and media companies converge (recall the cautionary tale of Columbia Pictures and Coca-Cola in the 1980s), there is no question that more marketers will entertain their consumers directly. Blue-chip brand marketers such as Coca-Cola and Mercedes-Benz are already major players in the digital music arena with *mycokemusic.com* in Europe and *mercedes-benz.com/mixedtape*.

   But the focus is not just on music. Marketers such as P&G have developed their own magazine-like capabilities. With four million "opt-in" email newsletter subscribers each month, P&G's *HomeMadeSimple.com* is in the ranks of the leading women's service periodicals. A destination environment focused entirely on Procter & Gamble's home-care portfolio, *HomeMadeSimple.com* is stocked full of contextually relevant product information, community information, and related promotions—and it generates a treasure trove of consumer insight for P&G that is entirely proprietary.

3. *Marketers will work directly with media companies to conceive and execute high-impact, integrated marketing solutions that combine both above- and below-the-line elements.* For example, The Home Depot and Discovery Networks teamed up recently to drive more women into Home Depot stores, a top priority for the United States' leading home improvement retailer. The Discovery Network's Solutions Group integrated branded cable programming on TLC, in-store and on-air promotion, and unique live events around the concept of "Do-It-Herself" workshops, which attracted, in the initial wave, more than 27,000 "tool-belt divas."

   You can expect more such direct marketer-media collaboration moving forward, despite the transitional "pains" as media companies encroach on the territory of their traditional ad agency customers. We expect some of the more innovative media companies to leverage their media assets and audience relationships by becoming "category managers" for their larger advertising clients in specific demographic segments (e.g., youth, young adults, boomers, etc.). The more enterprising among them will proactively package their own media with that of other select suppliers. These category leaders and their "category partners" will increase their share by demonstrating that their solutions most effectively deliver a specific audience and support the marketer's purchase funnel objectives.

An Action Roadmap

As we suggested at the top of this letter, the gap between leaders and laggards in the new marketing landscape will widen in 2006.

There is terrific upside for most players in the reshaping advertising value chain, but only for organizations that respond to these dramatic changes the right way. Marketers and media companies are now able to exploit rich new areas of opportunity—but they will have to find ways to navigate a landscape vastly more complex than the TV dial, the newsstand, and the mailbox: territories they once effectively controlled.

Such careful navigation requires a map. Here are four major guideposts for marketers and media companies to follow on the road to near-term prosperity:

1. "Raise the Game" Online

Marketers need to rebalance their media strategies more aggressively and direct more attention and money to flexible, accountable, and interactive digital media. Media companies, on the other hand, need to build their presence and audiences in digital media (e.g., Web sites, mobile platforms, interactive gaming, etc.) and fully exploit them to develop deeper, more direct relationships with consumers.

We recognize that video is the most compelling creative environment available for marketers, which accounts for the continued large spend on TV commercials. But as both fixed and wireless broadband penetration increases, so do the opportunities to exploit video advertising on new interactive digital platforms. Online already appeals to marketers simply because the gap between an advertising message and a consumer action (e.g., a registration, a request for information, or even a sale) is so much narrower than in other media. Combine that benefit with perceived "higher-quality" advertising inventory and the ability to create a stronger, direct-to-consumer relationship, and blue-chip brand-oriented advertisers will flock online.

2. Measure Outcomes, Not Inputs

Media companies will need to demonstrate how well their offerings drive consumers through the "purchase funnel." They need to look beyond reach and frequency metrics to more tangible and quantifiable evidence of ROI.

The last several years have ushered in a new "culture of measurement" in marketing, in which the emphasis is on delivering results. No longer is it, "What is the cost of the GRPs I am buying?" Rather, it is, "How many 1-800 calls or online registrations did that ad generate, and how many were converted into sales?"

New outcome-focused metrics will emerge on both the buy and sell sides. Media companies are already trying to move toward more engagement- and audience quality-oriented measures to improve the perceived value of their inventories. In 2006, we're likely to see some of the following metrics take hold:

- Session quality (e.g., brand retention, number of ads viewed per session, type of advertising content viewed)
- Degree of consumer cross-platform activity (e.g., TV to online, print to online)
- "Opt-in" activities (e.g., online registrations, 1-800 calls, requests for information)
- Sales impact (e.g., leads generated, store traffic, volume lift at retail)

In sum, marketers will demand to know how well each element of their campaigns move consumers through the purchase funnel toward a sale (e.g., awareness, consideration, preference, purchase, and retention). Accordingly, media companies and planning agencies need to use the framework of the purchase funnel to communicate and justify their recommendations regarding media mix.

3. Insource New Skills and Capabilities

Both marketers and media companies need to reinvent their approaches to brand marketing and ad sales to create higher-value, more direct interactions with consumers, and better align media offerings with specific brand-marketing objectives.

Nearly 70% of all U.S. companies have reorganized their marketing departments during the past five years, according to our research with the ANA. One major driver has been their need for new expertise in digital technology, relationship marketing, and media innovation (e.g., branded entertainment, sponsorship, placement) to supplement their traditional brand management apparatus. The fact is the functional-skill profile for brand management positions at most leading marketers has remained largely unchanged since the 1970s, when broadcast TV was at its zenith. Brand managers are still primarily trained to assess TV-centric campaigns and pitches from agencies, and then relate them to data on consumers and the market from Nielsen and other service providers.

Moving forward, brand marketers need to think in new ways about how to connect directly and effectively with the consumer—either through their media partners, the retailer, or through their company's own database and assets. They have to be able to integrate their marketing system more dynamically across a broader network of partners and media alternatives, reshaping it in "real time" as they operate. Near term, this will require marketers to experiment with new advertising models and integrated media solutions, and redefine critical skills and competencies.

For media companies, the changes in their ad sales function will be no less profound. Leaders are already investing actively in:

- Making their ad inventory more interactive (e.g., NBC's linkage with Yahoo! for *The Apprentice*)
- Offering new forms of ad tailoring and targeting (e.g., MSOs and networks working with partners such as Visible World to offer locally tailored ads)
- Expanding their portfolios either organically or by acquisition into higher-growth platforms (e.g., video games, broadband, mobile, VOD)
- Reorganizing their sales forces around customers rather than platforms (e.g., ESPN)
- Developing integrated solutions that incorporate more elements that were traditionally below the line (e.g., Discovery Network Solutions Group)

4. Shift the Mindset From Supply-Driven Advertising to Demand-Driven Marketing Solutions

To better utilize new technologies and drive ROI, media companies and marketers have to forge closer and more direct working relationships. Both will need to cultivate the creative marketing talent and resources necessary to conceive and develop campaigns that cut across multiple media platforms in ways that are appropriate for specific consumer brands.

We anticipate that leading media companies will insource much stronger relationship- and experiential-marketing capabilities to enable the targeted two-way consumer dialogue and lead generation that marketers crave. In our view, this need to offer personalized, interactive, digital advertising inventory will be one of the most prominent drivers of acquisition and organic investment activity in media and entertainment in 2006.

Media companies will also need new "go-to-market" structures with clearer points of contact and differentiated sales and marketing services functions. As the distinction between "above-the-line" and "below-the-line" marketing blurs, media companies and agencies have to rethink their planning frameworks and redefine what constitutes advertising "effectiveness." As we have outlined, this will require both new metrics and the insight to map them to distinct phases in the purchase funnel. In the words of one CMO we interviewed: "The media supplier or agency that knows us maybe even a bit better than we do and can deliver results…that's the one we want to do business with."

As in any period of discontinuity, major opportunities exist on both sides of the advertising equation—for category leaders as well as more specialized players—to build, strengthen, and, in some cases, re-establish positions of market leadership. At no other time has the potential been so great for smart players, whatever their size, to invent new rules of the game. At no other time have marketers and media companies possessed so many compelling platforms to entertain and engage the consumer. At no other time has marketing been so measurable, accountable, and interactive. Together, these factors are sure to ignite a new era of creativity and innovation in marketing, as well as in media and entertainment. We believe that the strategies pursued today by senior management at media and consumer goods companies will play a defining role in determining who wins and who loses relevance with the next generation of consumers.

We at Booz Allen appreciate this opportunity to share our perspective on the *Future of Advertising* and its implications for consumer marketers and media and entertainment companies.

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