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The end of advertising as we know it

Media and Entertainment

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The end of advertising as we know it

By Saul J. Berman, Bill Battino, Louisa Shipnuck and Andreas Neus

The next 5 years will hold more change for the advertising industry than the previous 50 did. Increasingly empowered consumers, more self-reliant advertisers and ever-evolving technologies are redefining how advertising is sold, created, consumed and tracked. Our research points to four evolving future scenarios – and the catalysts that will be driving them. Traditional advertising players – broadcasters, distributors and advertising agencies – may get squeezed unless they can successfully implement consumer, business model and business design innovation.

A glimpse into the future of advertising

Jim, the Chief Marketing Officer of a consumer products company, used to spend 60 percent of his marketing dollars on broadcast, free-to-air television – a significant portion of which was spent in upfronts. But he never knew exactly who he was reaching or how effective his advertising was.

Now, he has a very different approach…. and is more comfortable with the effectiveness of his marketing. Jim assesses all media channels (television, radio, mobile devices, print, interactive portals and the like) neutrally to determine how best to allocate his marketing and advertising dollars. Recognizing that consumers have increasing control and choice over how they interact with, filter and block marketing messages, it is more important than ever for Jim to know his advertising is reaching individual consumers, not generic zip codes at the household level.

With the help of Cathy, the company's Chief Consumer Officer, he has gained a full understanding of who his target consumers are, where his consumers are going, and how to reach them on their terms across the plethora of media devices they interact with on a regular basis. As consumers move to 360-degree content and information experiences, marketing also personalizes its content to consumers' lifestyle, context and location.

Previously, Jim bought broad-reaching spots, hoping to reach his target audience. But now, targeting, measurement and analysis capabilities that previously were only available for Web advertising are available for all channels. Jim can develop an interactive, integrated marketing plan tailored to his individual target consumer, and he pays based on actual impact rather than by cost per thousand impressions (CPM). His marketing message follows those customers across content platforms to deliver a consistent experience.

His advertising includes a mix of creative spots and formats, like special interest content, product placement and self-published advertising that are tailored to his consumers' preferences, community affiliations and devices. This enables his target consumers – be they traditional moms in Des Moines, Iowa, urban professionals in Berlin or university students in South Korea – to better experience the value of his product. Jim created his advertising campaigns jointly with broadcasters, semi-professionals and avid product fans (or "influencers"), who develop creative at a significantly lower cost than his traditional agency. Though Jim creates multiple versions of his advertising campaigns in order to appeal to numerous customer micro-segments, his budget has not increased because of the decreased cost of developing creative campaigns. His ROI is also improved, because the advertising is more effective.

Because much of the budget is based on impact, he works closely with the Sales team, and a portion of the direct marketing budget has moved to advertising channels. He is now able to measure the effectiveness of his marketing campaigns through the use of marketing software packages that have centralized and standardized disparate data sources.

Jim's team can purchase much of its advertising space through an open, Web-based platform and manage its impact through a "dashboard" that delivers realtime metrics and analysis across all advertising platforms. Gone are the days of "hoping" advertising works. Jim is now in a world where he has full control of the effectiveness of his marketing spend.

Introduction

"We will see 'neutral' evaluation of all media formats. There is no primary role for linear TV any more."

– Managing Director, advertiser, Europe

The trends toward creative populism, personalized measurements, interactivity, open inventory platforms and greater consumer control will generate more change over the next 5 years than the advertising industry has experienced in the last 50. This means that many of the skills and capabilities that were the mainstay of success in the past will need refinement, transformation or even outright replacement.

Based on an IBM global survey of more than 2,400 consumers[1] and feedback from 80 advertising executives worldwide collected in conjunction with Bonn University's Center for Evaluation and Methods,[2] we see four change drivers shifting control within the industry:

Attention – Consumers are increasingly exercising control of how they view, interact with and filter advertising in a multichannel world, as they continue to shift their attention away from linear TV and adopt ad-skipping, ad-sharing and ad-rating tools.[3] Our survey suggests personal PC time now rivals TV time, with 71 percent of respondents using the Internet more than two hours per day for personal use, versus just 48 percent spending equivalent time watching TV. Among the heaviest users, 19 percent spend six hours or more a day on the PC versus just 9 percent who watch a similar amount of TV.

Creativity – Thanks to technology, the rising popularity of user-generated and peer-delivered content, and new ad revenue-sharing models, amateurs and semi-professionals are now creating lower-cost advertising content that is arguably as appealing to consumers as versions created by agencies. Our survey suggests this trend will continue – user-generated content (UGC) sites were the top destination for viewing online video content, attracting 39 percent of respondents. Further, established players, like magazine publishers and broadcasters, are partnering with advertisers to develop strategic marketing campaigns – taking on traditional agency functions and broadening creative roles.

Measurement – Advertisers are demanding more individual-specific and involvement-based measurements, putting pressure on the traditional mass-market model. Two-thirds of the advertising executives IBM polled expect 20 percent of advertising revenue to shift from impression-based to impact-based formats within three years.

Advertising inventories – New entrants are making ad space that once was proprietary available through open, efficient exchanges. As a result, more than half of the ad executives interviewed expect that open platforms will, within the next five years, take 30 percent of the revenue currently flowing to proprietary incumbents such as broadcasters.

To envision four possible scenarios for the industry in 2012, we juxtaposed two of the most uncertain change drivers – the propensity for consumers to watch, block or participate in marketing campaigns; and the openness of advertising inventories. Because players across geographies and media formats will progress at differing rates, these scenarios will likely coexist for the foreseeable future. The four scenarios are:

Continued Evolution: In this scenario, the one-to-many model still dominates, but the industry evolves in response to digital video recorder (DVR) penetration, the popularity of user-generated and peer-distributed content, and new measurement capabilities (albeit for “old” formats). Advertisers, therefore, allocate a greater portion of dollars traditionally spent on direct marketing to channels typically used for brand-oriented advertising.

Open Exchange: Here, the industry morphs behind the scenes, with little to no additional consumer influence. Advertising formats largely remain the same, but advertising inventory is increasingly bought and sold through efficient open exchanges, bypassing traditional intermediaries.

Consumer Choice: Tired of intrusions, consumers exert more control over the advertising they view and filter. Formats evolve to contextual, interactive, permission-based and targeted messaging to retain attention.

Ad Marketplace: Consumers choose preferred ad types as part of self-programming their media choices and are more involved in ad development and distribution. Advertising is sold predominantly through open, dynamic exchanges, allowing virtually any advertiser (large or small) to reach any consumer. With new consumer monitoring technologies in place, consumer action drives pricing.

As the advertising value chain reconfigures, broadcasters, advertising agencies and media distributors in particular will need to make a number of "no regret" moves (necessary actions regardless of which scenario plays out in the future) to innovate in three key areas:

1. Consumer innovation: Drive greater creativity in traditional ads, while also pursuing new ad formats across media devices to attract and retain customers. For example, consider tactics like campaign bleeds, micro-versioning, video ad flickers, pod management and ad-supported content creation (embedded in the programming) to limit ad-skipping.[4] This also means making segmentation, micro-segmentation and personalization paramount in marketing. Anyone that touches buyers and consumers needs to collect and analyze data to produce relevant and predictive insights.

2. Business model innovation: Pioneer changes in how advertising is sold, the structure and forms of partnerships, revenue models, advertising formats and reporting metrics. For example, broadcasters, agencies and distributors can pursue opportunities such as agency gain sharing, more sponsored shows, impact-based pricing models, user-generated advertising revenue-sharing models and open inventory, cross-channel sales.

3. Business design and infrastructure innovation: Support consumer and business model innovation through redesigned organizational and operating capabilities across the advertising lifecycle – consumer analytics, channel planning, buying/selling, creation, delivery and impact reporting.

We know advertising remains integral to pop culture and media investment. But it also will need to morph into new formats and new channels and offer more intrinsic value to consumers to capture a meaningful share of fragmented audience attention.

There is no question that the future of advertising will look radically different from its past. The push for control of attention, creativity, measurements and inventory will reshape the advertising value chain and shift the balance of power. For both incumbent and new players, it is imperative to plan for multiple consumer futures, craft agile strategies and build new capabilities before advertising as we know it disappears.

Key questions to consider

- Will advertisers still need a traditional agency? If so, in what capacity?
- Will traditional programmers lose significant revenue to the Internet, mobile device providers and interactive home portals?
- Will consumers reject outright the concept of interruption marketing in the future?
- Will consumer receptivity vary by medium (for example, mobile devices versus home-oriented devices)?
- Will consumers see value in advertising as a trade-off for content?
- To what extent will advertising inventory be sold through open platforms?
- Do advertising industry players have the customer analytics needed to better understand and reach target customers?
- Are companies organized correctly to create, market and distribute cross-platform content?

The end of advertising as we know it

Interactive advertising formats are key to overall industry growth.

Industry battles and trends: Power shifts

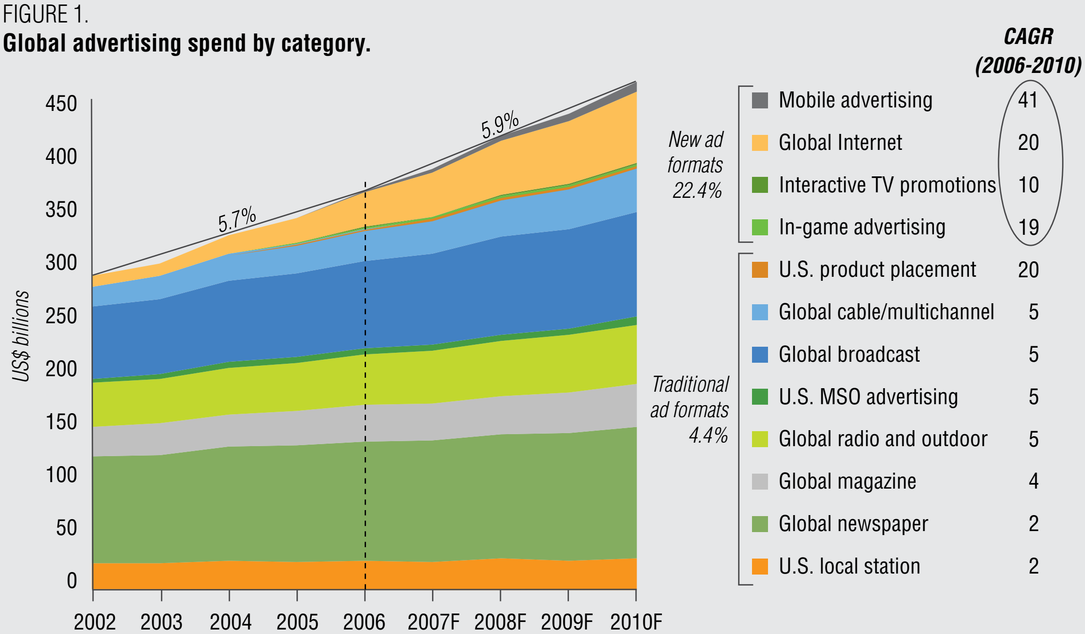
As advertising budgets shift to new formats and shape the future advertising market, control of marketing revenues and power will hinge on four key market drivers: *attention, creativity, measures and advertising inventories*. This section will explore these changes and their economic impacts through 2012.

We expect overall ad spend to grow in line with the general health of the economy, but the composition of that spending will change. We have used an amalgamation of industry forecasts for our consensus view in Figure 1. While this spending breakdown is helpful for highlighting the *direction* of change, the speed and magnitude of this kind of disruptive change tends to be underestimated by traditional forecasting methods. For example, our analysis shows that the actual growth of Internet advertising has outpaced forecasts by 25 to 40 percent over the past two years.[5]

But even in Figure 1's forecasts – which may be too conservative – digital, mobile and interactive formats are clearly the key to overall industry growth going forward. Mature channels like print, traditional direct marketing and TV have 2010 CAGR forecasts of low single digits, while the combined growth forecast for interactive advertising formats, such as Internet, interactive television promotions, mobile and in-game advertising, is over 20 percent.[6]

Product placement is the only "traditional" marketing tool with comparable growth expectations – spurred by advertisers' desire to drive relevancy and reach for their advertising as consumer control over interruption advertising continues.

FIGURE 1.
Global advertising spend by category.



Source: IBM Institute for Business Value analysis based on an amalgamation of industry forecasts.

While control of *attention, creativity, measurements* and *advertising inventories* impacts all forms of advertising and content funding, we are focusing here on TV/video as an illustration of significant change.

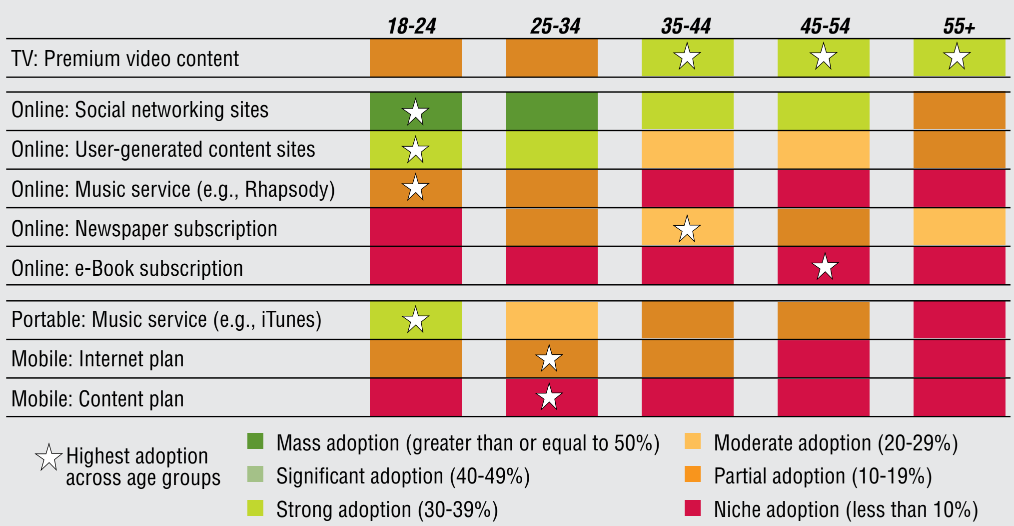
Attention

"Consumers will continue to gain more power over content, but they will not 'skip' all forms of advertising. Fewer will pay for all the content they want to consume; there will be new models to trade attention to advertising for content."

– Account Executive, full-service media agency, North America

As we predicted in our 2002 "Vying for Attention" paper, audiences continue to fragment.[7] While this is not a new phenomenon, we are reaching a critical juncture where new platforms may soon have more impact than TV. Today, consumers have more options for visual entertainment than ever before – TV, PC, game consoles, mobile devices and more. Studies from several countries have shown that, especially for young users, TV is increasingly becoming a secondary "background medium."[8] The primary focus of attention is elsewhere – surfing the Internet, chatting or playing an online game. Our consumer survey showed that more respondents spend significant blocks of time on daily personal Internet usage than watching TV, especially among the heaviest users. This behavior is particularly prominent for younger audiences (ages 18 to 24) and "gadgetiers" (early adopter consumers who own at least four multimedia devices). Our survey also illustrates the ongoing fragmentation of consumer attention and the wide variations in adoption by age groups across content services (see Figure 2). The only content service with mass adoption (greater

FIGURE 2.
U.S. content subscription services adoption by age group.



Source: IBM 2007 Digital Consumer Study.

than 50 percent) was Social Networking, and this was only among respondents under the age of 35. Younger audiences are far more willing to experiment with new content sources, though less willing to pay, particularly for online services. Older audiences had higher adoption of more traditional services, such as premium content for television and online newspaper subscriptions.

Advertising spend will eventually synchronize with shifts in consumer attention from television to other media formats.

As users migrate to new screens for content and information, advertising and marketing will need to shift as well. It is more important than ever to reach consumers where they want, when they want and how they want. And with advertising dollars funding a significant portion of entertainment around the world (sponsoring an estimated 50 percent of television in major markets, for example), the medium, content and advertising spending must synch up.[9]

We are also witnessing the possible substitution of other visual media for TV viewing time. Though mobile video consumption is currently lower than PC video consumption among our respondents, 42 percent said they have already watched or want to watch video on a mobile device. In the United Kingdom, nearly one-third of those who watch mobile TV had consequently reduced their standard TV viewing patterns.

In addition to preferring hot new devices and screens for entertainment, users are also enjoying and exploiting new control tools. With spam-blockers, “do-not-call” and “do not mail” lists in the United States, the DVR and peer distribution tools, marketers are being forced to rethink how to prevent buyers from tuning out.

For example, 25 percent of our U.S. consumer respondents and 20 percent of our U.K. respondents already have a DVR. Given high customer satisfaction rates, forecasters project DVR penetration to reach close to 40 percent in the United States within the next five years, which poses a significant threat to the traditional TV advertising model.[10]

In our consumer survey, 53 percent of DVR owners in the United States report watching at least 50 percent of television content on replay, supplying them with the fast-forward capabilities that allow ad-skipping. As DVRs gain traction across demographic groups and consumer segments, traditional television advertising may be the first major casualty of changing media consumption habits. And though new commercial rating tools can now track viewership via DVR, industry debate continues about the true value of an ad if it is viewed after the initial, targeted broadcast period.

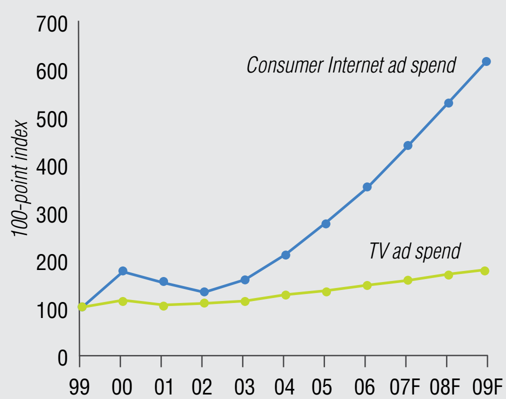
Multimedia devices are also proliferating, though adoption behaviors vary by country. For example, respondents from Germany appear to prefer portable devices and are far more likely to have MP3 players and Internet-enabled phones than any other country. Almost 70 percent of German respondents own an MP3 player, and almost 40 percent have an Internet-enabled phone, compared to global averages of 50 percent and 20 percent, respectively. In Japan, portable game player adoption is widespread, with almost 40 percent of respondents owning one, versus between 15 and 23 percent in other countries. U.S. respondents report higher adoption of living-room-related devices, such as DVRs, high-definition television sets, and game consoles, but have lower adoption rates for portable devices, such as MP3 players, Internet-enabled phones and portable game players, than other countries. Finally, video on demand (VOD) habits vary, with close to 50 percent of U.K. and U.S. respondents having already watched VOD, as compared to less than 5 percent of Germany and Japan respondents who have done so.

What do these trends mean for the industry's bottom line? Nearly half of the respondents in our advertising executive interviews expect a *significant* (i.e., greater than 10 percent) revenue shift away from the 30-second spot within the next five years, and almost 10 percent of respondents thought there would be a *dramatic* (i.e., greater than 25 percent) shift.

As consumers turn away from traditional television and toward new content sources, such as popular online sites (like YouTube, MySpace and Facebook), games, mobile and other emerging entertainment platforms, the shift in attention will eventually be reflected in advertising, subscription and transactional fees. This puts at risk the revenue base of incumbent, traditional content distributors and aggregators – especially for those that do not produce content or own rights to distribute content on these newer channels.

As shown in Figure 3, growth in Internet advertising far exceeds that of traditional channels like television. And while no evidence suggests a one-to-one correlation of advertising revenue with this audience migration to new channels, we believe that the current large discrepancy between advertising revenues and eyeballs will shrink significantly over the next five years.

FIGURE 3.
Index of U.S. ad-spend growth: All television versus consumer Internet.



Source: IBM Institute for Business Value analysis based on an amalgamation of industry forecasts.

The majority of the advertising executives we interviewed expect significant dollar shifts from traditional advertising vehicles to search, mobile, Internet Protocol Television (IPTV), VOD and online video ads. Advertising industry incumbents could lose out entirely if they do not keep up with advertisers who are following their audiences into new channels.

Creativity

"Consumer-created advertising will have all the appeal of anything crafted by the agencies, and will be 'coopted' by the brands themselves."
– CEO, advertiser, Asia Pacific

In addition to new tools for control of what consumers choose to view, lower cost tools are also available that allow new creative input from consumers, semi-professionals, amateurs and nontraditional players. Inexpensive video- and photo-editing tools create opportunities for hobby tribes and individual users to self-produce entertainment and advertising – a form of creative populism. At the same time, content owners are increasingly partnering directly with advertisers to develop innovative and strategic marketing campaigns that go beyond the traditional advertising formats.

Our consumer survey shows users – particularly those in the United States and the United Kingdom – are increasingly willing to participate in social networking sites, with 26 percent of U.S. respondents and 20 percent of U.K. respondents having already contributed content. And though not quite as popular yet, users are starting to create video content for UGC sites, with 9 percent of German and 7

Within five years, advertising executives expect 15 percent of television viewing time and 25 percent of PC time to be devoted to user-generated content.

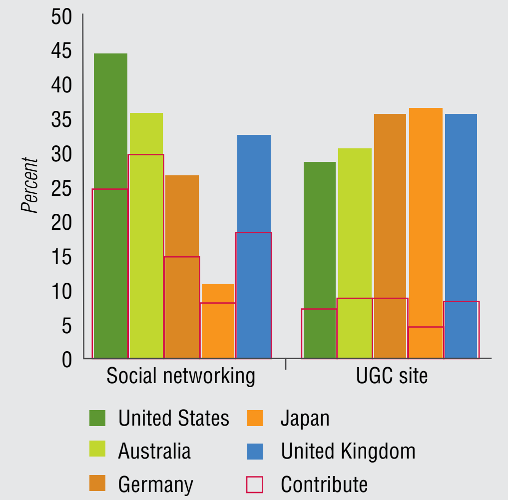
percent of U.S. respondents reporting they have contributed to those sites (see Figure 4).

We also see evidence of consumers becoming trusted influencers. When asked about how they find content on UGC sites like YouTube, 32 percent said they followed recommendations from friends. We expect the power of communities to grow as tools for community-based recommendations improve. The "voice" delivering a message, along with its perceived authenticity, will become as powerful perhaps as the message or offer.

There are also other creative forces at play. In addition to users, other members of the value chain – such as content owners and broadcasters – are increasingly working directly with advertisers to drive nontraditional campaigns, bypassing the agency's intermediary role as the cost of production declines and tools become generally accessible. For example, creating a professional video ad typically costs around US$100,000 to US$350,000 or more, which is prohibitive for most small businesses. However, cheaper tools and community-based or semi-professional content creation can lower production costs to reasonable levels, making them affordable for small and medium-sized businesses that cater to niche markets. Current TV, for example, pays US$1,000 for viewer-created advertisements (V-CAMs) that it chooses to air.[11]

Further, content owners are broadening their creative roles, taking on responsibilities that previously belonged to agencies. There are already many examples of broadcast and publishing content owners that are displacing traditional ad agencies in creative and campaign planning. Companies like Conde Nast's Media Group have creative units that work directly with advertisers to produce and distribute custom advertising programs often at lower prices than agencies by charging cost for creative services and making their money on the media.[12] Conde Nast trades on its ability to blend images, characters and stories from content into relevant, marketing campaigns, relying on a panel of more than 100,000 consumers to evaluate the advertising.[13]

FIGURE 4.
Percentage of global respondents who visit and/or contribute to social networking or UGC sites.



Source: IBM 2007 Digital Consumer Study.

UGC impacts the industry through two primary avenues: content production and attention influence. We've already discussed the rise of semi-professionals, user enthusiasts and amateurs producing content. Now, let's link back to issues of attention, a circular topic of sorts. As new types of content are created, audience fragmentation increases. The advertising executives we interviewed expect a significant portion of content consumed on different devices to be user-generated within five years – nearly 15 percent of TV time and about 25 percent of PC time. This means that there is an opening for new aggregators and distributors – the likes of YouTube, Grouper or Current TV – to capture a share of revenue that would have previously gone to traditional programmers or channels.

The majority of the respondents in our panel of advertising industry executives also indicated that UGC is not "hype" and is here to stay. They also felt that inexpensive video production tools will increase competition among professionals, amateurs and semi-professionals.

As a result, content owners, distributors, advertisers and agencies are all becoming more creative about how to reach the target consumer. For example, broadcasters are making use of content bleeds in advertising pods – where characters become a part of the commercial message. On the flip side, product placement continues to become more popular as a way to integrate the marketing message directly into the program itself. There are also an ever-increasing number of new ad formats to capture the consumer's attention, both on the TV screen and on the Web. Formats like short-form video, flickers, bugs, banners and pop-ups continue to evolve. Finally, players are doing a better job of matching the ad content with the programming content to drive relevancy. The recent results of an ongoing study by TiVo Inc. concluded that relevancy outweighs creativity in TV commercials.[14] The ads least likely to be skipped were well-tailored to their audience – they were often those ads that aired during the daytime on cable (where shows have smaller, niche audiences and it's easier to determine viewers' interests) or during prime time on directly relevant programs.[15]

With a wider group of content creators contributing to the mix, pieces of the creative value chain may commoditize or experience price pressure (similar to how independent films have lowered the cost of one echelon of filmmaking). The advertising value chain will therefore need to proactively integrate the more creative parts of its team, or others will do so from outside.

Measures

"It is becoming increasingly easy to measure actual viewership, engagement and response. Having that accurate information will greatly alter the way advertising is produced and disseminated and how it is ultimately paid for."

– Account Executive, full-service media agency, North America

Evolving technologies, coupled with advertisers' demands for improved targeting, accountability and ROI, are driving changes in measurement and associated advertising business models. As consumer attention continues to fragment, measurements will only remain relevant if advertisers track finer segments and perhaps even individual viewers.

We therefore predict individual- and micro-targeting becoming prevalent across all media formats. In addition to requiring new partnerships and investment, this kind of advertising will also necessitate a major increase in the number of creative spots and campaigns to reach targets with niche or specialized messages. More spots will likely mean lower average price points on creative. Companies like QMeCom are allowing for customization with automation, so that hundreds of creative outputs take the place of the mere one, two or five variations common in days past.[16]

Hardware (i.e., set-top-box-based, head-end-based, portable device) and software technology advances are enabling improved targeting and response tracking capabilities across media formats. Companies like TiVo and Nielsen are beginning to supply realtime, non-sampled measurements of ad-skipping,

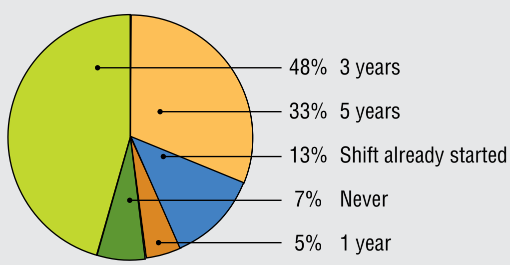
Two-thirds of the industry executives we interviewed expect 20 percent of advertising revenue to shift from impression-based to impact-based formats within three years.

purchasing influence and the like.[17] Other companies are moving toward providing targeted delivery capabilities across media platforms, based on a combination of user behavior and opt-in data.

Furthermore, a new breed of Chief Marketing Officer (CMO), conversant with Internet metrics, is seeking more focused targeting and accountability (ROI) for marketing budgets across channels. As the first generation of professionals who have grown up with the Internet rises to positions of responsibility among advertisers, we are likely to see more experimentation and a greater readiness to adopt new platforms – especially if they can demonstrate effectiveness.

Two-thirds of our global advertising industry executive panel expects 20 percent of advertising revenue to shift from impression-based to impact-based formats within three years (see Figure 5). Targeting, measurement and accountability capabilities will have to evolve to reflect new advertiser goals and demands. This shift will be particularly critical for traditional TV, as it is increasingly delivered digitally. New types of advertising, such as pod management, skip-resistant creative campaigns, greater creativity immersed within ads (to entice people not to skip), more dynamic product placements and more, should produce greater impact.

FIGURE 5.
Time horizon for shift from impression-based to impact-based advertising.



Source: IBM 2007 advertising industry executive interviews and panel discussions.

Finally, while much of the current industry discussion is related to new measures for arguably "old," one-to-many advertising formats, the era of truly interactive, experience-based advertising is coming. For example, in virtual 3D worlds, audiences can use and interact with a brand, rather than just be "exposed" to it. And these new advertising experiences are marching forward largely without leadership from established broadcasters, agencies and advertisers.

These trends imply the boundaries between "local" and "national" advertising will blur. Media companies historically strong in local advertising (e.g., cable, newspapers) will have to improve their interactive capabilities, while national advertisers (e.g., Broadcast TV) and interactive players will have to improve upon their local targeting capabilities (meaning, know where the consumer is).

Advertising inventories

"The U.S. television advertising upfronts are not likely to exist more than another few years."

– Executive, major online media aggregator, North America

Today, most inventory systems, such as the television upfronts in the United States, involve relatively few buyers and sellers, most of which are very large companies. For example, GroupM, of the London-based WPP Group,

According to our industry executive panel, 30 percent of advertising revenues will shift from traditional incumbents to automated placement/auction platforms within the next five years.

sealed the first major deal of the 2007 upfront season with a multiplatform, US$1 billion agreement with NBC Universal.[18]

New platform players are offering advertisers the ability to purchase ads via aggregated networks. These capabilities provide key benefits such as: improved inventory management, improved pricing transparency, streamlined buying/selling processes, and improved analysis and reporting capabilities. These new entrants/platforms are positioned to capture an important part of the future advertising and marketing value chain. Going forward, we anticipate that inventory management systems will become more open and transparent and will involve a larger number of smaller buyers and sellers.

The majority of our advertising industry executives agreed with this directional trend. In fact, they predict a significant shift in control of advertising revenues, with more dollars flowing from private to open markets over the next five years. The panel also expects 30 percent of advertising revenues to shift from traditional proprietary sales models to placement/auction platforms within the next five years. However, changes to back-end platforms, along with the increased willingness of suppliers to sell both remnant and premium inventory through these open systems, will be required in order for this revenue shuffle to occur.

The reason for this trend? As revenues shift in response to consumer fragmentation, it will no longer be efficient to have dedicated platforms for each channel. Market forces will move the industry to open, dynamic platforms capable of following a customer by serving messaging across multiple channels. This is a natural progression caused by the shift of advertising dollars across channels, which, in turn, is driven by advertisers seeking to follow their customers' interests as content is increasingly divorced from devices.

Internet players have shown themselves to be more adept at extending their predominantly online platforms into other channels. Google, for example, is leveraging its tracking capabilities and matching algorithms for both new and traditional channels, such as radio, TV and print through its acquisition of dMarc, partnerships with EchoStar and Astound Cable, and the launch of Google Print Ads.[19] This is a shift in focus to adjacent growth opportunities from Google's initial focus on paid search.

Investments in the traditional advertising space by new entrants may pose a threat to current value-chain incumbents. As fragmentation becomes a permanent fixture within media and entertainment, advertisers will be forced to move to more efficient and dynamic platforms capable of managing inventory, planning, delivering, tracking and measuring effectiveness of advertising *across* multiple channels and in realtime.

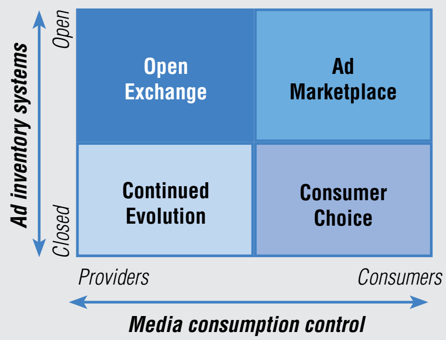
Future scenarios: Scenarios of disruption

To assess the degree and depth of change expected, we used a process called scenario envisioning. In this process, the most disruptive and uncertain variables are combined to create and articulate a variety of extreme outcomes for the year 2012.

Our scenarios are based on the following two variables, which we believe will be the most disruptive over the next five years:

- *Marketing control:* The propensity of the consumer to control, interact with, filter and block marketing messages
- *Advertising inventory system control:* The degree of movement from controlled, impression-based ad inventory systems to open auction or exchange platforms for advertising spots.

FIGURE 6.
Four scenarios of the industry's future.



Source: IBM Institute for Business Value.

In Figure 6, the x-axis illustrates how the control of media consumption is shifting from providers to consumers. As we move to the right along the x-axis, consumers wrestle more and more control over their media experiences from providers.

The y-axis illustrates the change from closed inventory to open auctions. As we move up the y-axis, more television, print and interactive advertising deals become accessible to smaller, independent buyers and sellers.

Based on these two variables, four scenarios emerge:

The two variables likely to be most disruptive to the industry's future are: the increasing degree of consumer control over marketing and the shift toward open exchange platforms for advertising sales.

Continued Evolution is arguably the least disruptive scenario, though it still involves rapid change from today's one-to-many advertising model. Control, in large part, remains with content owners and distributors, but growing consumer demand for control forces some progressive adjustments. The industry cannot ignore the implications of the current DVR penetration level and the associated ad-skipping behavior it enables, the explosive growth in popularity of UGC and related advertising opportunities, or the measurement capabilities now available to track ad viewership. These factors imply a bifurcated market – one in which a portion of consumers can still be addressed through traditional advertising models, while others must be attracted through interactive and innovative strategies. Increasingly sophisticated targeting, measurement and accountability tools enable advertisers to continue to allocate a greater portion of dollars traditionally spent on direct marketing to channels historically reserved for brand-oriented advertising. Traditional agencies will continue consolidating in their efforts to respond to advertisers' demands for seamlessly integrated, cross-platform planning, buying, delivery and measurement services. Similarly, broadcasters and distributors will continue to focus on horizontal advertising opportunities for advertisers.

Open Exchange represents a scenario in which the industry changes behind the scenes, primarily driven by distributors – traditional players like Multiple Systems Operators (MSOs) and Telcos, as well as newer technology players – with little to no additional consumer-driven change. In other words, marketing stays the same as what was described in Continued Evolution, but the process of buying, selling and delivering becomes more efficient. Also similar to the Continued Evolution scenario, majority control remains with content owners and distributors rather than with consumers, and a majority of consumers continue to passively ingest marketing messages without a great deal of interference or proactivity. However, efficiency efforts – largely driven by new entrants – shuffle profits and power within the industry. A significant portion of advertising inventory that was proprietary is now "open" – sold through exchanges, as a result bypassing traditional intermediaries. New exchanges take major share in all advertising categories, and inventory that was once exclusively available to large advertisers – including historically proprietary national television spots – is now available to smaller buyers.

Consumer Choice is a scenario in which advertising formats change at the behest of consumers who are tired of interruption or intrusive marketing. Consumers exhibit more control and choice over the types of advertising that they choose to view and filter. Advertising formats, therefore, evolve to contextual, interactive, permission-based and targeted messaging to retain consumers' attention and to help minimize both irritation and "tuning out." To remain relevant, distributors offer consumers choices – in some cases, enabling the consumer to select the appropriate advertising "packages" that are most appealing or relevant. For example, a consumer might request advertising be confined to automotive, male-oriented consumer products, travel and leisure. At times, these choices will act as currency, with consumers opting-in for messaging in exchange for content. In other cases, relevancy is determined by combining opt-in information with behavior analysis of television, the Web, mobile and beyond. New measurement capabilities and consumer rating tools become a crucial component of any advertising deal.

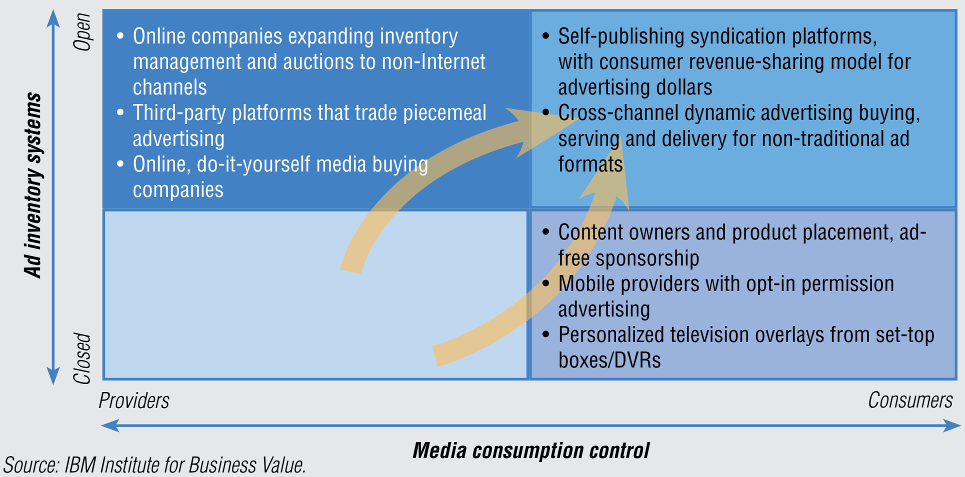
Ad Marketplace, compared to all other scenarios, is the most disruptive. Significant change in back-end systems and consumer-facing marketing enable new entrants to emerge across the value chain. In this scenario, consumers reject traditional advertising and instead choose their preferred ad types as part of self-programming their media choices. The user-generated and peer-delivered content trend explodes, and consumers become much more involved in ad development and buzz/viral distribution of brand information. Further, back-end players revamp the process behind the scenes. Because this scenario involves a truly open, dynamic exchange, virtually any advertiser can reach any individual consumer across any advertising platform – as long as the advertising is relevant and appealing. Consumers have significant choice over the types of advertising they choose to see – and can decide the specific content and form of their advertising. And with new consumer monitoring technologies in place, consumer action directly impacts the price of an ad – driving bids up and down. Advertisers can know immediately whether a spot or interactive experience is producing anticipated results. Likewise, media networks will know immediately if they have increased or decreased reach – with prices calibrating elastically. The definitions of "reach," "effectiveness" and even "marketing" itself change entirely.

Scenario evolution

Based on their legacy assets and ability to develop new media capabilities, players across the value chain will take different evolutionary paths (see Figure 7). Though we believe the industry will eventually become an "Ad Marketplace," multiple scenarios will likely coexist for the near term.

Signs of this evolution are already evident in the marketplace. Examples of Open Exchange initiatives are currently limited to niche areas, but they illustrate what the future could look like.

FIGURE 7.
Potential scenario evolutionary paths.



Source: IBM Institute for Business Value.

Although we expect the industry to eventually become an *Ad Marketplace*, this scenario as well as the other three – *Continued Evolution*, *Open Exchange* and *Consumer Choice* – will likely coexist for the next few years.

- Google
  - Online: Adsense – Offers online media publishers enhanced revenue opportunities by placing contextual advertising sold by Google on their Web sites[20]
  - Cable/Satellite: Astound Me, EchoStar – leverages Google online capabilities to sell, deliver and measure targeted advertising on cable (Astound Me) and satellite (EchoStar) based on consumer behavior patterns[21]
  - Radio: dMarc – Acquisition made in 2006 that enables Google to offer its advertising capabilities to the radio industry[22]
  - Newspaper: Print Ads – 2007 initiative by Google to streamline the buying/selling process for the newspaper industry[23]
- NextMedium – Platform to sell, deliver and track product placement for film and TV[24]
- BlackArrow – Ad platform for the cable industry that aggregates inventory into a network and focuses on delivering targeted traditional and advanced advertising formats.[25]

The following present-day examples of Consumer Choice illustrate experiments in new formats and marketing themes – in reaction to consumers driving change.

- TiVo's interactive advertising technology enables pop-up messages while consumers are watching programs, as well as while they are fast-forwarding through programming.[26]
- Aerie Tuesdays is a Partnership between American Eagle and The CW Television Network to target teenage girls in more innovative ways, by developing unique content programming related to two Tuesday night prime-time programs.[27]
- Sugar Mama from Virgin Mobile pays subscribers one minute of free air time for every minute spent interacting with ads. One year after launch, Virgin had given away 9 million free air-time minutes and was experiencing high response rates of around 5 percent.[28]
- NBC Direct announced its 2007 programs will be available for free online for one week after initial broadcast. The content must be viewed on NBC proprietary technology, which prevents ad skipping.[29]

Marketplace platforms that trade completely new marketing formats through an open exchange are still in the experimental phase. But we are beginning to see examples of how the Ad Marketplace scenario could play out in the UGC segment of the industry through evolving business models like those of Revver, Narrowstep, Brightcove and YouTube.

Value chain impacts

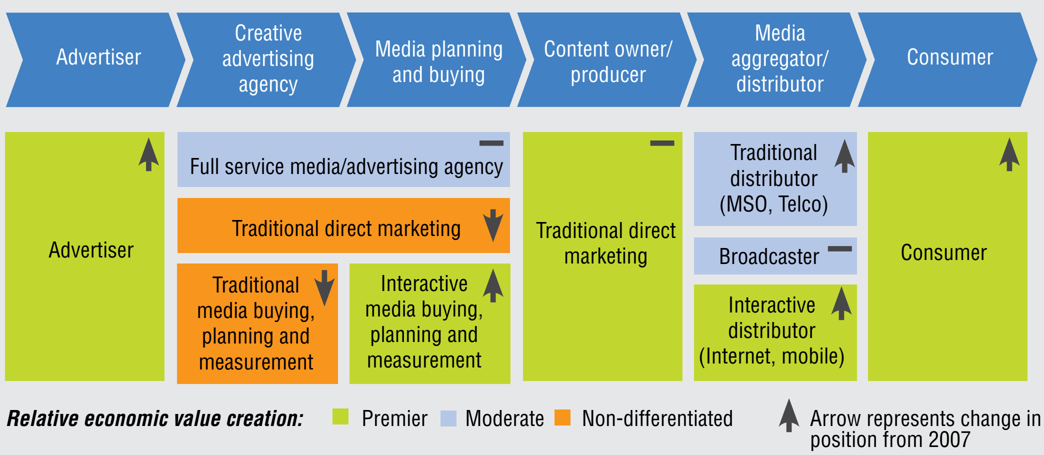
Given consumer and supplier changes, we believe that mid-term economic shifts will favor consumers, advertisers and interactive players over the other players in the value chain (see Figure 8). And as advertisers, Internet/interactive players and consumers gain power, traditional agencies and broadcasters must evolve or risk being disintermediated.

We believe looming changes and shifts in advertising revenue and industry control will affect a number of players in the industry value chain, in particular:

Broadcasters: Arguably, broadcasters that rely on linear television advertising to fund operational and content costs are at risk in a world of increasing consumer control, niche content and fragmented attention. And yet, broadcasters have the opportunity to leverage their current mindshare with customers, while transforming their operations to embrace the plethora of new digital content distribution opportunities. By delivering integrated, cross-platform advertising programs tied to their programming assets, they can migrate into a successful future model.

Distributors: Both traditional distributors (MSOs and Telcos) and newer interactive players (Internet and mobile providers) have a small share of the estimated US$550 billion 2007 global advertising market.[30] Slowly but surely, incumbents are introducing the new platforms and formats needed to defend their positions in the value chain. They are developing new advertising capabilities (such as interactive

FIGURE 8.
Expected impact on the advertising value chain.



Source: IBM Institute for Business Value.

and VOD advertising), integrating advertising across in-home video, mobile and Internet channels and focusing on local advertising delivery opportunities. By opening their inventories through dynamic platforms, distributors create an aggregated inventory view that makes it easier for advertisers to see the full reach and volume a distributor can offer, helping distributors capture a greater share of advertising revenues. The race is on to deliver cross-platform integration. Telcos and MSOs currently have a window in which they could take the lead on integrating wireless, broadband and video campaigns.

These prevailing trends are shifting power to consumers, advertisers and interactive players, leaving traditional agencies and broadcasters at risk of disintermediation.

Advertising agencies: Naturally, agencies would like to protect their creative and analytical positions as intermediaries and consultants. To do that, agencies will need to guard against increasing commoditization of their services by experimenting heavily with creative advertising content. If the rise of user-generated advertising seems "outlandish," consider how far-fetched the idea of a consumer-generated encyclopedia was only a few years ago. Agencies need to become the masters of 5-, 10- and 30-second ads that are not tied to linear formats – be the vanguard of testing new alternatives. Agencies can mitigate the risk of the open inventory trend by offering robust planning and analysis capabilities – helping their clients analyze massive amounts of customer data and plan the optimal, integrated advertising strategy across the ever-increasing platforms, formats and pricing models available to them.

Recommendations: Refashioning success

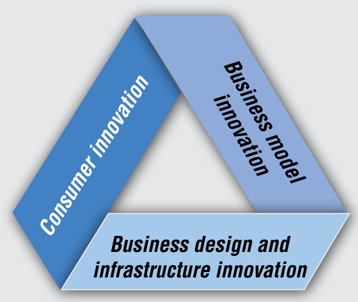
How can advertising value chain participants prepare for the implications of these scenarios? Broadcasters, traditional ad agencies and media distributors, in particular, will need to make strategic, operating and organizational changes now to succeed in a world with more fragmented communication channels and new media interaction and consumption habits. We believe there are a number of "no regret" moves for industry participants to work toward, regardless of how scenarios evolve (see Figure 9):

1. *Consumer innovation*: Making segmentation, micro-segmentation, communities and personalization paramount in marketing

2. *Business model innovation*: Developing new revenue-sharing, distribution and pricing strategies, radically shifting the dynamics in the industry

3. *Business design and infrastructure innovation*: Improving horizontal organizational capabilities and adjusting operations to enable consumer and business model innovation.

FIGURE 9.
Three innovation types.



Source: IBM Institute for Business Value.

Consumer innovation means making marketing more interactive and personalized – changing how advertising is developed, delivered and measured.

Consumer innovation

For all players, consumer innovation means making marketing more interactive – bringing users and semi-professionals into the content development, delivery and response measurement processes to make the content innovative and relevant for consumers.

Building upon our recommendations for media companies in the "The end of television as we know it," we believe the advertising industry will also have to address a bifurcated market of avant-garde, fashion-forward consumers that we call *Gadgetiers* and *Kool Kids,* as well as the large traditional segment we refer to as *Massive Passives*.[31] These vastly different markets mean companies need to adopt a dual strategy, focusing on both traditional and emerging digital business to address audiences. Regardless of advertising vehicle, micro-segmentation and targeting are necessary to drive relevancy for consumers. For example, *Kool Kids* and *Gadgetiers* will likely demand less intrusion, fewer interruptions and a new interactive customer experience, while *Massive Passives* may still require a more traditional approach to advertising.

For *broadcasters*, these shifts imply the need to create relevant campaign content and marketing opportunities for diverse segments. Retaining audiences will also require innovative marketing tactics like campaign bleeds (in which advertising capitalizes on well-known characters and programming), pod management during commercial breaks (focusing on the order and length of commercial breaks), cross-platform integrated messaging and promotions and innovative ad-supported content creation that limits ad-skipping. These capabilities are part of an ongoing cycle of "attention (re) invention," which can help generate increased affinity for broadcasters' brands. Broadcasters can develop their own enhanced, integrated brand marketing around television content franchises to drive viewership of television shows across media devices. Finally, broadcasters that reach out directly to consumers on the Web or contract with new suppliers, such as mobile providers, are better positioned to gather consumer data on their own or through partners. This allows them to mine aggregated consumer data for insights that can lead to improved content and advertising relevancy.

In this kind of market, *distributors* will need to differentiate by delivering location-specific, relevant content to consumers. This can be achieved in part by marrying set-top box and opt-in data with user behavior analysis. Distributors must also integrate new platforms (video, Web, mobile and beyond), allowing advertisers to deliver fluid, follow-me content and marketing programs. Finally, the explosive growth in UGC will necessitate new distribution channels for delivering self-published videos and associated advertising messages across devices – PC, mobile phone and TV. Recent partnerships between media distributors and user-generated content sites provide an example of how distributors can exploit the explosive growth in UGC to capture an increasing share of advertising revenues.

Business model innovation involves changes to advertising formats, revenue models and how and where advertising inventory is sold.

For their part, *agencies* should embrace the ability to reach consumers, regardless of their device preferences, and welcome consumers as part of the traditional, agency-driven processes by bringing users and semi-professionals into the creative dialogue. They should also consider investing in differentiated creative development to drive advertising relevancy (micro-versioning). Agencies can combine their creative and analytical capabilities to develop multiple versions of an advertisement for various customer segments, and deliver the appropriate version based on a consumer profile. Agencies are also well-positioned to be "insight brokers" – aggregating the required information to enable integrated, cross-platform, targeted marketing campaigns – across the advertising planning, buying and analysis/optimization functions. All of this implies the need for strong customer-data analytic capabilities, as well as the increased importance of the media planning role.

Agencies are developing new approaches to put consumers at the center of marketing programs. Niche-focused consumer research panels are increasingly used to test concepts and develop ongoing dialogues with target segments. Efforts to target online influencers or "magnets" are underway to fuel peer distribution of messages. Micro-versioning delivery concepts are being developed by combining consumer segmentation and analytics with low-cost creative development processes and dynamic ad-serving capabilities.

Business model innovation

All players must work toward differentiated business models that can address the changing business demands of advertisers. Innovation related to how and where advertising inventory is sold, the structure and forms of partnerships, revenue models and advertising formats are all applicable.

Broadcasters must diversify their traditional focus to take on broader roles in driving relevancy and creativity in advertising. Broadcasters are in a position to strike strategic partnerships directly with advertisers. By combining consumer insights with their creative knowledge, they can develop relevant, integrated and innovative creative content (both short and long form) and campaigns that span media device platforms. Broadcasters can also expand their advertiser buyer base, by opening up select inventories through media platforms. They will also need to think through how to compensate broadcast affiliates as content ubiquity continues. Finally, broadcasters need to assess the alternative go-to-market options available to them for new distribution opportunities – whether that be by linking more closely with peers (e.g., NewsCorp and NBC) or with platforms (e.g., Google, Joost, Apple).

Distributors can drive persuasion and personalization by combining opt-in, permission-based information, click-stream analysis and data on existing customer relationships. Distributors have a distinct advantage: the information they already have about their customers. This allows distributors to deliver relevant, contextual advertising to consumers and, thus, strong ROI for advertisers. It also allows them to deliver truly personalized portals of content and marketing across media devices. Distributors can also offer advertisers the ability to more accurately assess ROI through targeting, measurement and analytics, as well as response-based advertising and impact-based pricing models. Advertisers are increasingly interested in having these kinds of capabilities (which are typically missing in today's world of television advertising) across advertising channels.

Agencies can leverage their current stronghold positions in traditional advertising and creative aspects of the business to capture revenues from the broader marketing communications industry, such as market research, media planning and customer relationship management. For example, conversations with Sir Martin Sorrell, CEO of WPP, confirm goals to continue to diversify WPP's revenue streams and grow revenues from nontraditional advertising sources, such as consulting and customer relationship management, to two-thirds of overall revenues in the next ten years.[32] Agencies also need to be fearless in pursuing new formats and platforms, particularly integrated, cross-platform advertising opportunities. Finally, agencies need to seamlessly integrate new digital businesses and develop strategies to avoid conflict between traditional and digital ad buying and ad placement.

Distributors are piloting new models for advertisers related to targeting, mobility and interactivity across platforms. Online advertising platforms are being developed to support the sales, delivery and analysis of traditional and advanced advertising formats. Initiatives are underway to enable content and associated advertising portability across TV, Web and mobile devices. Finally, distributors are increasingly expanding UGC and social networking tools beyond the PC.

Business design and infrastructure innovation

For most industry players, significant shifts in current business design and infrastructure will be required to enable horizontal (meaning cross-platform) customer communications.

Broadcasters must move from departmental silos to a more integrated structure that enables horizontal content development and distribution, while also investing in "open platform" capabilities and operating systems to make portions of their advertising inventories available to larger buyer bases. They must also assess their current operating and organizational structures to determine if they have the right resources and appropriate capacity to handle increased marketing promotions and integrated advertising sales across distribution platforms.

Distributors must continue their focus on behavioral analytics, but expand to measure outcomes holistically across platforms. Distributors should also continue to invest in commerce and community tools that enable the delivery of interactive and response-based advertising. By working collectively across the industry, distributors can establish standards for emerging advertising capabilities – and sidestep the barrier that has historically impeded growth in the early stages of other new advertising formats, such as Internet advertising.

Finally, *agencies* must work across media platforms by integrating, or consolidating their currently siloed agencies – this is particularly relevant in areas such as horizontal customer analytics. Agencies have a wealth of data; however, much of this information cannot be turned into insights because of disparate data sources and incompatible underlying data infrastructures. To fund advanced and innovative advertising formats, agencies will need to drive cross-unit efficiencies, for example,

Business design and infrastructure innovation centers on developing flexibility to enable horizontal, cross-platform communications with consumers and integrating business unit silos to create greater synergy.

connecting and standardizing the back-offices of all of their boutiques through the use of shared-services or off-shoring.

Broadcasters are realizing that the rapid expansion of non-linear distribution opportunities has resulted in a dramatic increase in both the number and variety of promotions materials. The processes have become increasingly difficult to manage with existing, often manual, processes and disparate tools. Consequently, companies are investing in tools to digitally transform their internal content management, creative development, production and sign-off processes. Digital Asset Management and Marketing Resource Management applications are being implemented to automate processes, store creative assets and facilitate approval processes. The resulting time and cost savings can be substantial.

Industry outlook

There is no question that the future of advertising will look radically different from its past. The struggle for control of attention, creativity, measurements and platforms will reshape the advertising value chain and shift the balance of power.

As we have witnessed in previous disruptive cycles, the future cannot be extrapolated from the past. With incumbent and new players in the advertising space, each attempting to turn the tide in its favor, it is imperative to plan for different future scenarios and build competitive capabilities for all of them.

Regardless of their positions in the advertising value chain, participants will need to cover the three key bases of innovation – consumer, business model, and business design and infrastructure – to make sure they keep up with the industry changes underway.

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[2] Our interviews and panel discussions primarily involved executives from the advertising buy-side, including representatives from advertising agencies and major advertising companies across key advertising segments.

[3] By "linear TV," we mean historical television programming that is not interactive and is available to viewers at a particular time on a particular channel. The broadcaster is in control of when and where content is viewed. DVRs and VOD offer the opposite environment – the viewer is in control.

[4] *Campaign bleeds* combine programming content with advertising to make the advertising more relevant to the program; *micro-versioning* means developing thousands of versions of an advertisement to make messaging more personalized and targeted to consumers, based on preferences, demographics and location; *video ad flickers* are advertisements that are displayed for a very brief period of time; and by *pod management*, we mean determining the appropriate number of advertisements to include within a commercial break "pod" and paying careful attention to the ordering of the commercials.

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