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"The Great Recession: Trends Impacting Advertising Spending & Agency Remuneration to 2014"

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On behalf of marketer clients, Morgan Anderson periodically draws upon its own and reliable third-party intelligence to trend global advertising spending and agency economics. In this white paper, we provide trends from 2009 through 2014.

We intend this to help client-side marketing, procurement, finance, and legal with budgeting and to aid their negotiations with marketing services agencies. In the paper, we deal with advertising spending trends, agency economic trends, and the substantial link between GDP trends and advertising spending. We may update 2009 trend data as agency holding companies report their actual 2009 results and indicate what 2010 may look like.

MACRO TRENDS: ADVERTISING SPENDING

- Global advertising spending by clients in 2009 suffered the sharpest decline in any single year since the Great Depression
- The outlook for advertising going forward is one of subdued recovery across spending/media disciplines
- Media spending in the US declined by 12.9% in 2009 as estimated by Zenith
- 2010 will see a decrease in total spending although we anticipate healthy growth for digital/interactive, events, and PR
- Global growth for digital/interactive in 2010 is estimated at 9.2% by Zenith

At Table 1 below, comparative U.S. and Global advertising media spending growth is set forth for 2008 through 2011, and we work with estimates by three major global media agencies.

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TABLE 1: MEDIA SPENDING GROWTH 2008 - 2011

U.S.	GROUP M	MAGNA	ZENITH	AVERAGE
2008	-2.4%	-6.3%	-4.2%	-3.6%
2009P	-8.0	-16.1	-12.9	-12.3
2010P	-4.3	0.4	-2.6	-2.2
2011P		0.2	1.6	0.9
GLOBAL	GROUP M	MAGNA	ZENITH	AVERAGE
2008	1.8%	1.4%	1.0%	1.4%
2009P	-6.6	-14.9	-10.2	-10.6
2010P	0.8	5.9	0.9	2.5
2011P	6.3	2.3	3.9	4.2

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The most likely economic scenario for the U.S. is a slow-paced recovery with high unemployment. This will keep growth in check by hampering consumption in the mid-term, especially in the U.S. where 70% of GDP is, directly or indirectly, generated by private consumption. Weak consumption means lower revenue for marketers, and this is a concern of many major global advertisers. Many industry analysts expect "frugality to stay, among consumers, for a long time" in the U.S. Sir Martin Sorrell of WPP, when he announced a drop in profit of 47% for 2nd Q. 2009 at WPP, noted that it would be some time before marketers begin to spend as they did several years prior. It will be interesting to see what the chairmen of the holding companies predict for 2010 when they report upcoming 2009 final data.

Globally, projections for 2009 of steep revenue decline in the advertising industry have been industry specific (e.g., finance, automotive, and business travel), but not for others (e.g., retail, consumer goods, and value products). Of the 79 countries covered by Zenith, 25 were still growing, in 2009, with many of these small, young markets, but it also included some large markets such as China and India. China will likely soon overtake the UK to become the world's 4th largest advertising market, while India will overtake Norway, Mexico, and The Netherlands to become the 14th largest. Predictability of timing, however, is poor.

Digital/internet advertising was holding up better than expected in 2009, and its characteristics have proved more attractive in a recession than traditional disciplines. Internet ad expenditure is forecast to grow 10.1% globally in 2009, and Zenith by 2011 expects it to account for 15.1% of all ad expenditure, up from 10.5% in 2008. Most of this growth is expected to come from paid search. In the U.S., search advertising is expected to grow 20.0% in 2009, with traditional display expected to grow 3.0% and classified 1.8%.

There is said to be an 81% relationship between advertising spending and GDP and other macroeconomics, and we provide data to 2014 at Table 5 below.

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MICRO TRENDS: AGENCY ECONOMICS

Although some agencies are reluctant to provide granular data on their economics even to clients, confident agencies provide such information in the spirit of transparency if they are given reasonable assurances that non-disclosure will be honored. It is fortunate, however, that useful agency economic information is obtainable from publicly available reports and modeling, notwithstanding whether an agency provides data to its clients or not.

In this white paper, we focus on comparative agency profit margins as the metric to use in this paper for trending. Other metrics we can use are comparative staffing equivalents (FTE), agency salaries, agency overheads, and cost per defined deliverable.

At Tables 2, 3, and 4 below, we trend pre-tax profit margin comparables for a) global holding companies, b) regional operating agencies, and c) large operating agencies in two major markets, U.S. and UK. Although profit margin is but one element of agency compensation and the tip of the iceberg at that, it is one both agencies and clients give undue focus to these days. Information for these tables was obtained by publicly available sources.

In summary:

- For the public global holding companies, Publicis and Omnicom exceed WPP pre-tax profit margins and these three exceed IPG margins (Table 2)
- For large operating agencies by region, North America profit margins exceed Europe and AsiaPacific/Other margins (Table 3)
- For large agencies in two major markets, U.S. profit margins exceed UK margins (Table 4)

Tables 2, 3, and 4 were compiled by Morgan Anderson using its modeling, publicly-filed SEC reports, UK government company reports, Morningstar, trade publications, and other sources deemed reliable by Morgan Anderson.

TABLE 2: HOLDING COMPANY PRE-TAX PROFITS 2005 – 2011

GLOBAL HOLDING CO.	2005	2006	2007	2008	2009P	2010P	2011P
OMNICOM	12.2%	13.3%	15.1%	15.4%	10.8%	11.2%	13.0%
PUBLICIS	13.6	14.6		14.3	13.3	13.6	14.5
IPG	-3.0	-0.1	3.6	6.8	4.3	5.0	6.0
WPP	11.1	11.6	11.7	10.0	7.0	8.0	10.0
AVERAGE	8.5	13.1	10.1	11.6	6.2	9.5	10.9

TABLE 3: OPERATING AGENCY REGIONAL MARGINS 2008 – 2011

REGIONAL LARGE-AGENCY	2008	2009P	2010P	2011P
NORTH AMERICA	11.2%	7.5%	9.5%	11.5%
EUROPE	3.0	3.5	6.5	9.5
ASIA PACIFIC/OTHER	3.9	5.0	7.0	9.0

TABLE 4: U.S. & UK AGENCY MARGINS 2005 – 2011

BY COUNTRY	2005	2006	2007	2008	2009P	2010P	2011P
UK LARGE AGENCY IQ AVERAGE	7.0%	12.5%	10.5%	9.5%	8.0%	9.0%	10.5%
U.S. LARGE AGENCY IQ AVERAGE	15.5	14.0	13.5	11.0	7.5	9.5	11.5

It is likely that several years will pass before agency profit margins return to levels of the mid 2000s. Perhaps this will not happen for a number of years. However, if non-traditional disciplines such as digital/interactive, events, and PR experience strong growth, as seems likely to happen, and if innovative agency business models are adopted, agency profit margins could be the beneficiary.

MACRO TRENDS: GDP & RELATED METRICS

Given there is an 80% correlation between GDP and advertising spending, it is highly useful to look at trends in GDP and related macroeconomics (Chart 5).

Most macro indicators for major (OECD) countries point to the end of the most severe recession in decades as growth has resumed in recent months, albeit at a moderate pace and with sharp differences between countries. The recovery was driven by the broadest, biggest and fastest demand-supporting government response known. Failing banks were supported by trillions of public cash and guarantees while central banks drastically reduced interest rates. These extraordinary interventions, carried out consistently by the major world economies, helped control panic, support the financial system, and ebb the fall in private demand. Area-wide unemployment is expected to continue to rise well into 2010 and to fall only modestly in 2011 from its peak. Some see a double dip recession as well although there is certainly no consensus on this.

The expectation is for moderate recovery going forward. 2014 Global GDP is expected to underperform 2007 for both advanced and developing/emerging markets (Chart 5). Given the substantive relationship between advertising spending and GDP, as new GDP numbers are reported, we intend to update these trends and correct to market.

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Should you wish specifics of the study or to learn more, please email Lee Anne Morgan at lamorgan@morgananderson.com or Arthur Anderson at aanderson@morgananderson.com.

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