

Advertising in a downturn

A report of key findings from
an IPA seminar



Promoting the value of agencies

Contents

Objectives	1
Management summary	1
The context	1
Impacts on brand health	
Millward Brown	3
Impacts on business performance	
Data2Decisions	5
MalikPIMS	8
Peter Field, IPA dataMINE	11
Contacts	17

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Objectives

On 4th March 2008 the IPA convened a conference of leading consultancies in the area of the business effects of marketing communications. The purpose of the event was to see what lessons could be learned from their experience about the most profitable marketing response to an economic downturn. This document records the key findings presented by each of the consultants.

Management summary

- Cutting budget in a downturn will only help defend profits in the very short term.
- Ultimately the brand will emerge from the downturn weaker and much less profitable.
- It is better to maintain SOV (share of voice) at or above SOM (share of market) during a downturn: the longer-term improvement in profitability is likely to greatly outweigh the short-term reduction.
- If other brands are cutting budgets the longer-term benefit of maintaining SOV at or above SOM will be even greater.

The context

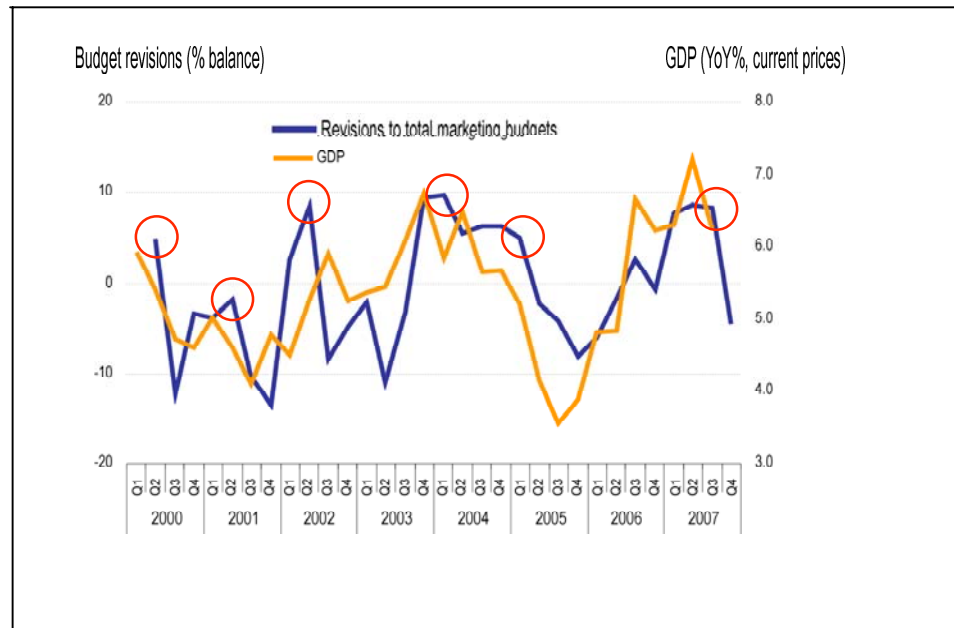
In his introduction, Guy Murphy, Chairman of the IPA Strategy Group, and Worldwide Planning Director, JWT, spoke of the importance of maintaining advertising and marketing communications expenditure during a downturn, and anticipated that additional proof would be adduced during the seminar to support this idea.

He reminded the audience that while powerful data would be shown on the effects of media expenditure on brand performance, there was also considerable evidence of the impact of superior creative content which would not be. Thus there are two main opportunities for informed brand managers and their agencies to gain competitive advantage, and not only during a recessionary phase. Firstly, by ensuring that a brand's 'share of voice' exceeds its 'share of market' and secondly that its creative communication is more relevant and engaging than its rivals.

In his opening address, Hamish Pringle, Director General of the IPA, showed data from the *Bellwether* Report that suggested it was prudent to be planning for a downturn, although the severity of such an event was not yet clear. As Sir Martin Sorrell has suggested, it may be mitigated by the effects of the Beijing Olympics, the US Presidential Election and the 2008 UEFA European Football Championship. *Bellwether* records intended marketing communications expenditure by a robust sample of UK businesses and collected data since 2000 has correlated closely with subsequent Government economic data when it was later reported. Thus *Bellwether* data is widely regarded as a useful leading indicator because it reports before information is available on GDP and corporate profitability.

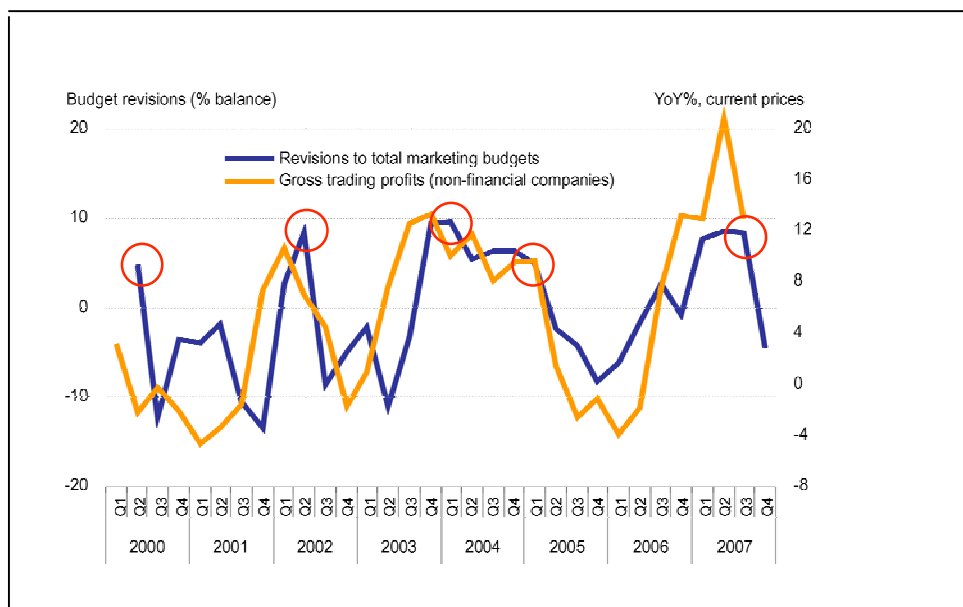
Latest *Bellwether* data suggests that both GDP growth and corporate profits are likely to have fallen in Q4 2007 (see Figs. 1 and 2).

Fig. 1 Bellwether vs GDP Q4 2007



Source: IPA/ NTC Economics

Fig. 2 Bellwether vs Corporate profit Q4 2007



Source: IPA/ NTC Economics

Moreover, in comparison with previous cycles, *Bellwether* suggests that further falls may be seen in Q1 2008.

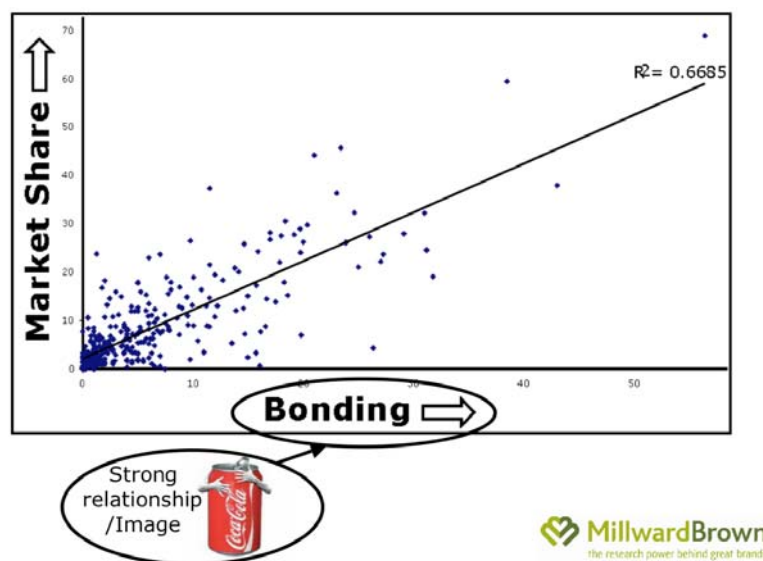
Speakers were asked to address the likely impact on brands – and their profitability – of reducing their marketing communications expenditure during a downturn. Clearly if all brands in a category were to cut expenditure equally, then apart from some minor effects on the category as a whole (the most important of which might be an increase in price sensitivity), there would be little impact on brands individually. Experience of previous downturns reveals that this is not the general response: some brands maintain or even increase their expenditure, whilst others cut theirs. The *Bellwether* data corroborates this variability in spending intentions. So the question under examination in reality boiled down to: what is the impact on those who cut their marcoms expenditure versus those who maintain or raise theirs?

Impacts on brand health

Millward Brown

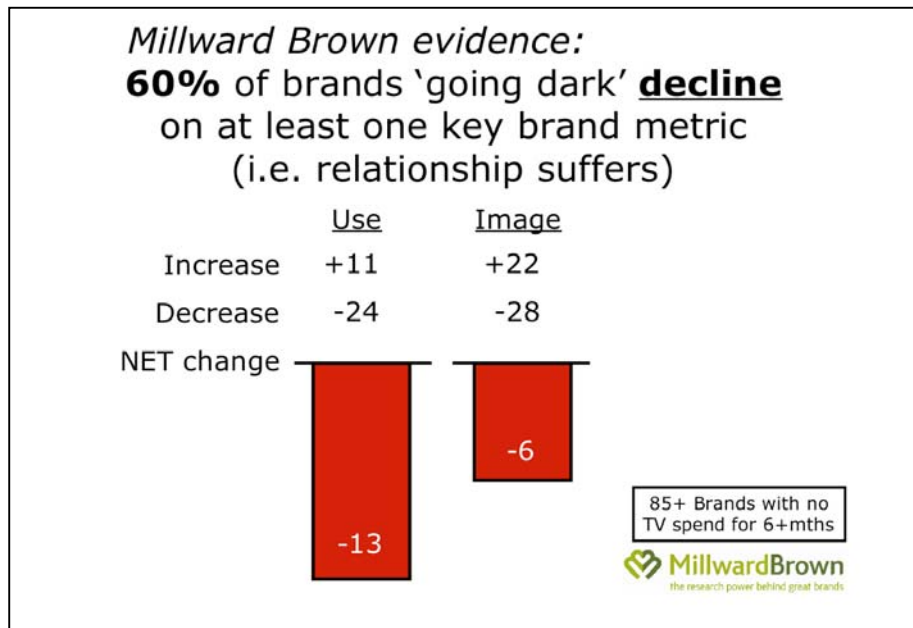
The conference saw data presented by Peter Walshe of Millward Brown on the impacts on brand health and effects of budget cutting on those consumer research metrics that are widely regarded as leading indicators of business performance. As a leading UK provider of consumer research, Millward Brown has an extensive database with which to examine the impacts of budget cutting. Walshe presented data showing a strong correlation between market share and the level of 'bonding' – an aggregate measure of multiple brand-consumer relationship metrics. The clear implication being that if budget cutting results in a decline in 'bonding' then market share can be expected to decline (see Fig. 3).

Fig. 3



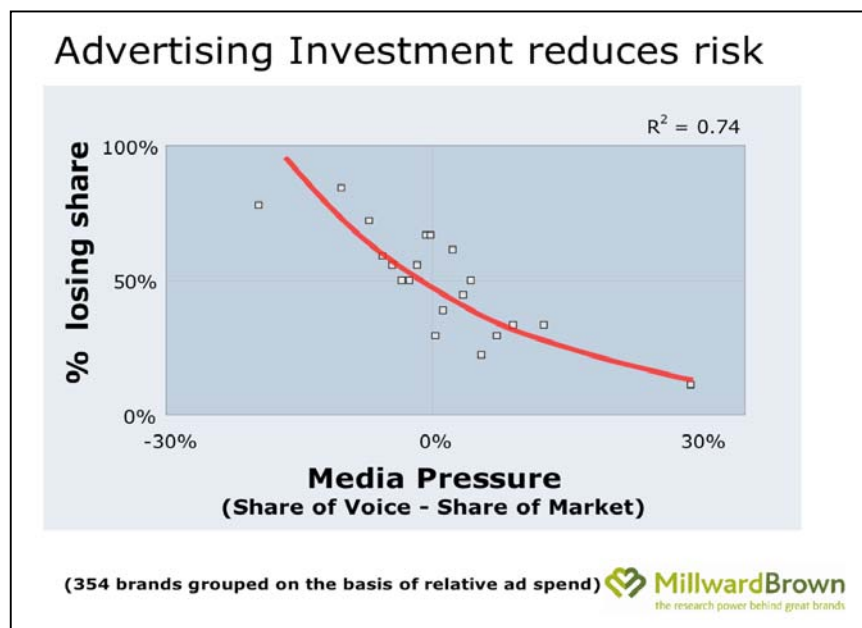
Crucially, further data was presented to demonstrate that two key constituent brand relationship metrics – brand usage and brand image – suffered considerably when brands 'went dark' (i.e. ceased to spend on communications) for a period of six months or more (see Fig. 4).

Fig. 4



The data went on to illustrate the increased risk of failure when communications expenditure was then resumed after the end of the downturn. Further data was presented showing a strong relationship between the level of risk of loss of share and the key expenditure metric: share of voice (SOV) minus share of market (SOM), where share of voice is defined as a brand's share of total category communications expenditure (see Fig. 5).

Fig. 5



Thus brands that cut their budget relative to competitors are at greater risk of share loss.

It was observed that the level of risk was greater in some categories than others. Brands in categories that are more price-driven and where brands carry less importance to consumer choice (such as motor fuel, mineral water and apparel) are more susceptible to share loss when cutting budgets. Conversely, brands in categories where the reverse is true (such as luxury cars, financial services and fragrances) tend to be more resilient. It was noted that the average proportion of consumers across all categories, who were exclusively motivated by price, was around 10% and so even if this increased considerably during a downturn, the proportion would remain small: there was therefore good reason in continuing to build brand preference during a downturn.

Finally a cautionary note was sounded concerning the speed with which 'buzz' (online and offline word-of-mouth) now spreads consumer views of brands: a brand judged to be on the way down, because it has fallen silent, will very rapidly see this manifested in word-of-mouth, which will accelerate the perception of failure.

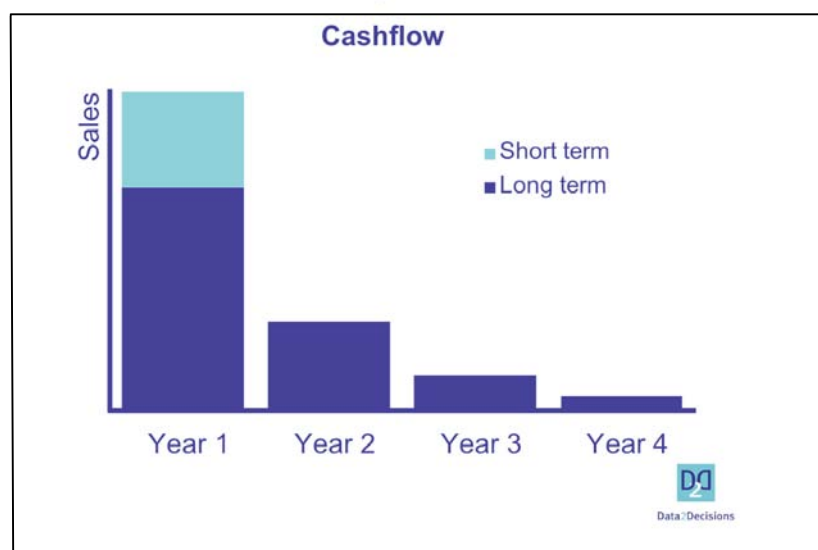
Impacts on business performance

The remaining three papers presented examined the hard business effects of reducing advertising and marketing communications budgets during a downturn.

Data2Decisions

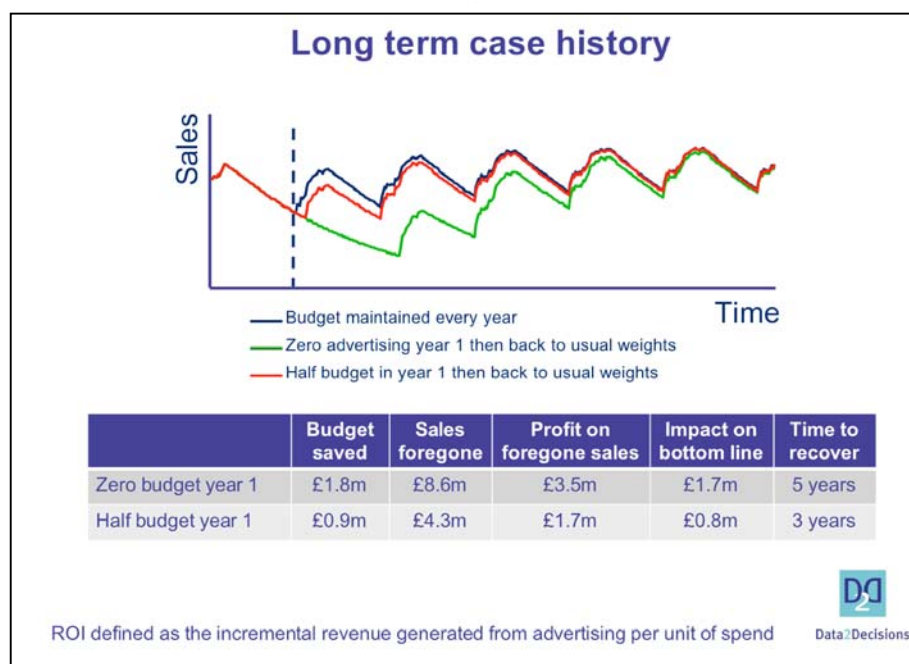
The first of these, from econometric modelling consultancy Data2Decisions, brought to the attention of the conference a key factor in determining the business effects of budget cutting: the time-lag effect. Evidence was presented by Karl Weaver that although most estimates of short-term payback from advertising (i.e. over small numbers of purchase cycles) was around 50%, the payback over the longer term (one to four years) was usually considerably greater than this (see Fig. 6).

Fig. 6



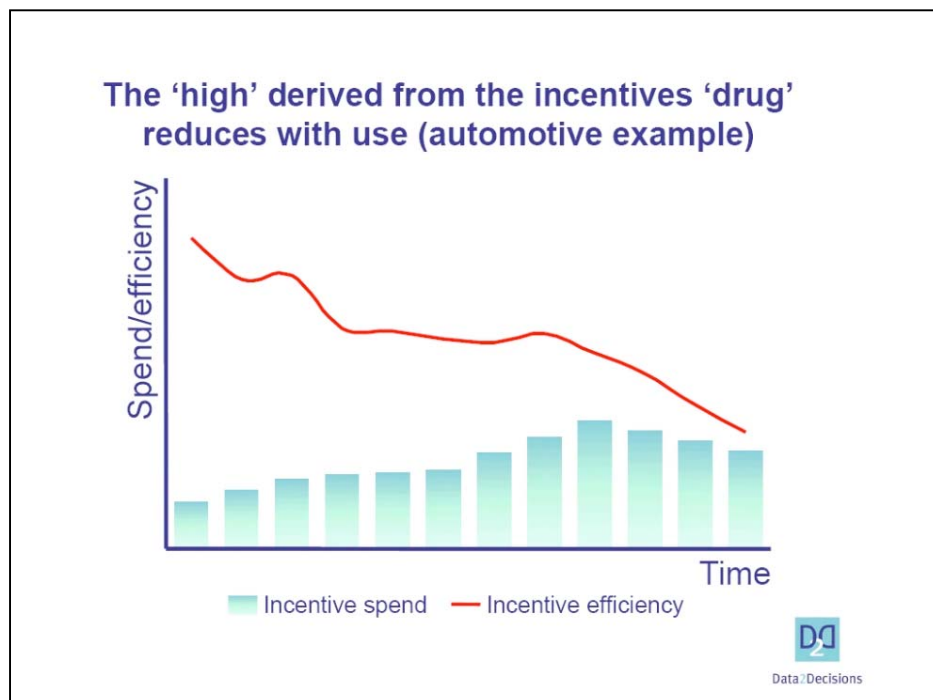
A typical brand case study was shown where the long-term element of payback was over four times greater than the short-term. The importance of this is considerable. Following a budget cut, a brand will continue to benefit from the marketing investment made over the previous few years. This will mitigate any short-term business effects, and will result in a dangerously misleading increase in short-term profitability. The longer-term business harm will be more considerable, but will not be noticed at first. The long-term effects of two different budget-cutting scenarios were modelled for the brand. In the first scenario the budget was cut to zero for just one year and then returned to usual levels. In the second scenario the budget was halved for one year and then returned to usual levels. Sales recovery to pre-cut levels took five and three years respectively, with cumulative negative impacts on the bottom line of £1.7m and £0.8m (see Fig. 7).

Fig. 7



Other dangers of common downturn behaviours were also identified. The diversion of communications expenditure into price promotions is a common response to downturn. The experience of widespread use of price promotions in the US automotive category illustrates how consumers quickly come to expect 'incentives'. They therefore lose their efficiency as a generator of incremental sales and end up as a loss of profitability (see Fig. 8).

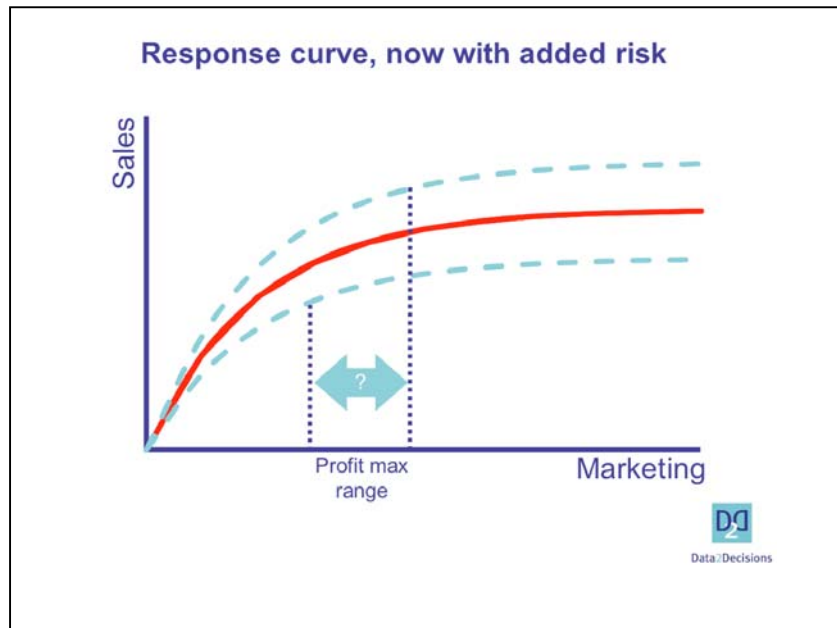
Fig. 8



Another widely overlooked impact of reduced brand communications expenditure is on price elasticity. Data was presented for a campaign that had reduced the price elasticity of the brand (i.e. the percentage change in volume for a one percent change in price) from -2.2 to -1.5. Such improvements often account for the majority of the profit impact of a successful campaign. By extension, the abandonment of communications is likely to result in the gradual increase in price elasticity and the growing need to reduce pricing to maintain volume. This may have a very damaging effect on profitability, but again one that is deceptively time-lagged.

Finally, the Data2Decisions presentation raised an unfortunate side effect of markets in downturn: greater unpredictability and hence risk. In particular it was shown how volatility in the response curve to marketing results in radically different optimum levels of expenditure for maximum profitability. This risk can deter expenditure, but the solution is to use modelling to determine the optimum expenditure and to maintain brand support (see Fig.9).

Fig. 9



Malik PIMS

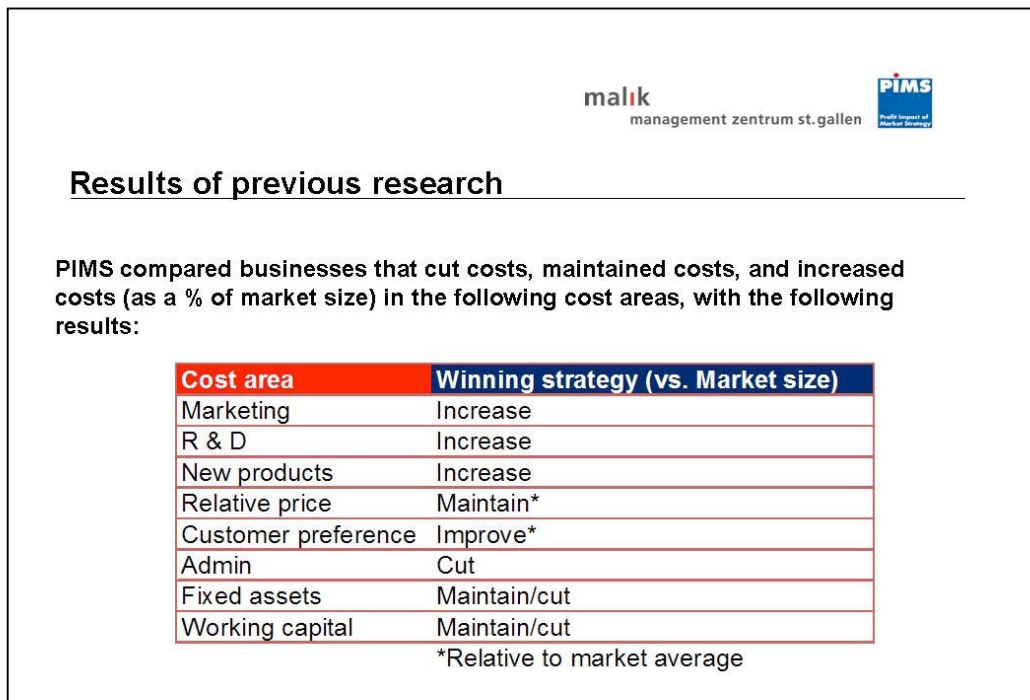
The second of the business effects papers was presented by Keith Roberts of Malik PIMS (Profit Impact of Market Strategy). PIMS has analysed data collected from around 1,000 business units in developed economies during periods of market downturn and subsequent market recovery. Their data is extremely robust, highly respected, and enables a comparison of downturns pre-2000 with more recent ones. Three performance metrics were presented: inflation-corrected ROCE (Return on Capital Employed) during downturn, inflation corrected ROCE during the first two years of market recovery, and market share change during the first two years of recovery.

The results of a 2001 analysis of the winning business strategies deployed during earlier downturns were presented, demonstrating the importance of **increased** commitment to marketing during a downturn.

The data showed that whilst maintaining or reducing fixed costs was desirable, the opposite was true of marketing costs. Communications, R&D and new product development were all areas where increased expenditure was associated with business success during downturns. Improving customer preference whilst enabling maintained relative price were the means by which increased marketing expenditure drove success.

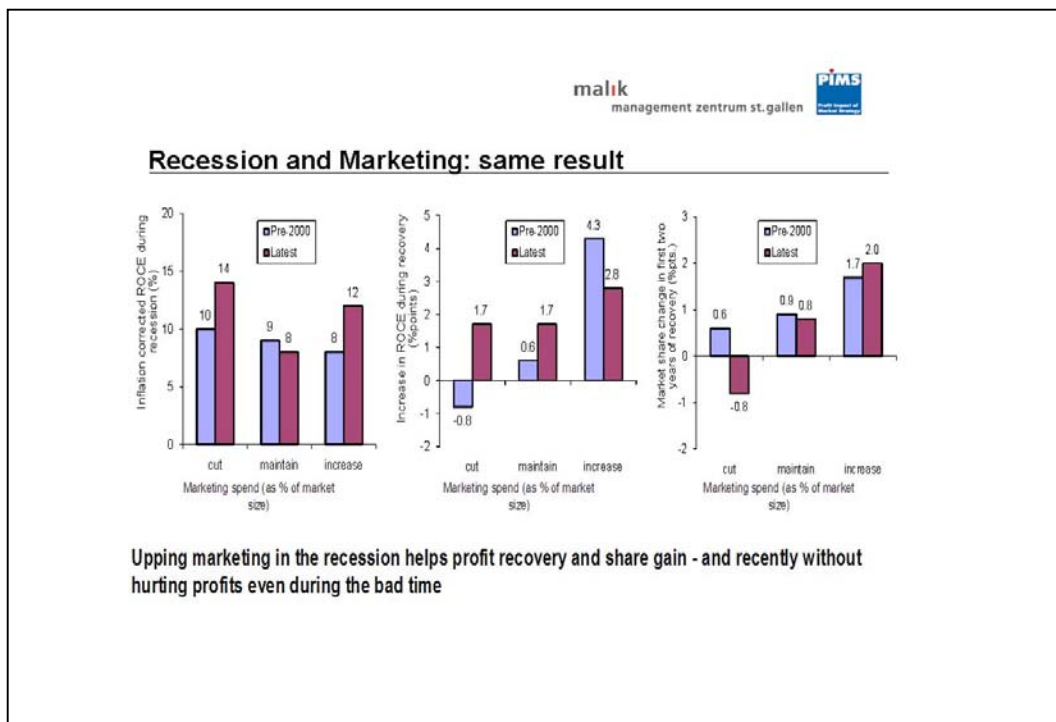
Data was then presented bringing the analysis of the effect of increased spend on marketing and R&D and more active NPD (new product development) up to date. In each case the three charts show the effects of cutting, maintaining or increasing expenditure/ activity on the three metrics: ROCE during the downturn (left), ROCE after it (centre) and market share after (right). The coloured bars show the comparison of the more recent data with the earlier analysis (see Fig 10).

Fig. 10



The first of these charts looked at marketing spend, and showed that ROCE and market share after the downturn were considerably enhanced by increased marketing expenditure during the downturn (see Fig. 11).

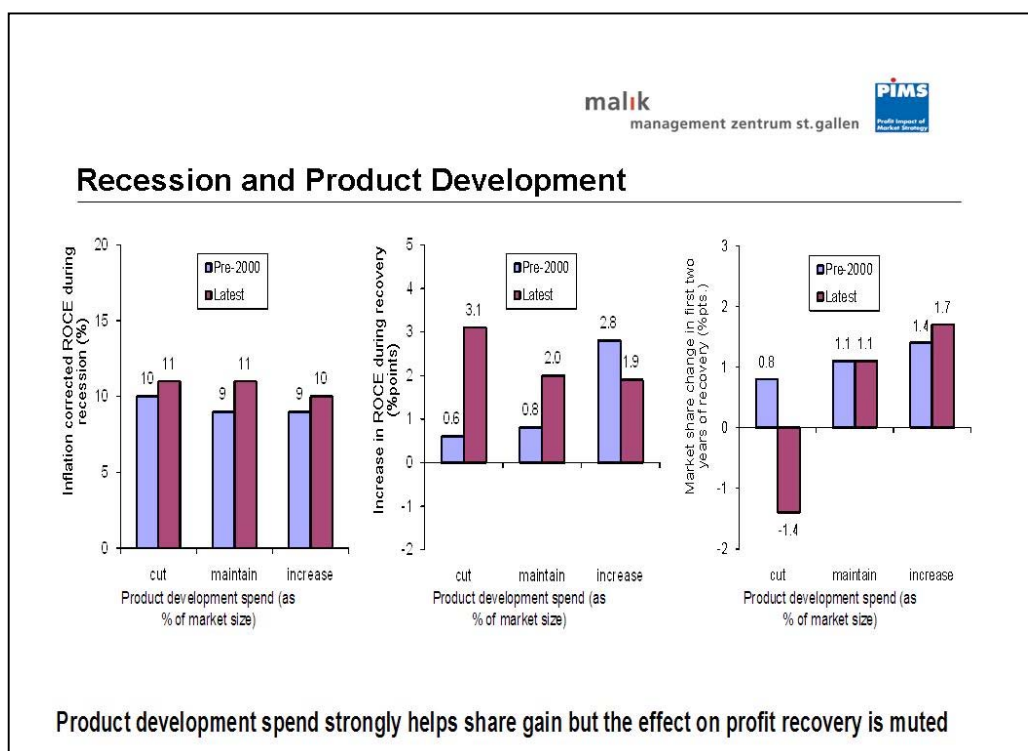
Fig. 11



ROCE during the downturn was perhaps mildly adversely affected by increased marketing spend, but not significantly and the longer-term upside greatly exceeded any short-term downside. By contrast, cutting marketing expenditure results in less ROCE recovery and reduced market share post-downturn. This pattern of more recent findings is therefore broadly the same as was found with the earlier data.

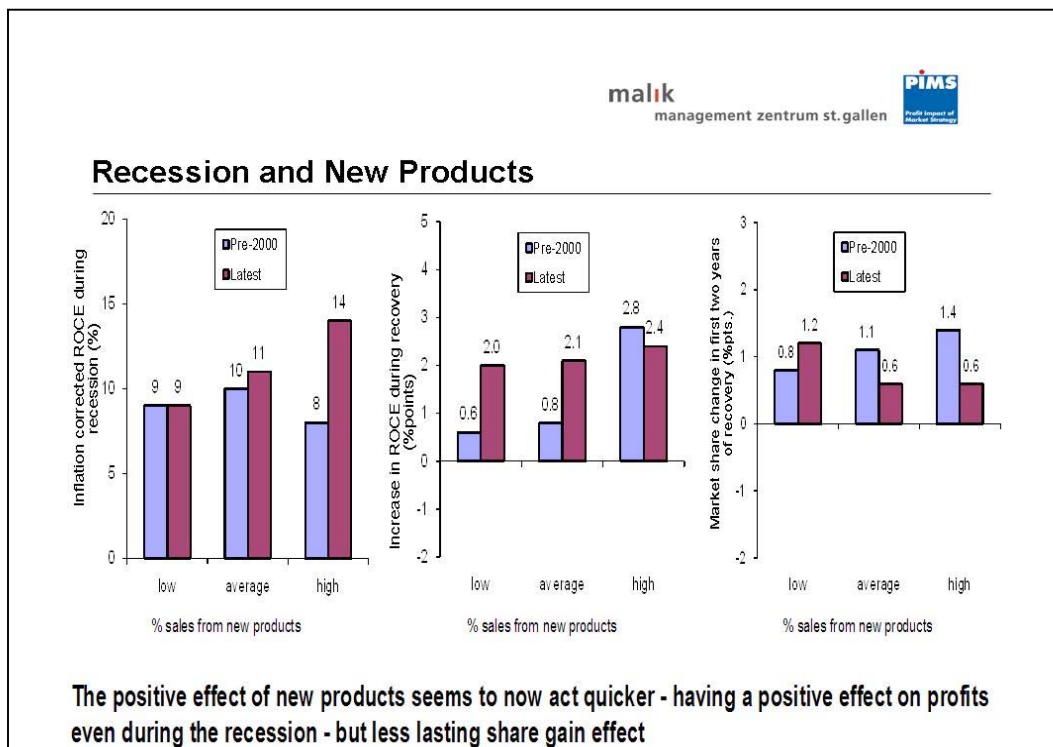
The second of these charts examined the effects of increased R&D expenditure during the downturn (see Fig. 12). In this case, some developments in the pattern have occurred since the earlier analysis. Whilst the effect on market share post-downturn of increased R&D spend during it, remains very positive, the effect on ROCE recovery post-downturn has become more muted. There is little or no observed adverse effect on ROCE during the downturn caused by increased R&D spend. **Cutting R&D expenditure appears on balance the least successful approach.**

Fig. 12



The third of these charts examined the effects of increased new product development activity (expressed as percentage of sales derived from new products) during the downturn. Again patterns have evolved slightly from the earlier analysis, but the central conclusion remains the same: NPD has a strongly beneficial effect on ROCE during the downturn, but rather less so post-downturn. This is explained by the observation that increased NPD brings less lasting effect on market share post-downturn. Competitor response to NPD has become swifter since the earlier analysis, resulting largely in only short-term benefits to the first mover. (See Fig. 13.)

Fig. 13



So the PIMS analysis provides clear evidence that increasing marketing communications expenditure in a downturn is a profitable strategy for recovery because media costs and competitor activity tend to fall. Essentially downturns provide a window of opportunity for cheap market share gain to brands that increase investment. Increased expenditure on R&D brings similar benefits, whilst increased NPD is the best strategy for enhancing short-term ROCE during the downturn, but brings little benefit thereafter.

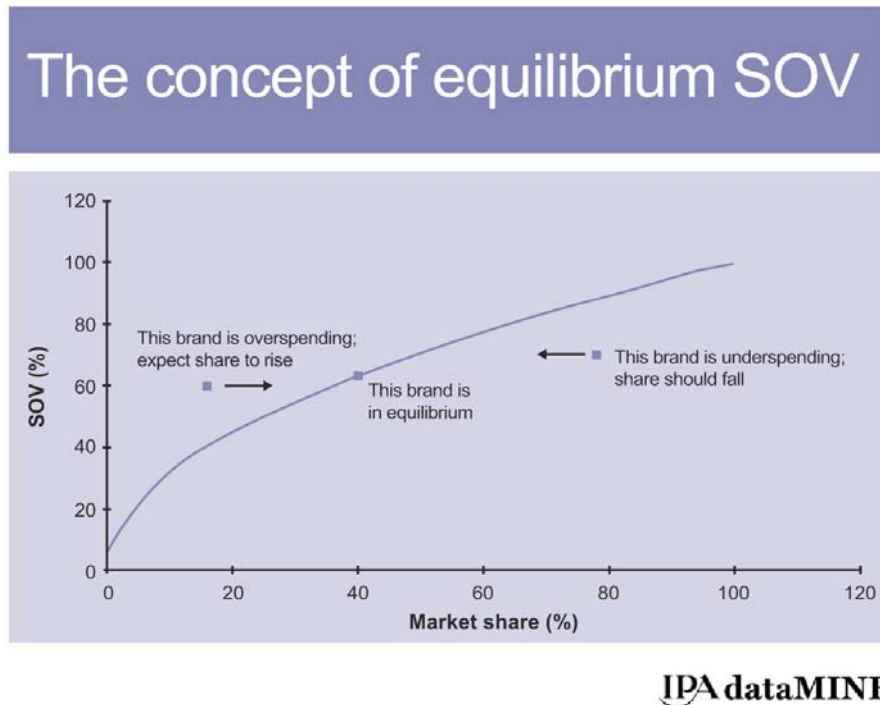
Peter Field – IPA dataMINE

The final paper was a presentation by Peter Field, marketing consultant, based on key findings of an analysis of 880 of the IPA dataBANK of case studies submitted to the IPA Effectiveness Awards since 1980. The IPA Effectiveness Awards are generally agreed to be the world's most rigorous competition – entries are double-vetted by industry experts and academics as well as senior clients from major marketing-focussed companies.

Share of voice (SOV) and share of market (SOM) data from the case studies has been collected and used to examine the relationship between SOV and SOM, and by extension the effect of cutting SOV. The paper went on to illustrate the likely effect on the bottom line of a brand of the predicted effects of various SOV strategies during a downturn.

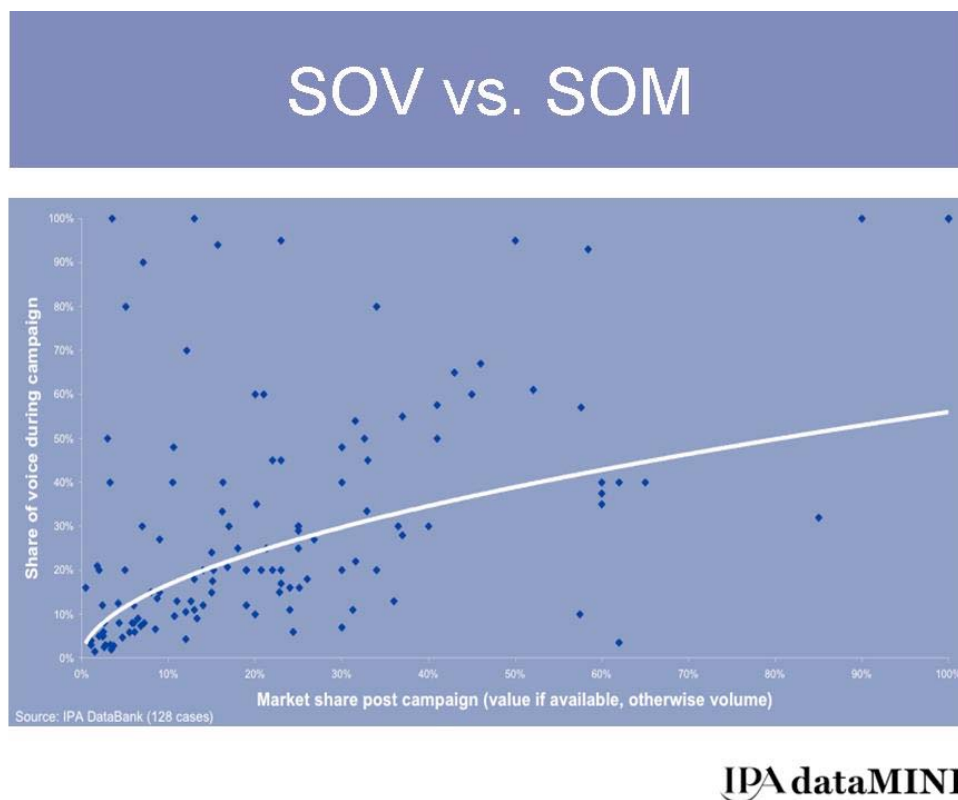
The paper began by presenting the theoretical relationship between SOV and SOM, showing the equilibrium line for stable market share. Brands spending above equilibrium SOV will grow, whereas those spending below equilibrium will shrink:

Fig. 14



Data was presented from the dataBANK to validate this theoretical relationship:

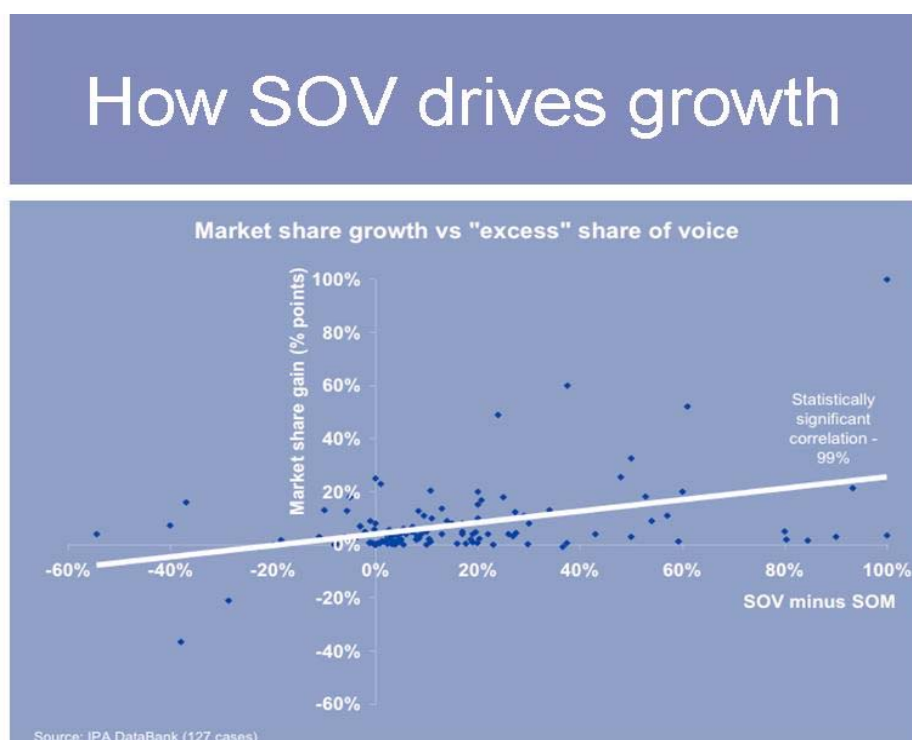
Fig. 15



It was observed that brands lying above the curve tended to grow market share in proportion to their distance from it, whilst brands below tended to lose market share in proportion to their distance from it. Thus the most critical factor in explaining subsequent SOM changes was found to be the 'excess share of voice' (SOV – SOM). This relationship holds during buoyant times as well as downturns.

The actual relationship between the market share growth (or decline) recorded and the level of excess share of voice (SOV – SOM) was presented, and the strong statistical reliability of the relationship was noted (see Fig. 16). It was also observed that analysis by researchers of other databases had revealed extremely similar relationships.

Fig. 16



IPA dataMINE

An approximate rule-of-thumb finding was extracted from the analysis: that for every **10 points that SOV exceeds SOM** a brand can expect to **gain one point of market share per annum**. The corollary of this is that a brand can expect to lose one point of market share for every ten points it allows its SOV to fall below its SOM. It was noted that this is an average finding across all categories and that ideally the relationship for any given category should be derived from econometric modelling. Nevertheless it was suggested that this rule-of-thumb could be used as a forecasting tool for the effects of different marketing communications expenditure strategies during a downturn, and subsequent charts illustrated such forecasting. Attention was drawn to an important facet of this relationship: that there is an inherent time-lag between relative marketing expenditure (SOV – SOM) and market share growth.

The chart shows the share resulting (in the following year) from expenditure in the previous. As with the earlier Data2Decision paper, it was pointed out that this causes deceptive short-term effects during periods of sudden marketing expenditure change. These were demonstrated in the forecast illustrations that follow.

The forecasting rule-of-thumb was applied to a hypothetical brand in a fairly common scenario. The brand operates in a previously buoyant category, but prior to the downturn mildly under-spent its SOM (SOV is 6.3% vs SOM at 7.1%). A 'panic' scenario was then modelled in which budget was cut to zero for two years (whilst competitors maintained real spend). The market share in the third year was then forecast: down from 7.1% to 5.7% (see Fig. 17).

Fig. 17

Panic scenario: zero budget				
Year	2007	2008	2009	2010
Brand X spend	£7.9m	£0m	£0m	
Competitor spend	£117m	£120m	£123m	
Market spend	£125m	£120m	£123m	
Share of voice	6.3%	0%	0%	
Excess SOV	-0.7%	-7.0%	-6.3%	
Share growth	-0.07%	-0.7%	-0.6%	
Share	7.1%	7.0%	6.3%	5.7%

IPA dataMINE

The likely impact of this decline on the profitability of the brand over the three-year period was then modelled assuming a fairly typical cost structure for a packaged goods brand. Other assumptions made were that category growth ceased for two years and resumed 5% growth in the third year; that marketing communications expenditure for the brand was restored in the third year; and that fixed costs for the brand rose with RPI across the downturn. The resulting profitability pattern echoed the conclusions of other researchers: that a short-term improvement was rapidly overtaken by a severe decline that became acute in the third year when the marketing budget was restored (see Fig. 18).

Fig. 18

Panic scenario: zero budget

Year	2007	2008	2009	2010
Brand X sales	£317m	£314m	£282m	£269m
Fixed costs (excl mktg)	£68m	£70m	£72m	£74m
Variable costs (excl mktg)	£202m	£200m	£180m	£171m
Mktg spend	£7.9m	0	0	£7.9m
Total costs	£278m	£270m	£251m	£253m
Operating profit	£39m	£44m	£31m	£16m

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Attention was drawn to the deceptive short-term improvement due to the lagged effects of marketing on sales (recent authoritative PricewaterhouseCoopers research suggests that 45% of the return on television expenditure comes through more than one year later). This short-term improvement usually provides the stimulus for such severe budget cutting and for a time masks the considerable damage being done to longer-term profitability.

Comparison was made with the profitability pattern for a less severe budget cut of 20% for two years (other assumptions remaining the same):

Fig. 19

Moderate cut scenario: 80% budget

Year	2007	2008	2009	2010
Brand X sales	£317m	£314m	£306m	£313m
Fixed costs (excl mktg)	£68m	£70m	£72m	£74m
Variable costs (excl mktg)	£202m	£200m	£195m	£200m
Mktg spend	£7.9m	£6.3m	£6.3m	£7.9m
Total costs	£278m	£276m	£273m	£281m
Operating profit	£39m	£38m	£33m	£32m

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In this scenario a similar but less severe pattern is shown. However the brand still emerges from the downturn in a considerably weaker profitability position.

Finally, the forecast profit pattern for the minimum recommended expenditure level (where SOV equals SOM) was compared with the pattern for the previous mild budget cut scenario (see Fig.20). This comparison reveals the wisdom of at least maintaining marketing budgets during a downturn.

Fig. 20

Comparison with SOV based approach: SOV=SOM				
	Operating profit:			
	2007	2008	2009	2010
Mild cut	£39m	£38m	£33m	£32m
SOV=SOM	£38m	£36m	£34m	£38m

IPA dataMINE

The comparison reveals that the cumulative profits generated in the SOV = SOM scenario over the three year period greatly exceed the mild cut scenario, despite a disadvantage in the first year. Though it should be noted that no discounted cash-flow (DCF) analysis has been applied, this tends to lessen the overall advantage.

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