MOORE Intelligence

TEAR UP THE SCRIPT

Advertising agencies were staring at collapse, now they are set for a record year

Advertising is one of the industries that many predicted would be decimated by Covid – instead, it reinvented itself and now faces the prospect of a better-than-expected 2021 with higher revenues and improved profit margins.

It is not a universal good news story. There are clear winners and losers but those that made the right calls when times were toughest are set to benefit from what many industry experts predict will be a strong bounce-back in marketing spend.

Global advertising investment is forecast to grow by 5.8% globally in 2021 to $579 billion, according to Tokyo-based Dentsu, a leading advertising agency.

In its January Ad Spend Report, the first since the global pandemic began, Dentsu predicted all regions would see positive growth to offset a fall of 8.8% in 2020.

Western Europe, Asia-Pacific and North America should perform best, while sectors hit hard by Covid lockdown such as travel, entertainment and automotive are expected to record the biggest rises in spending as clients invest in campaigns to woo back customers after lockdown.

The predictions are in line with the first-hand experience of Moore's own media experts across the world who collectively deal with hundreds of independent advertising agencies with annual revenues of $3 million to $25 million, as well a much larger private equity backed and listed multinational groups.

These mid-tier, owner-managed businesses are the engine room of the global advertising industry. Almost all saw big revenue drops in the second and third quarters of 2020 but many of those that managed their human and financial resources carefully ended the year within sight of their initial profit forecasts, while some were even slightly ahead.

"The ones that had to close their businesses were already in trouble," says Matías Tejero, CEO of Moore Tejero in Buenos Aires, one of the world's key creative hubs. "However, others got to the end of the year and realised it was not as terrible as they thought it would be."

$579bn

Total global spending on advertising predicted in 2021

Once the initial shock subsided, many agency owners saw Covid as an opportunity to reconnect with clients that had stopped seeing them as strategic advisers, and merely as the providers of a commodity service.

Tejero, an industry veteran of more than 30 years, says those that seized the moment and demonstrated their creativity shifted perceptions and have put themselves back at the top table of decision-making. “As clients had to move their businesses online, agencies showed them how to improve their e-commerce operations, generate cross-selling options and use different channels to drive sales.

“They were able to show CEOs that they could add value with fresh ideas and new ways of developing their businesses while reducing costs and increasing profits.”

How different it looked in the summer of 2020.

Back then, film shoots were brought to a grinding halt because of Covid working restrictions. Masks, social distancing and stay-at-home orders were incompatible with filming adverts with up to 150 cast members and crew.

Gradually, workarounds were found. Animated characters could replace humans in many instances, video editors could complete post-production tasks at home and share files with clients in the cloud.

The summer saw a raft of visually similar adverts that revolved around “real people” being filmed at home on smartphones and laptops – but these attracted widespread criticism for “lack of creativity”.

As the year wore on the studio-in-a-box concept allowed live filming to start again. These are sealed environments containing all the equipment that is needed to shoot the script with actors and production crew being tested regularly to prevent the spread of infection. To keep physical numbers on set down, some agencies used CGI to generate crowd scenes of electronic extras.

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>
> **Matías Tejero, Argentina**

And then as the advertising industry began to recover something began to happen in Argentina and several other Latin American countries: the phone started ringing with inquiries about outsourcing production work, mainly from the United States.

The reason was straightforward: US agencies woke up to the fact they could get Madison Avenue-quality work at less than half the cost. Also, with high inflation and currency devaluations, the commissioned work might cost even less in dollar terms by the time it had to be paid for.

"Some US companies found that they could outsource digital production and increased their production hubs in Latin America," says Matías Tejero.

"They manage the account with clients and are responsible for all the strategy and creative ideas, then production is done in Latin America. That has increased since Covid and digital production companies have grown and increased staffing levels."

From a US perspective, the arrangement is one of a number of fundamental changes to business models that have been adopted by the most successful agencies.

There, the Paycheck Protection Program (PPP) has been a major factor in helping many agencies survive. It is a federal loan initiative that helps small- and medium-sized businesses affected by the pandemic cover payroll costs and certain other expenses.

For many experiential agencies that specialise in on-site promotions in malls and events, it was vital to offset an estimated 80% drop in revenue across the board. However, those are the companies that could show the biggest growth in 2021 as the economy reopens and consumers flock to stores and events after a year of being cooped up at home.

Elsewhere, many agencies have discovered previously untapped opportunities in digital marketing as their clients have grown their own online businesses. Devising strategies for standing out from the e-commerce crowd has opened a new seam of creativity.

Armanino LLP, part of Moore North America, has more than 500 clients in entertainment and helped many survive by making use of government support packages, careful cash management, reducing waste office space and reappraising every cost line in the budget.

Now, they have to focus on their creative endeavours. "Advertising is under more pressure than ever to be entertainment," says partner Jenn McCabe.

"We all have the ability to zoom through it or pay more money to skip it, so advertising absolutely has this imperative to be entertainment, to be beautiful and something you want to see again."

Armanino believes this is a pivotal moment for smaller agencies. Clients are in search of new ideas and are giving them a chance to work on accounts that would previously have been beyond their reach, albeit usually in collaboration with their established agencies.

Owners who were intent on selling out nine months ago are now rethinking as they have seen the new strategic directions they were forced to take to avoid collapse beginning to bear fruit. With a more diverse spread of work, a foothold in new high-growth markets and better margins achieved with drastic cost-cutting, the value of their life's work is on the rise once again.

"I would say this is an industry far from bombed out - perhaps, perversely, Covid had helped many agency owners and clients recognise its strengths," says Jenn McCabe.

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> **Jenn McCabe, United States**

The one storm cloud on the horizon is the possibility of nationwide legislation that would impose a sales tax on digital adverts based on where they are viewed. However, it may be some way off as a robust methodology for measuring geographic reach has not yet been agreed.

There are no such worries in the United Kingdom, which is set to be one of the world's most buoyant advertising markets in 2021. The latest Advertising Association/WARC Expenditure Report expects the UK's ad market to grow by 15.2% this year to almost £27 billion, a new record.

As with many other countries, online advertising is a key driver of growth and London's ad agencies have used the pandemic to reassess their capabilities and identify gaps in their skillsets.

Previously, if agencies did not have in-house capability they hired freelancers without much consideration of the impact on the bottom line. Pre-Covid, it was not uncommon for an agency with £5 million turnover to spend £400,000 on freelancers. .

"For some, the necessity to tighten their belts and review their resource requirements has proved positive for the long-term health of the business," says Esther Carder, a partner at Moore Kingston Smith in London.

"Perhaps it forced them to trim back where they had become a bit flabby or remove personnel with legacy skills no longer fit for purpose. Now, they can make do with fewer people because they have the right people."

Average profit margins across the UK advertising industry – according to Moore Kingston Smith's annual survey on The Financial Performance of Marketing Services Agencies – have sat at a lacklustre 10-12% over the last ten years or so. However, the most efficiently-run agencies can achieve margins in excess of 20%.

While profit margins achieved by UK agencies throughout 2020 were inevitably down on 2019, they were certainly not as bad as originally expected.

20%

profit margins are now achievable after a 10-year average of around 10-12%

As well as trimming staffing budgets, there have been huge savings on international travel and space. These will flow through to 2021 prompting an expectation that margins for 2021 will exceed those achieved in 2019.

Marketing automation platforms, bidding sites for media buying and automated content creation are all technologies that used to be the domain of large multinationals but are now within reach of mid-tier companies.

However, that has created new pressures as well as opportunities. “Data insight, research, digital skills: everyone is looking for a point of differentiation,” says Esther Carder. “Agencies that can wrap technology or some form of intellectual property (IP) around their business will be the ultimate winners.”

As the advertising world adjusts to the tumultuous changes wrought by Covid there has been a financial and strategic reckoning for agencies of all sizes. However, a real eye opener over the past year has been the ability of even the smallest players to exploit changing consumer behaviour and ride the waves created by new trends.

One Armanino client trebled in size in the last year by understanding how to monetise the extraordinary global appeal of video-sharing app TikTok, racking up billions of views for the music and dance-focused campaigns it has created for clients.

Like many other creative agencies, it has torn up and rewritten the script about what is possible in the new world of media.

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>
> **Esther Carder, UK**

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