

Turn On. Tune In. Buy It.

The medium is the ad. How the fusion of commerce and entertainment is changing advertising

By Sridhar Gopaluni, Gyula Kangiszer, Scott Spencer and Joon Won Suh

Executive Summary

Interactive advertising puts the consumer in control: screen banking and clickable content allows viewers to obtain additional information about the props and background they see in any content.

“First they ignore you, then they laugh at you, then they fight you, then you win.” -- Mahatma Gandhi

The New Reality

Dwindling consumer attention spans and rapid technology developments have caused a shift in customer buying behavior. As traditional “ad-skipping,” especially of television commercials, becomes more widespread, advertisers are looking for new ways to help increase customers’ awareness and motivate purchasing.

We believe that content is the linchpin in the relationship between advertisers and consumers, and interactivity is changing this relationship. Technology is being developed that puts consumers in control by allowing them to choose the types of ads they see and to customize their personal buying experience.

The spread of interactive advertising is likely to lead to a new level of interdependency between entertainment and commerce, fundamentally transforming traditional business models and changing the landscape for all business players involved. Significant changes that will likely take place include:

- Customers will demand more flexibility, including the ability to purchase whatever they see on media channels, without wasting time watching traditional commercials.
- Media industry financing flow will be restructured; advertisers will begin to fund content creation primarily as they pay a premium for product placement rights.
- Manufacturers and service providers will face a growing fight for digital real estate on television; they need to become comfortable with new factors resulting in marketing ROI uncertainty.

- Content producers will be empowered; increasingly, content will be financed by advertisers (e.g., manufacturers, service providers, software providers, and financing) in the effort to reach customers.
- Media channels will need new financing arrangements; content owners’ share of payment and click-through revenue will replace significant amounts of commercial revenue.
- Distributor networks will have increased insight into customer preferences; this could lead to a role in the management of commerce transaction activities.

We believe that companies that understand the implications of these changes and align themselves to take advantage of them will influence the shape of the industry in coming years — and put themselves in a position to reap the lion’s share of profits to come from the new environment.

Behind the Growing Interdependency between Commerce and Entertainment

Recent advances in technology have forced advertisers to rethink the way they reach consumers. The arrival of television “ad-skipping” and commercial-free satellite radio has significantly diminished advertisers’ ability to reach the increasingly demanding consumer.

So what are you, as a marketer, to do if new developments are preventing you from even getting in front of your audience in the first place? Marketing leaders are fighting back with technology of their own. Their philosophy is radical: give consumers the power to control and interact with the advertisements they see. Screen banking¹ and “clickable” Internet video² allow viewers to obtain additional information about the objects, characters, and background they see in any content.

On television and the Internet, marketers are finding ways to let prospective buyers shape the type of interactions they have with advertisements.

We believe that interactive media will only solidify the increasingly fruitful relationship between commerce and entertainment. The end result could be more dramatic than you think: the entire revenue cycle may shift, with advertisers paying content producers to write their products into plotlines.

The Changing Advertising Landscape

DVR Penetration

Estimates of DVR penetration rates vary by source.

According to Magna Group, in 2005, more than eight million homes owned DVRs, a number that is expected to grow to 33 million, or a third of households, by 2010.

The Yankee Group forecasts that a third of homes will have DVRs by the end of 2008.

Juniper Research believes the interest in DVRs varies significantly between digital cable customers and satellite TV customers. Only 8 percent of digital cable customers selected DVR service (approximately two million households). DVR penetration among satellite TV customers will be 66 percent in 2009.

The three largest cable system operators, Comcast, Time Warner and Cox, offer DVR service in all of their markets.

According to TNS Media Intelligence, U.S. spending on advertising will total \$152 billion in 2006. Not surprisingly, spending is increasing fastest in the Internet sector, due in part to higher levels of interactive advertising (see Figure 1).

In fact, according to data from the Acacia Group³:

- Companies spent \$26 billion in 2005 on interactive advertising for television, the Internet, mobile applications, video games, and other areas.
- Interactive advertising could double to \$52 billion by 2010.
- For gaming alone it may grow to \$1 billion in 2010.

According to the Interactive Advertising Bureau (IAB), interactive advertising is being driven by, among other things, the growth and

development in the Internet channel, including the proliferation of broadband. The IAB also cited increasing desire from consumers for more control in their ability to view advertisements.

Additional drivers behind the move to interactive advertising include:

- The movement of cable and satellite providers to a video-on-demand subscription-revenue model that competes directly with traditional ad revenue models.
- The emergence of other forms of entertainment channels, including the Apple iPod and on-line gaming.
- The increasing rate of ad-skipping by viewers. Enabled by the spread of Digital Video Recorders (DVRs), ad-skipping poses a viable threat to the existing revenue model of television. According to CBS, 64 percent of DVR owners skip ads all the time. ZDNet Research reports that of 4.5 million DVR users in 2005, 64 percent skip all commercials.⁴ Research conducted by InsightExpress indicates that half of television viewers tune out TV commercials by channel surfing via remote controls or leaving the room.⁵ Forty percent of DVR users say their lives have been enhanced significantly with DVRs.

The November 2005 Deloitte Touche Tohmatsu report, "The Trillion Dollar Challenge - Principles of Profitable Convergence,"⁶ describes convergence across platforms, products and services, and organizations. As more and more consumers shift their attention to Internet-based activities, advertisers are rapidly moving dollars toward the Internet.

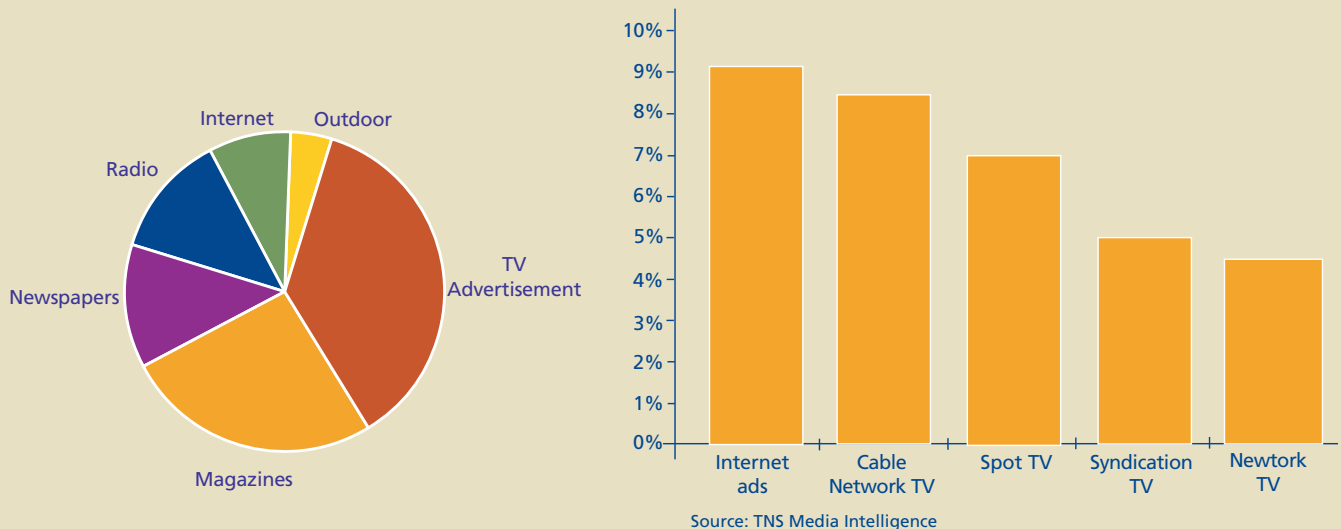
An interesting byproduct of the digital lifestyle is an increase in the number of advertising channels available to marketers. As services converge and new devices are brought to the market, advertisers' ability to pinpoint their target market will improve significantly.

Evolving Innovations in Advertising

These changes in the advertising landscape, especially the shift to interactive advertising, are forcing advertisers and content producers to find innovative ways to capture the attention of viewers and to influence their buying preferences and patterns.

The Wharton School faculty and advertising executives described the change in December 2004: "The 30-second television spot, once the mainstay of mass marketing, is waning in influence as new technology, including the Internet, cable television and TiVo, fractures the viewing

Figure 1. Ad Growth Advertising Landscape



audience. Consequently, advertisers are turning to alternative forms of promotion to reach consumers.”⁷

One of these alternatives is embedded content – that is, the use of promotional items as “props” used to fill in the space around the main characters on stage or screen or to figure in the plot lines of the programs themselves. Traditionally, props have represented a cost item in content creation. Increasingly, they are being viewed as revenue opportunities by content producers and as effective and creative forms of promotion by advertisers.

According to the Writer’s Guild, “In 2004, the use of products in filmed entertainment increased 44 percent and generated revenues in excess of \$1 billion. In television alone, product-related revenues skyrocketed a whopping 84 percent. For example, during the third season of ‘The Apprentice,’ Burger King, Dove Body Wash, Sony PlayStation, Verizon Wireless, and Visa reportedly paid upwards of \$2 million per episode to have their products incorporated into plotlines.”⁸

Other traditional and recent examples of the use of embedded advertising include:

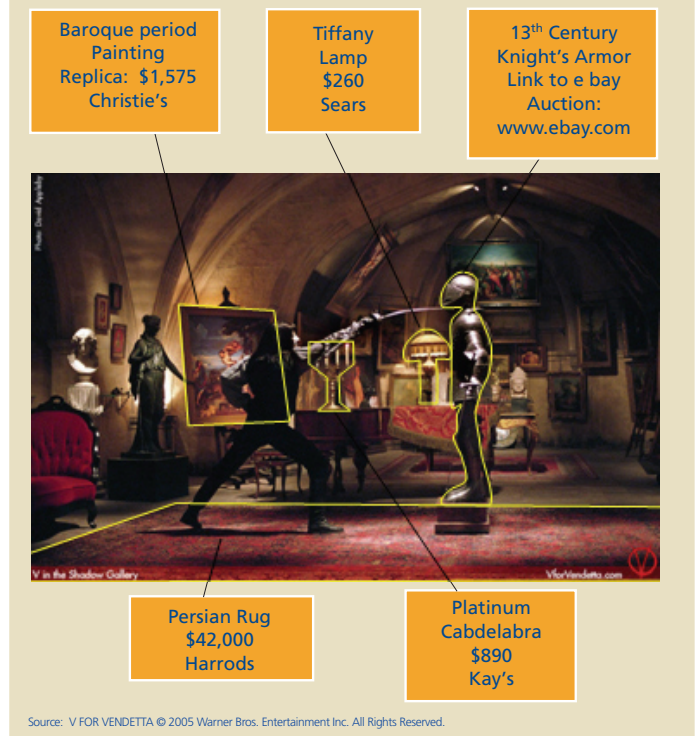
- For years, the brand awareness of consumer product companies and service providers has been significantly increased by feature films – for example, the Coca Cola bottle in “The Gods Must Be Crazy,” K-Mart and Qantas in “Rain Man,” FedEx in “Cast Away,” the BMW Z3 in the James Bond movie “Golden Eye,” and the Chrysler Sebring Convertible in “Must Love Dogs.”
- Content producers have recognized viewers’ desire to be able to obtain additional information about props on screen, but until now the technology only provided limited solutions. For example, for a long time, “Sex in The City” fans could visit the program’s Web site and see the homes of the main characters.⁹
- In television, it is a widespread practice to list at the end of a program the sponsoring companies who provided props.
- Sponsors currently receive more direct exposure during programs. On the television show “The Apprentice,” Pontiac and Staples sponsored a challenge that featured their brand or product. Sears and Kenmore support the crew of “Extreme Home Makeover.”
- In some cases, the original production of a television series may be sponsored by one major company while its rival pays to replace the products in the version that is released on DVD.
- As part of a new product introduction, a U.S. fast food chain recently placed a TV ad containing a promotion key that encouraged people with DVRs to watch the ad again and search for the key, which provided a discount.
- In March 2006, Chrysler introduced a contest for filmmakers to create a short film, starring a Chrysler vehicle. The winner will receive a full-length feature film production deal.
- In April 2006, Disney announced that it will make episodes of its shows available on-line for free and on-demand the day after they air on broadcast TV. The shows will contain commercial breaks that viewers can’t skip.
- As significant time is spent on playing video games, advertising is being embedded into this content.¹⁰

While embedded advertising is evolving into a major new approach for promotion of products and sponsors, it is also encouraging the development of new technologies that extend the medium into a new realm.

Screen Banking and “Clickable” Content—the Next Frontier

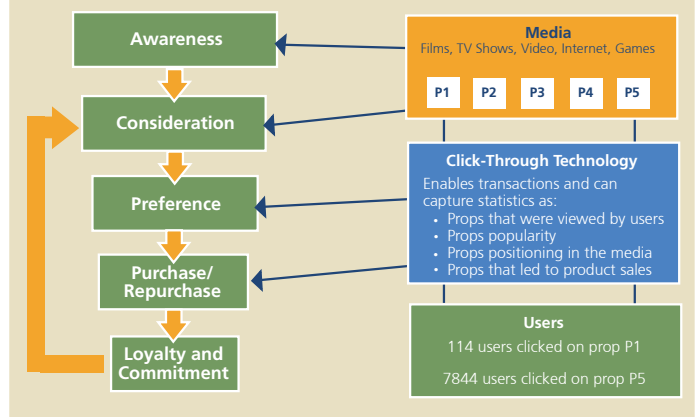
Imagine a world in which you could shop for clothes by choosing products from among the wardrobes of characters on your favorite TV show. With “clickable video” technology, this fantasy will be a reality sooner than you think. Using just your TV remote control, you will be able to learn about and purchase items you see on TV (see Figure 2 with potential vendors).

Figure 2. Clickable Video Technology: Example



The technology is already available to enable these capabilities. For example, advertisements on the Internet allow viewers to click on certain areas of the video as it plays, then later delve deeper into clicked-on features. This technology provides an opportunity for the advertisers to create multiple selling points for their products. Plus, this technology provides a powerful link between video and e-commerce (see Figure 3).

Figure 3. Click-through technology enables the user to move along the sales funnel.



These new technology developments can further enhance opportunities for program sponsorship and product placement:

- Technology will bring once mundane background props into the foreground of consumer consciousness.
- The range of advertising possibilities will dramatically increase in the future. An exciting two-hour film or television program could present thousands of opportunities to promote products to viewers, from food and goods to exotic travel destinations and services.
- Interactive advertising provides a convenient opportunity for consumers to obtain additional information about selected products and how to purchase them.

As such, these enabling new technologies put consumers in control. When they are in control, they are more likely to spend time and energy interacting with the advertiser's message.

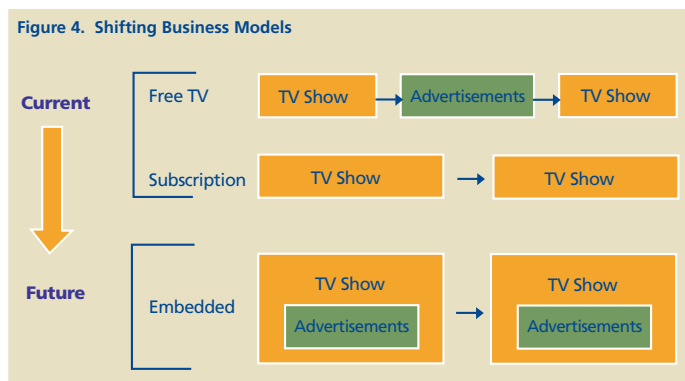
Avant Interactive¹¹ is a start-up technology provider that is built on the premise of giving the consumer the power to interact with an advertisement. The company has a patent pending for clickable video. "V-Click" allows consumers using video applications such as RealPlayer to highlight objects on the screen with their mouse. When viewers click on an object, details of that object appear in a separate part of the screen.¹² When this technology is involved, consumers are likely to watch the video more than once and click on a significant number of objects each time they watch.

In these ways, interactive advertising can bestow numerous benefits on consumers, not the least of which is an increasing number of opportunities to learn about and purchase products and services while simultaneously enjoying the entertainment in which the informational/promotional content is embedded.

Changes in Traditional Media Business Models

Advertisers will continue to fund a significant portion of the media industry, but increasingly they will fund content producers rather than media channels.

Even while the enabling technologies for interactive advertising are still emerging, the implications for traditional players in the business are already being seen. Traditional media business models are already shifting, and dollars are increasingly flowing from advertisers to content producers rather than to media channels (see Figure 4).



Additional business model changes and new opportunities can include:

Supply Chain Changes

- Product placement will dominate content and account for the majority of props, background, and style.

- Props will be precisely defined. For example, a round table shown two times for 25 seconds each, the first time alone and the second time with a popular actor leaning over it for five seconds.
- A few key closed electronic marketplaces will emerge to facilitate product placement, matching the need with the advertiser or manufacturer.
- Additional props will be acquired via open auction.
- Many props will have dual value:
 1. Marketing value to enable viewers to buy identical products (e.g., a new line of clothes by a high-profile designer).
 2. One-time revenue opportunity for selling actual items (e.g., a specific dress worn by a popular actress during the program).

Catalog Content Changes

- Similar to the remastering of old catalog films for DVD release, the creation of metadata for products in old DVDs can provide a business opportunity for early adopters. The same content could be sponsored by different advertisers in different time periods.
- In 2005 there were more than 55,000 DVDs available in the U.S. market. In 2006 this market is expected to grow by additional 12,000 titles, representing significant opportunity for advertisers to sponsor content.¹³

Similarly, interactive advertising can create opportunities for other players in the industry because of critical elements of the commerce process that will need to be integrated seamlessly and, thus, offer the desired experience to the viewers. The most important of these is billing execution because many players in the chain can have relevant value propositions:

- Manufacturers and service providers in line with existing Internet-based commerce capabilities.
- Interactive advertising technology providers as part of following through the click stream.
- Media networks that can consolidate product bills with existing service billing to customers.
- Specialized financial clearing companies.

Furthermore, another major component of the interactive advertising commerce is the cross-compensation model between the involved parties – a topic that is beyond the scope of this paper.

Considerations for Key Players

Interactive advertising has begun to impact the value proposition of traditional media by changing consumer behavior and creating new opportunities and threats for existing and emerging firms. Launching a cross-functional initiative to incorporate the implications of interactive advertising could provide significant competitive advantage during the next few years.

We believe that every company should update its strategy and incorporate actions responding to the anticipated changes. Key implications and next steps to consider for specific players in the industry include:

Content Creators

Implications

- As the traditional ad-based revenue model becomes threatened, the ability of traditional television media channels to pay for a premium for content will be significantly hampered.

- However, the spread of interactive advertising promises additional revenues to a number of market players by allowing for the creation of interactive ads and entertainment content, such as theatrical films, television shows, and music videos.
- Interactive content can be an effective way to increase viewership and time with the viewer. As interactive ads gain acceptance, effective content producers will take advantage of the natural connection interactive technology establishes with the viewer.
- Product placement revenues have continued to gain acceptance in movies and television. But this is only the beginning. In the future, content producers will be able to place increasingly high-value interactive product ads into their content to grow their ad revenues.
- Interactive advertising may enable content creators to attract advertising dollars away from traditional channels and turn the use of props from a cost center into a revenue stream.

Recommended Next Steps

Don't get lost in the technology. As it is today, the effectiveness of any interactive ad depends on the content that is being delivered in the ad. The power of interactive advertising is that it draws the viewer into a more intimate relationship with the material being viewed. The viewer spends more time in the ad, resulting in greater brand recognition and purchase intent. The technology provides more options for both entertainment producers and ad content producers to convert brand recognition into purchase intent.

Consider these next steps:

- Develop more direct relationships with ad purchasers to create interactive ad content.
- Develop post-production processes for interactive ad content.
- Develop a strategy for closed-market versus open-auction based prop acquisition.
- Explore the development of entertainment programming, such as cooking, lifestyle, and travel shows, that is better aligned with interactive ad placement.

Media Channels

Implications

- The traditional television ad model is at great risk. The primary threats to the ad model come from changes in technology and their effects on consumer behavior.
- Most studies indicate that DVRs significantly reduce customer viewing of ads. As adoption of DVRs continues, this will pose significant threats to the ad model. According to a recent poll conducted by Forrester with advertisers, 24 percent indicated that they will pull back TV ad budgets by at least a quarter when DVR penetration reaches 30 million homes.¹⁴
- Media and entertainment conglomerates that own television stations may lose \$160 billion in equity by 2010 from ad skipping and content piracy.¹⁵
- Particularly at risk may be the large networks and local television stations in smaller markets.
- In the next five years, consumers will spend \$60 billion on DVRs, satellite radio, iPods, and mobile technology, which compete directly with and drive personal viewing outside of the home.¹⁶ This will further decrease ad viewership.
- Viewership of traditional television content containing ads is being threatened by premium channels and new revenue models, such as video on-demand.

- Television stations face a significant threat of becoming dependent on cable, satellite, Internet, and other gatekeepers.
- Television companies have experienced only a limited impact as advertisers have shifted on-line ad dollars from other sources, such as magazine and radio ads. However, as the Internet channel continues to mature, it represents a long-term challenge to its ad business.

Recommended Next Steps:

Develop interactive advertising as a part of a larger response to help protect your ad revenue base:

- Work with your production companies and ad sponsors to develop interactive ad content.
- Develop relationships with gatekeepers, such as satellite and cable companies, that are developing the technology to track ad revenue performance. The ability to track ad performance will give you greater information to gauge the effectiveness of interactive advertising campaigns.
- Managing revenue split will require new legal frameworks between the studios, content producers, and advertisers. Capturing click-through revenue stream will be critical to your effectiveness in the future.
- Adjust to the significant changes taking place as a result of new technology, or you will lose accounts to other media outlets that can provide a greater ROI.
- Be open to considering even more creative responses, such as auctioning time slots to content providers.

Content Distributors (Cable, Satellite, Mobile, and Internet) Implications

- Cable and satellite companies are increasingly turning to ad revenues to help enhance revenue growth.
- Cable and satellite companies offer programming that stratifies customers into different customer demographics. This creates a significant advantage for advertisers that have increasingly been placing ads through these channels.
- Increasingly, cable, satellite, and mobile companies are developing technology that will enable interactive advertising. Yet at the same time, interactive technology poses a threat to these content distributors because product placement provides competition for the revenue they generate from commercials. Find a way to negotiate for a piece of the product placement dollars. Shows will likely become more attractive to viewers as commercials are phased out and as the amount and quality of clickable content increases.
- As with traditional television broadcasters, cable ad revenues face a long-term threat from the growth of ad placement on the Internet.
- As spending on Internet advertising and "pay for placement" search increases, advertisers will look for more insight and assurance on the ROI of their spend. As convergence between traditional media channels and emerging channels increases, existing measurement systems will need to evolve. This should result in the continued evolution and increased adoption of industry standards on measurement.

Recommended Next Steps:

- To achieve desired long-term results, develop technology that makes it easy for advertisers to place interactive content.
- Work with other content distributors to develop an industry standard for interactive media. There is little advantage to developing proprietary solutions if they create barriers for interactive ad content providers.

- Monitor or participate in the development of emerging measurement standards, such as those published by the IAB. Distributors of Internet content should proactively provide assurance to advertisers and agencies by obtaining an independent audit of their measurement processes and controls.
- Develop compelling technological solutions that allow advertisers to gain critical information on interactive ad viewing patterns. By arming advertisers with better ad performance information, you can enable them to make better purchasing decisions and encourage them to drive ad placement with you.

Product Manufacturers/Service Providers/Advertisers/Marketing Professionals

Implications:

- Interactive advertising offers improved opportunities to educate interested consumers about the product features that matter most to them.
- Interactive technology gives you more detailed information on the viewing habits of your target audience because each viewer interacts with the ad. This capability will allow you to collect information with a granularity and precision that was previously impossible from mass media ad placement.
- Consumers will be able to purchase products directly from you through advertisements.
- By allowing customer interaction, interactive advertising allows customers to move further along in the purchasing funnel compared to traditional mass media. This factor, along with the ability to capture data, will allow you to better quantify advertising ROI as compared with traditional mass media campaigns.
- There will be increasing uncertainty at the time of buying product placement. Historic results will only provide limited guidance for future audience estimates. Balancing between placing bets on the long-running television series versus a new feature film will require improved marketing capabilities.

Recommended Next Steps:

- Most importantly, develop a cohesive strategy around your ads across different media channels.
- Work with television content producers to create effective product placement.
- Expand your analytical capability to track and evaluate these additional ad campaigns. Given the increasing options for ads, you will need to develop metrics to evaluate ad performance more precisely.
- With more options available, you will need to develop new relationships, including interactive placement in video games, interactive product placement on TV shows, with producers, and with set-top companies and cable and satellite companies.

- Develop ad campaigns that are creative and innovative. Do not be afraid to take risks.
- Consider developing the bidding department in your sales organizations to be able to effectively compete for the product placement and program sponsorship offers of content producers.

Contacts

Sridhar Gopaluni, Consultant
Deloitte Consulting LLP
480-241-5201
sgopaluni@deloitte.com

Gyula Kangiszer, Manager
Deloitte Consulting LLP
213-688-5534
gkangiszer@deloitte.com

Scott Spencer, Business Analyst
Deloitte Consulting LLP
213-593-4450
sspencer@deloitte.com

Joon Won Suh, Senior Consultant
Deloitte Consulting LLP
213-688-5377
joonsuh@deloitte.com

¹ Technology allowing a television viewer to save and revisit a frame using the remote control. Objects within that frame can be highlighted for additional information and even purchase.

² Clicking on an object within an Internet video will reveal additional information about that object in a separate section of the screen.

³ "Interactive Advertising Spurs Tool and Middleware Growth," Acacia Group, 2005. Retrieved January 22, 2006, from <http://www.acaciarg.com/company/releases/pr120605.htm>.

⁴ "4.5 mln DVR users in 2005, 64% of them skip all commercials," ZDNet Research, 2005. Retrieved January 20, 2006, from <http://blogs.zdnet.com/ITFacts?p=9302=rss&tag=feed&sub=zblog>

⁵ "New InsightExpress and MediaPost Report Reveals Digital Video Recorders Offer Advertisers Opportunities, Not Threats," InsightExpress, 2005. Retrieved January 20, 2006, from http://www.insightexpress.com/pressroom/release_052504.asp.

⁶ See the full report at: <http://www.deloitte.com/dtt/article/0,1002,sid=2245&cid=102392,00.html>.

⁷ "James Bond's BMW and Other Product Placements: New, Racier Ways to Advertise," Wharton Marketing Web site, December 2004: <http://knowledge.wharton.upenn.edu/article/1093.cfm>

⁸ See the Writer's Guild West Web site: http://www.wga.org/subpage_newsevents.aspx?id=1422.

⁹ See the HBO Web site: <http://www.hbo.com/city/interiors/carrie.shtml>.

¹⁰ See Advertising in Games Forum Web site at: www.advertisinggames.com.

¹¹ Visit: <http://www.avantinteractive.com>

¹² See http://lupus.v-click.com/demos/honda_island_new/honda_island/index.htm for an example of this emerging technology.

¹³ "No Shortage of New DVDs as 12,000-Plus Bow in '05," a year-end tabulation compiled by DVD Release Report, released by Reuters/Hollywood Reporter and reported by Muzi.com News on January 12, 2006 at: <http://home.muzi.com/news/english/10000378.shtml?cc=13259&ccr>

¹⁴ Rodgers, Zachary, "Our TV Spots Are Tanking," ANA Marketers, 2006. Retrieved April 20, 2006, from <http://www.clickz.com/news/article.php/3593536>.

¹⁵ Mermigas, Diane, "Convergence Fulfilled: A Fleet New Class of Corporate Entrepreneurs Invents the Future," Retrieved January 20, 2005, from http://www.hollywoodreporter.com/thr/film/feature_display.jsp?vnu_content_id=1001096287

¹⁶ Mermigas, Diane, "Broadcast TV Facing Broadband Realities," Retrieved January 20, 2005, from http://www.hollywoodreporter.com/thr/search/article_display.jsp?vnu_content_id=1000947232

The information contained herein is based on the experiences of our Deloitte Consulting LLP professionals.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, its member firms and their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu is an organization of member firms around the world devoted to excellence in providing professional services and advice, focused on client service through a global strategy executed locally in nearly 150 countries. With access to the deep intellectual capital of 120,000 people worldwide, Deloitte delivers services in four professional areas, audit, tax, consulting and financial advisory services, and serves more than one-half of the world's largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global growth companies. Services are not provided by the Deloitte Touche Tohmatsu Verein and, for regulatory and other reasons, certain member firms do not provide services in all four professional areas.

As a Swiss Verein (association), neither Deloitte Touche Tohmatsu nor any of its member firms has any liability for each other's acts or omissions. Each of the member firms is a separate and independent legal entity operating under the names "Deloitte", "Deloitte & Touche", "Deloitte Touche Tohmatsu" or other related names.

In the US, Deloitte & Touche USA LLP is the US member firm of Deloitte Touche Tohmatsu and services are provided by the subsidiaries of Deloitte & Touche USA LLP (Deloitte & Touche LLP, Deloitte Consulting LLP, Deloitte Financial Advisory Services LLP, Deloitte Tax LLP and their subsidiaries), and not by Deloitte & Touche USA LLP. The subsidiaries of the US member firm are among the nation's leading professional services firms, providing audit, tax, consulting and financial advisory services through nearly 30,000 people in more than 80 cities. Known as employers of choice for innovative human resources programs, they are dedicated to helping their clients and their people excel. For more information, please visit the US member firm's web site at www.deloitte.com/us.

Copyright © 2006 Deloitte Development LLC. All rights reserved.

Member of
Deloitte Touche Tohmatsu