The Boston Consulting Group

Against the Tide

July
2002

Value Creation through Countercyclical Brand Development

The Boston Consulting Group (BCG) is a general management consulting firm that is a global leader in business strategy. BCG has helped companies in every major industry and market achieve a competitive advantage by developing and implementing unique strategies. Founded in 1963, the firm now operates 54 offices in 36 countries.

For further information, please visit our global Web site www.bcg.com or our German Web site www.bcg.de.

The Brand Topic Group of the Boston Consulting Group focuses on brand management and brand value creation. A team of BCG experts under the leadership of Dr. Antonella Mei-Pochtler works to stay at the forefront of global know-how in the field and continuously builds on this knowledge. Proprietary methods and analytical tools such as the Brand Value Creation approach, MindDiscovery® method, and Brand Value Added® analysis support the conception and realization of superior brand strategies.

If you would like to learn more about "Strategy-linked Branding" at BCG, please e-mail us at branding@bcg.com.

The Boston Consulting Group
Marketing & Communications/Legal
Sendlinger Str. 7
80331 Munich
Germany

Fax: +49 (0)89-2317 4718
E-Mail: marketing.de@bcg.com

CONTENTS

INTRODUCTION

"There are times when taking the greatest risk can be considered the wisest course of action."

Carl von Clausewitz

In 2001, after decades of prosperity and growth, the German advertising industry was caught up in the tide of a general economic downturn.

It was in this context that The Boston Consulting Group, in cooperation with Gruner + Jahr and IP Deutschland, wrote and presented the study "Against the Tide—Value Creation through Countercyclical Brand Development" between December 2001 and March 2002.

The study concludes that in spite of recession, there is no immediate cause for panic. Clausewitz' insight applies particularly well to actors engaged in economic competition: in periods of crisis they should actively seek out opportunities to redistribute the cards in their own favor. Advertising plays a central role in this process.

This study focuses on the interdependencies between advertising, market position, and corporate value. Examining as many different industries as possible, the study tests the thesis that continuous brand cultivation forms the foundation for long-term growth, leading to superior value development in capital markets. This is especially true during periods of recession or crisis. The results showed that continuity as a principle of success is particularly valid in times of crisis. These situations also provide major opportunities for efficiency: managers who maintain or increase their advertising investment against the general trend can strengthen their brand relative to the competition, build up long-term brand value, and secure their position in both the market and in capital markets.

The focus on advertising investment should not blind us to the fact that other factors also exert a major influence on commercial success, most importantly the attractiveness of the product range as well as the company's innovation pipeline and sales strength. To have considered all of these individual aspects within a single study would have exceeded its scope. Our message is clear: countercyclical advertising offers enormous possibilities, but countercyclical action should not remain restricted to advertising alone.

"Against the Tide—Value Creation through Countercyclical Brand Development" is aimed at individuals with responsibility for the economic success of a company and who have an influence on the importance of advertising communication within this context. It is also directed towards marketing and advertising managers, media and advertising agencies, and all those with an interest in advertising and competition.

We would like to express our gratitude on behalf of all the partners—Gruner + Jahr, IP Deutschland and BCG—for the huge commitment of all those involved in the preparation of this study, above all Yunfeng Cui, Helma Spieker, and Michael Walter from Gruner + Jahr and Dr. Gitte Katz, Guido Modenbach, and Matthias Süßlin at IP Deutschland. Our thanks also go to the BCG project team who conceived and drew up the study: Dr. Berndt Hauptkorn, Oliver Merkel, Sabine Ruff, Dr. Claudia Tourneau, and Dr. Jens Willenbockel. We would furthermore like to thank the numerous specialists in the advertising industry who provided invaluable contributions in individual discussions and thereby greatly enriched the study.

Hopefully, we have contributed to a necessary change of attitude regarding continuous brand development and enduring corporate value creation—during the current crisis and beyond.

Dr. Friedrich Wehrle
Member of the Board of Management
Publishing House
Gruner + Jahr

Dr. Antonella Mei-Pochtler
Senior Vice President
BCG

Dr. Walter Neuhauser
Managing Director
IP Deutschland


BRAND

1 STRONG BRANDS INCREASE VALUE:

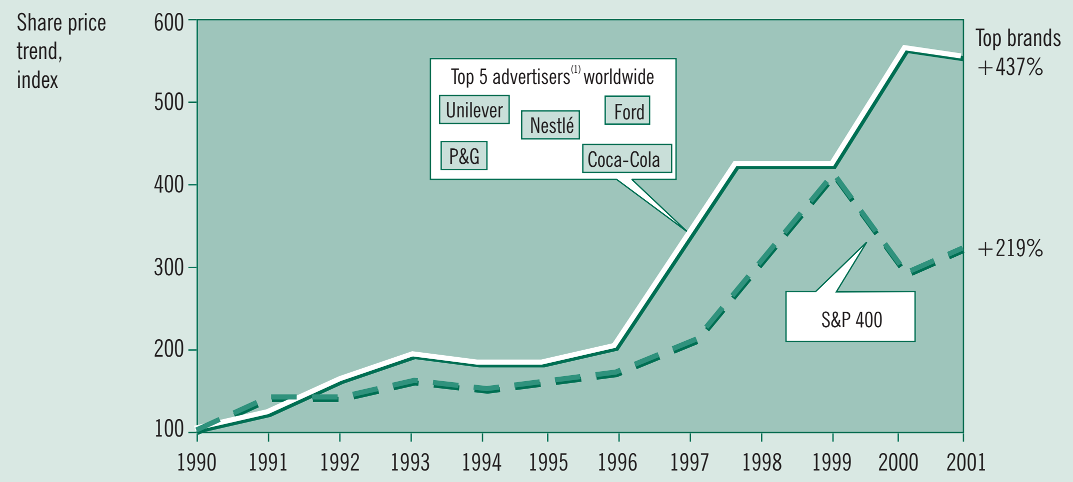
TOP BRANDS WITH BETTER PERFORMANCE ON CAPITAL MARKETS

Strong brands are central to increasing their owners' corporate value—especially as part of a clear growth strategy. Continuous high advertising investment plays a decisive role in this.

The capital markets reflected a clear trend: from 1990 to 2001, the five multinationals with the largest advertising spending—Unilever, Procter & Gamble, Nestlé, Coca-Cola, and Ford—all performed impressively. On average, their share price rose by a full 437 percent. This is almost double the growth rate of the S&P 400 U.S. share price index (diagram 1). A difference of this magnitude leads us to conclude that there is a causal connection between brand portfolios, brand cultivation, and the performance of a company in the capital markets.

As was shown in the BCG study entitled "Value Creators 2001: Dealing with investors' expectations", the value of a company is made up of two components: fundamental value and expectation premium.

DIAGRAM 1



(1) Multinationals with the highest advertising spending worldwide: Unilever; Procter & Gamble; Nestlé; Coca-Cola; Ford
Sources: Advertising Age; Datastream; BCG analysis

Fundamental value is defined as the net present value of future cash flows, with the company-specific cost of capital used as the discount rate. Cash flow projections are based on current profitability and the previously achieved growth rate of gross investments. They are not linear since no company grows faster than the market average in the long term. Growth rates and yields tend towards market averages due to competitive pressure.

If calculated fundamental value is compared with the value of a company on the market(1), fundamental and corporate values do not normally coincide.

In fact, the fundamental value is frequently lower. We refer to the difference between fundamental value and corporate value as the “expectation premium”. This part of a company’s value is based on expectations that its future development will either exceed or remain below its fundamental value. A company’s growth potential is influenced, amongst other things, by its quality of management, brand strength, and capacity to innovate.

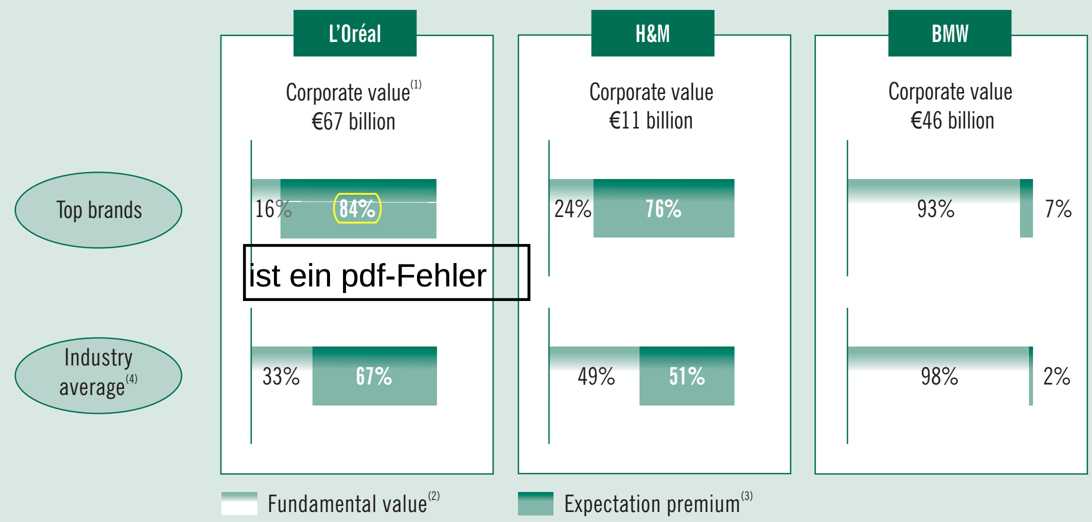
Our study demonstrates that expectation premiums are particularly high as a proportion of corporate value amongst the top performers in an industry and usually exceed the average for that particular industry as a whole (see diagram 2). At the beginning of 2001, for instance, L'Oréal's expectation premium amounted to 84 percent of its €67 billion corporate value, while the average proportion in the cosmetics sector was 67 percent.

ist ein pdf-Fehler

The automotive sector follows different rules. The average level of expectation premiums in this industry is a meager two percent of corporate value. Top performer BMW, however, exceeds this figure significantly: its expectation premium makes up seven percent of corporate value.

Corporate value in the automotive industry reflects moderate growth expectations. Many areas of consumer goods, however, are subject to extreme pressure due to high expectation premiums.

DIAGRAM 2



(1) Corporate value: market capitalization and liabilities at the beginning of 2001
(2) Fundamental value: net present value of future cash flows based on current profitability and growth
(3) Expectation premium: difference between corporate and fundamental values
(4) Cosmetics: Avon, Marbert, L'Oréal, Revlon, Beiersdorf, Wella, Procter & Gamble; Auto and Trade: BCG Study of Top Performers 2001
Source: Datastream; BCG analysis

CORPORATE VALUE IS THE RESULT OF COMPARATIVELY HIGH EXPECTATIONS—TOP BRANDS HAVE HIGHER EXPECTATION PREMIUMS THAN THE INDUSTRY AVERAGE

(1) Company value includes own and outside capital

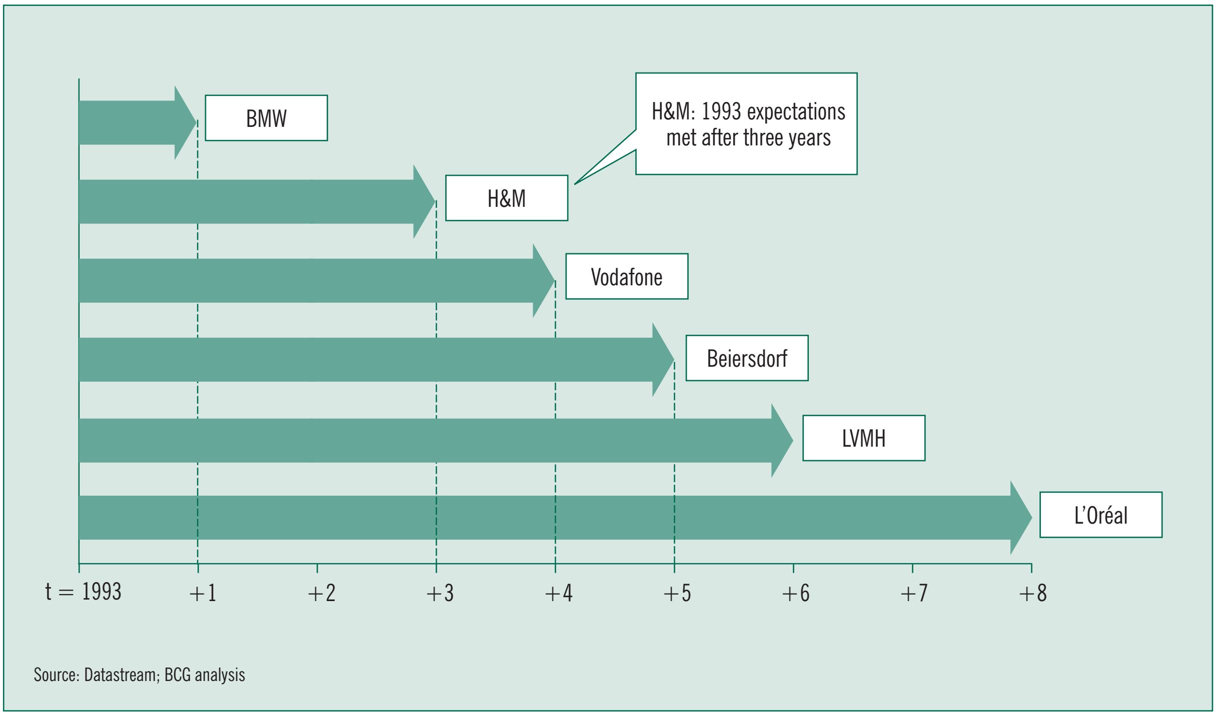
"A high expectation premium does not mean a company is seen in too positive a light by capital markets," stresses Dr. Daniel Stelter, a vice president with the Boston Consulting Group and author of the BCG study "Value Creators 2001: Dealing with investors' expectations". Initially, he states, a high expectation premium shows only that "the market has confidence in the competitive strength and management of the company in question." He goes on to say, "Top performers in particular, with their extraordinarily positive fundamental increases, regularly face an equally impressive increase of expectation premiums." Companies with strong performance are trusted to produce even better results in the future. In the past, this confidence has proven well founded with the majority of top brands. Our analyses have shown that Beiersdorf, for example, fulfilled the value of its 1993 expectations within five years on the basis of the company's increased fundamental value (diagram 3). H&M reached its fundamental value in just three years, while BMW took only one year. This finding poses an important question for the strategy of corporate management: what exactly are the crucial drivers of value creation? In this context, we differentiate between two types of influencing factors (see diagram 4):

- Efficiency impact: describes the increase in corporate value in the time period being analyzed through measures designed to reduce costs and increase capital productivity.

- Brand impact: describes brand- and innovation-driven growth of turnover, profits, and gross investments in the time period being analyzed. Brand impact includes all investments in product innovation, sales, and advertising.

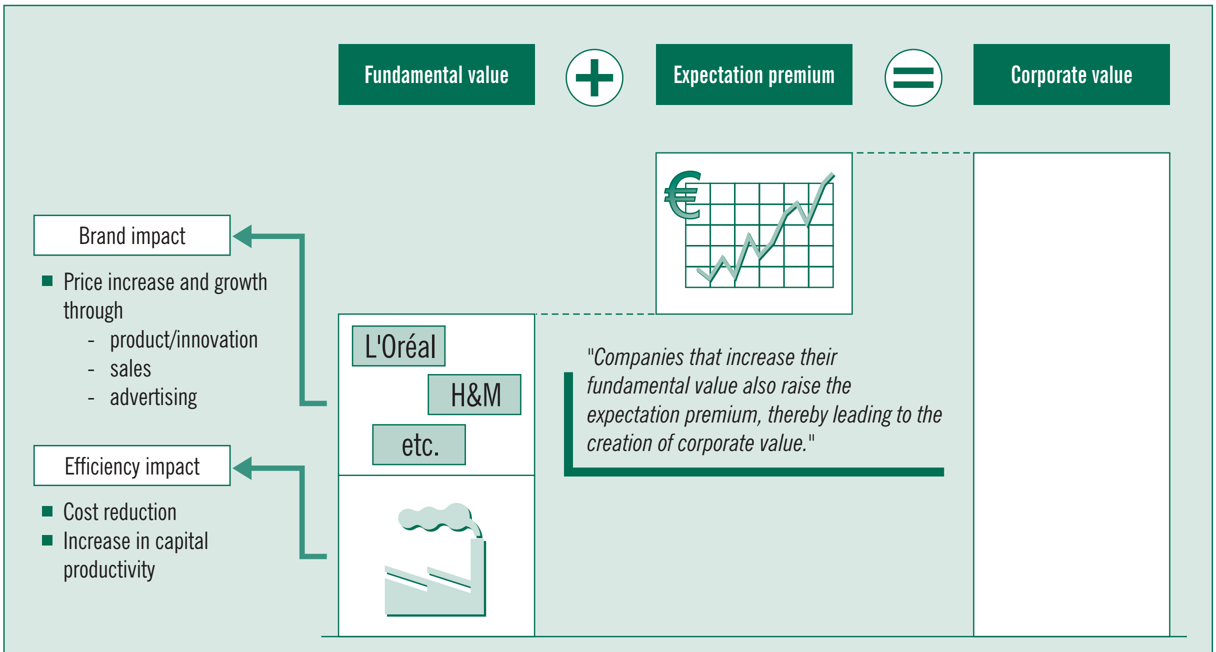
We were able to prove through detailed analysis that a general improvement in the fundamental data of a company does not increase its value to the same extent. The left-hand table in diagram 5 shows that, statistically speaking, the correlation between the development of fundamental value and that of corporate value is relatively low (R = 0.28).

DIAGRAM 3



TOP BRANDS FULFILL EXPECTATIONS—NUMBER OF YEARS BEFORE INCREASES IN FUNDAMENTAL VALUE MEET CAPITAL MARKET EXPECTATIONS

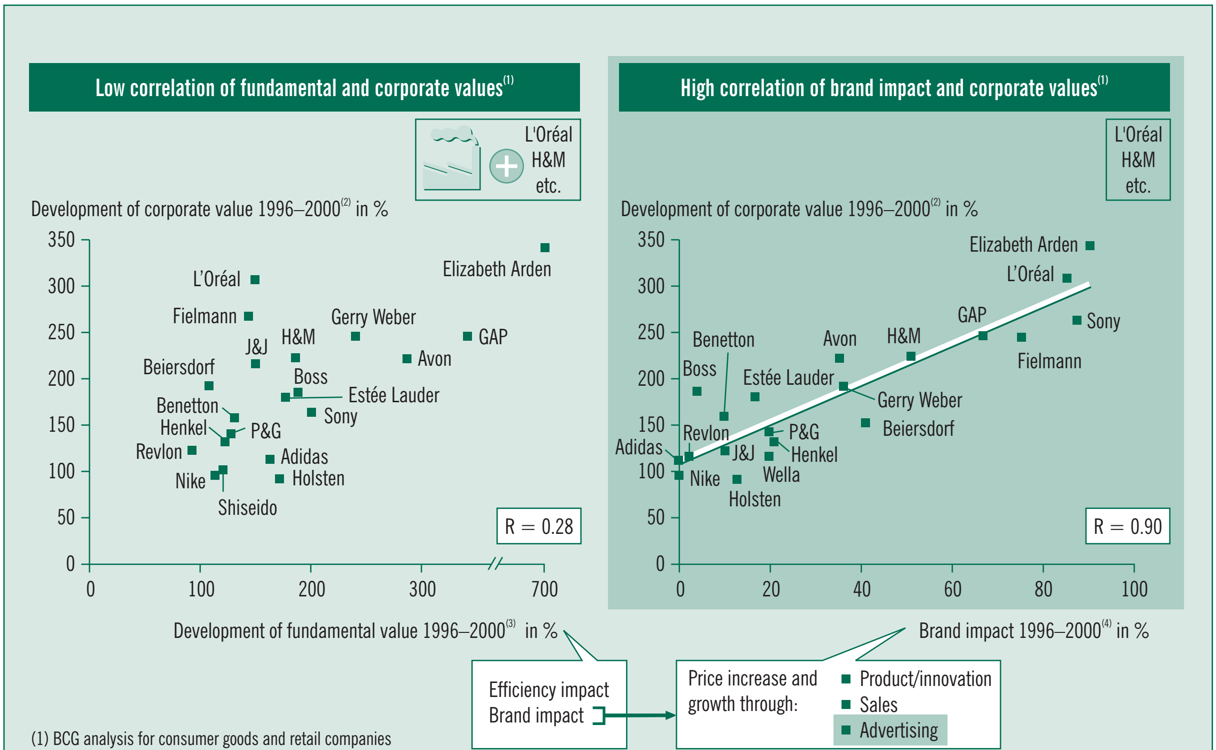
DIAGRAM 4



Source: BCG analysis

WHAT DRIVES VALUE CREATION? A SCHEMATIC ILLUSTRATION

DIAGRAM 5



(1) BCG analysis for consumer goods and retail companies
(2) Defined as corporate value 2000 ÷ corporate value 1996
(3) Defined as fundamental value 2000 ÷ fundamental value 1996
(4) In percent of development of fundamental value
Source: Datastream; BCG analysis

VALUE INCREASE DRIVEN BY BRAND IMPACT—HIGH CORRELATION WITH DEVELOPMENT OF CORPORATE VALUE

The right-hand table in diagram 5 clearly demonstrates the connection between an increase in brand impact and the creation of additional corporate value. Consider the following examples:

1. Holsten: Between 1996 and 2000 the company was hardly able to increase its fundamental value through brand impact, while its corporate value also remained virtually constant.

2. H&M: The 50 percent share of the increase in fundamental value attributable to brand impact was accompanied by the creation of additional corporate value on the capital market equal to 200 percent of the initial value.

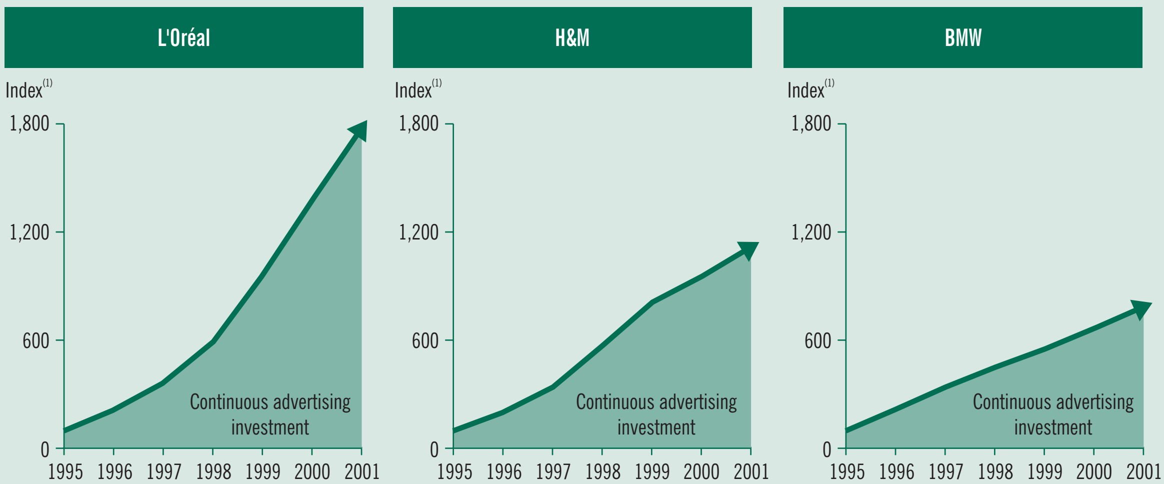
3. L'Oréal: The proportion of the increase in fundamental value resulting from brand impact is over 80 percent, and corporate value grew to 300 percent of initial value.

The correlation coefficient R = 0.91 demonstrates the precision of this descriptive model.

The question of which drivers impact value creation can be answered clearly: it is primarily the level of brand impact that creates value at a company—a firm's investment in new products, efficient sales channels, and persuasive brand communications. The formula for commercial success of top brands is continuous brand cultivation through advertising, as demonstrated by the examples of H&M, BMW, and L'Oréal (diagram 6).

As an individual measure, of course, advertising can only increase company value where it is employed in support of the unattractive range of products and services. Then, however, it is the brand that creates the added value; the stronger the brand, the higher this value will be.

DIAGRAM 6



	L'Oréal	H&M	BMW
Average growth p.a. – Turnover[1]:	9%	17%	8%
Corporate value:	27%	42%	23%
Advertising:	26%	9%	5%

(1) Cumulative advertising investment indexed, 1995 = 100
Source: AC Nielsen; Datastream; BCG analysis

CONTINUOUS ADVERTISING INVESTMENT IS THE TOP BRANDS' FORMULA FOR SUCCESS


BEFORE
AFTER

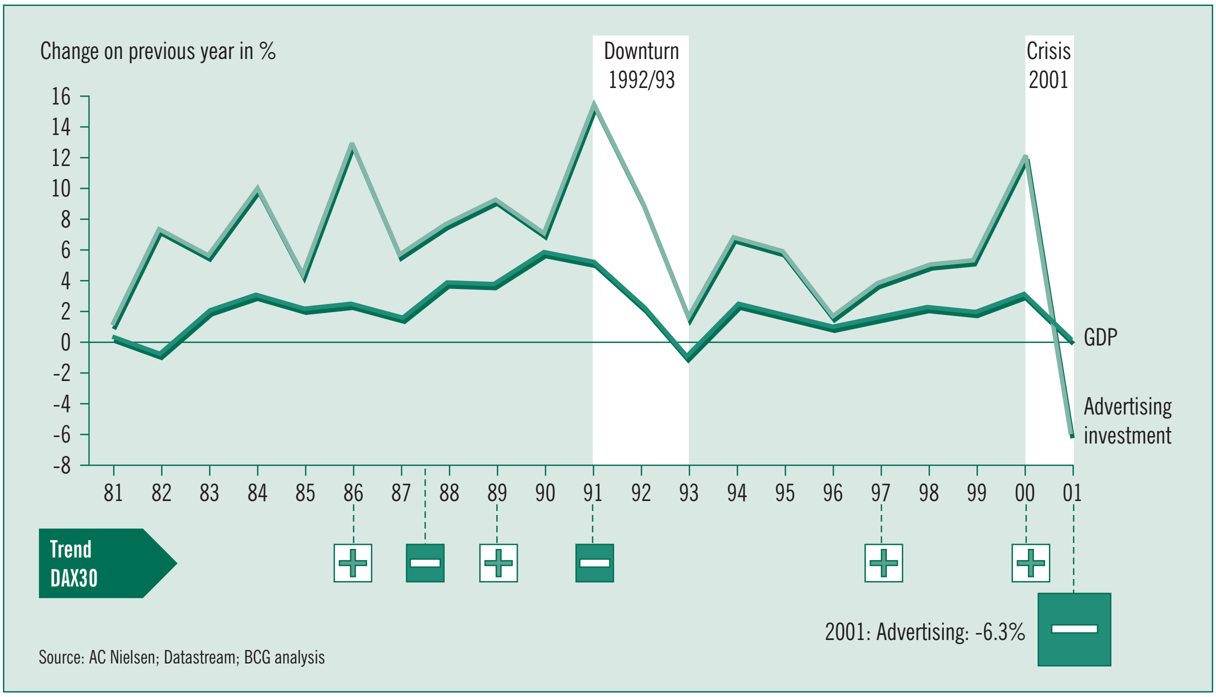
2 COMMON PRACTICE IN TIMES OF CRISIS:

REDUCING ADVERTISING EXPENDITURES

Although brand cultivation is regarded as important in most companies, advertising spending still comes under severe pressure in times of crisis. Brand value and shareholder value are put at risk for the sake of short-term improvements in profit. This was never more true than in the year 2001.

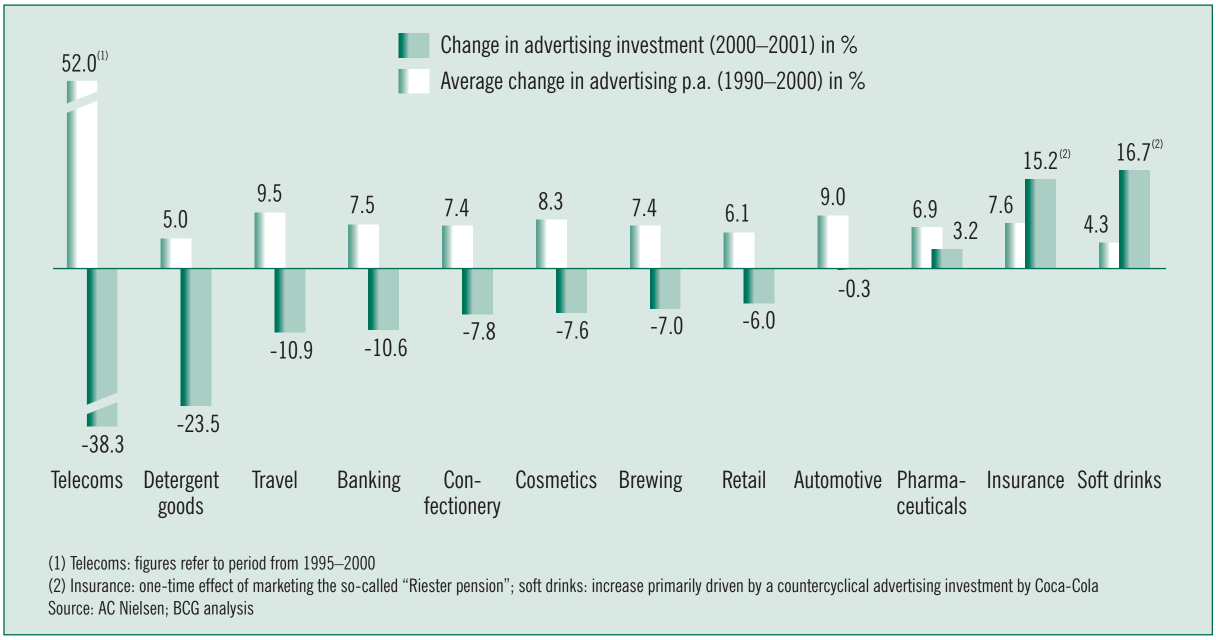
In 2001, total advertising investment in Germany fell by 6.3 percent compared to 2000. This meant that for the first time since 1981, advertising expenditures fell below the levels of the preceding year (diagram 7). Even in the recession year of 1993, when the German reunification boom came to an end, the advertising industry still managed to record a slight increase over 1992. In 2001 almost all industries reduced their advertising expenditures (diagram 8). The reduction in spending was greatest in telecommunications, with investments down 38 percent compared to 2000, although advertising spending in detergent goods and the travel industry also recorded double-digit falls (down by 23 percent and 11 percent, respectively).

DIAGRAM 7



CHANGE IN ADVERTISING INVESTMENT MORE PRONOUNCED THAN GENERAL ECONOMIC TREND

DIAGRAM 8



ALMOST ALL INDUSTRIES REDUCE ADVERTISING EXPENDITURES—REDUCTION IN ADVERTISING FOR 2001

Merely three of the largest industries increased their budget: pharmaceuticals with an increase of 3.3 percent; insurance with increased spending of 15 percent due to the “Riester pension”, and soft drinks where a 43-percent increase in advertising spending from Coca-Cola alone was enough to ensure a 17 percent average rise across the industry as a whole.

A comparison with average annual growth in advertising investment from 1990 to 2000 shows just how dramatic the collapse in spending has been. During this time period, advertising investments clearly increased. The reason for the current reluctance to advertise is patently obvious: during periods of reduced earnings, advertising spending is one of the few items a company can reduce in the short term to improve its cost situation. Measures, such as restructuring, adjustment of product portfolio, and staff reduction programs, take time to show effect. Cuts in the advertising budget, on the other hand, improve profitability immediately. The crisis is often characterized by a paradigm shift; controllers take the lead. According to a representative of a leading food processing company, “short-term pressure to improve profitability is considerable. Advertising is seen as a residual factor in influencing results.”

“The pressure to show positive results is enormous,” confesses the managing director of a detergent goods producer. In an interview with the magazine W&V, Hans-Dieter Liesering, president of the advertising association OWM, concludes: “It’s virtually impossible to consider personnel reductions and simultaneously increase advertising spending.” Gerhard Berssenbrügge, CEO of Nestlé Nespresso, on the other hand, sees this as a lack of steadfastness on the part of management. “Weak managers might feel under pressure, while strong managers will use the crisis to strengthen the brand.” The figures show how readily top advertisers in Germany have adopted this traditional recipe of cost reduction over the past year (diagram 9): Deutsche Telekom cut its communications budget by 59 percent, while its T-Mobil subsidiary did so by 46 percent. Competitor Viag Interkom also cut its communications budget by 46 percent. Other companies that went beyond the average reduction of 6.3 percent were Masterfoods at 27 percent, Procter & Gamble and VW with 23 percent each, and Henkel, where advertising spending was down 11 percent.

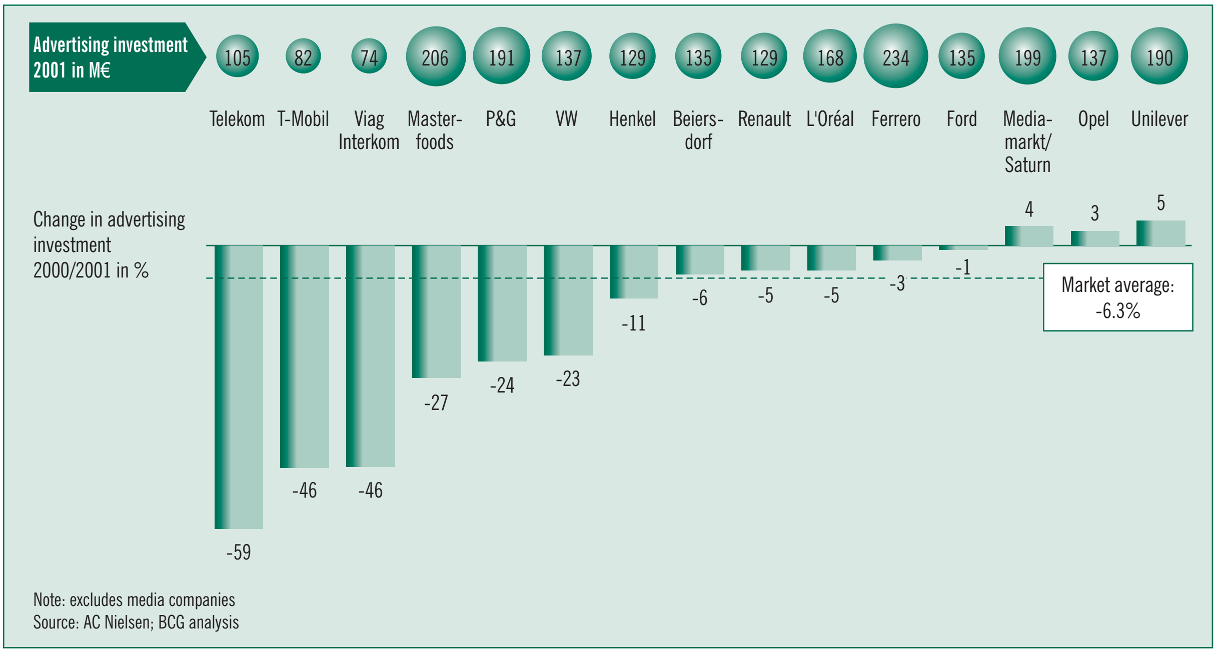
Passively orienting advertising behavior towards the overall market is typical of many companies' attitude to advertising investment. As the marketing manager of a bank we interviewed puts it: "We primarily observe the advertising behavior of the competition." Procyclical behavior, however, will at best cause market share to stagnate. And that will only happen if none of the competitor companies launch a countercyclical advertising offensive. It is highly inadvisable to rely on such an outcome, however. As one representative of a credit card company puts it: "Even during crises, it's important to remember that not everyone suffers to the same extent."

Those who have been tested by hard practical experience say that in times of crisis, it is not so much risk avoidance but rather concrete action that makes the difference. In marketing, this means that companies developing their brand during a downturn in the economic cycle should strengthen market position through advertising, while market leaders have the opportunity to bolster existing advantages. Current examples, such as Dell or Müller, prove that this strategy is not only theoretical in nature but works even in the adverse environments of extremely competitive markets.

CEO Gerhard Berssenbrügge sums up the huge opportunity: "If a company has created the prerequisites on the product side and done its homework, then there is a real opportunity to gain market share through countercyclical advertising." Peter Zühlsdorff, general manager for food retailing at Tengelmann, emphasizes the psychology of competition. "Periods of crisis represent the ideal time for a company to shift market share in its own favor. With most industry players practically paralyzed, opportunities remain for the more levelheaded managers."

The current situation not only affords opportunities to improve market position: Due to the overall reduction in advertising pressure, this can also be a time of greater efficiency. Wolfgang Bück, advertising manager at the German Association of Savings and Giro Banks, points out: "When can a company advertise more efficiently than in times like these?" In a quieter market, each individual voice can gain more strength.

DIAGRAM 9



LARGE ADVERTISING BUDGETS ARE CUT—ADVERTISING BEHAVIOR OF TOP ADVERTISERS IN GERMANY


V
A
LU
E

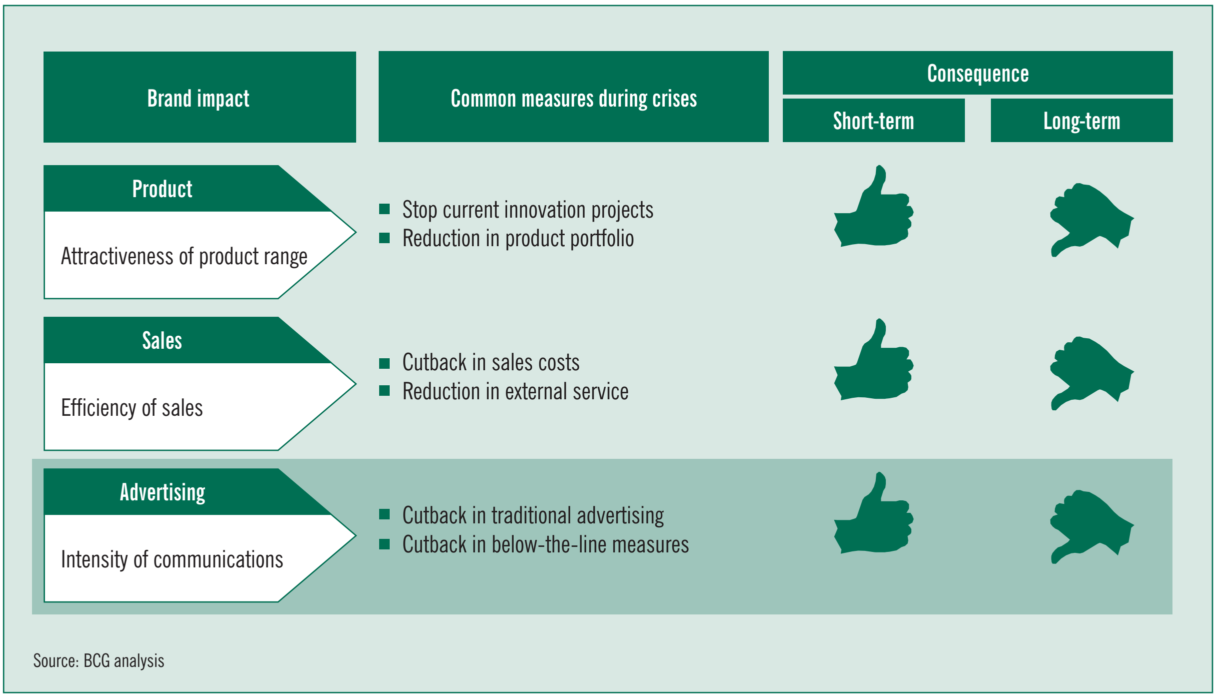
3 EXPERTS CAUTION:

SHORT-TERM MAXIMIZATION OF PROFITABILITY PUTS LONG-TERM GOALS AT RISK

Even healthy companies will cut their communications budgets in an attempt to stabilize earnings. On the playing field of international brands, however, this loss of advertising share can quickly result in the company being drawn into a double vicious circle, both in the market and in capital markets.

"Reluctance to act means companies are effectively squandering a major opportunity," is the conclusion of "Horizont", one of Germany's leading papers in the advertising industry. "Werben & Verkaufen" says "the cyclical and timid behavior of many managers" exacerbates the economic and advertising crisis, as well as the general mood of the market. The pollsters from the Allensbach Institute share this view. Managing Director Renate Köcher contends that there is a tendency to anticipate the worst from the very beginning, particularly in Germany. "It is very likely that such an attitude produces a self-fulfilling prophecy."

DIAGRAM 10



THE RISK OF SHORT-TERM ORIENTED PROFIT MAXIMIZATION: LONG-TERM DETERIORATION

In fact, the German economy has enjoyed a prolonged growth period since the early nineties, hitting a significant high in the summer of 2000. The sharp downturn in the economy therefore hit particularly hard, creating ideal conditions for overreactions. All items not immediately necessary for maintaining business activity were cut drastically, not the least of which was advertising.

The strategy of undifferentiated cost cutting appears risky (diagram 10); such a policy fails to account for long-term consequences affecting the brand. In some circumstances, the value of a brand, developed and cultivated over an extended period, can be permanently weakened by reductions in advertising expenditure. As a result, the long-term aim of strengthening the brand and increasing corporate value is sacrificed to an "actionist" approach designed only to achieve short-term profit maximization.

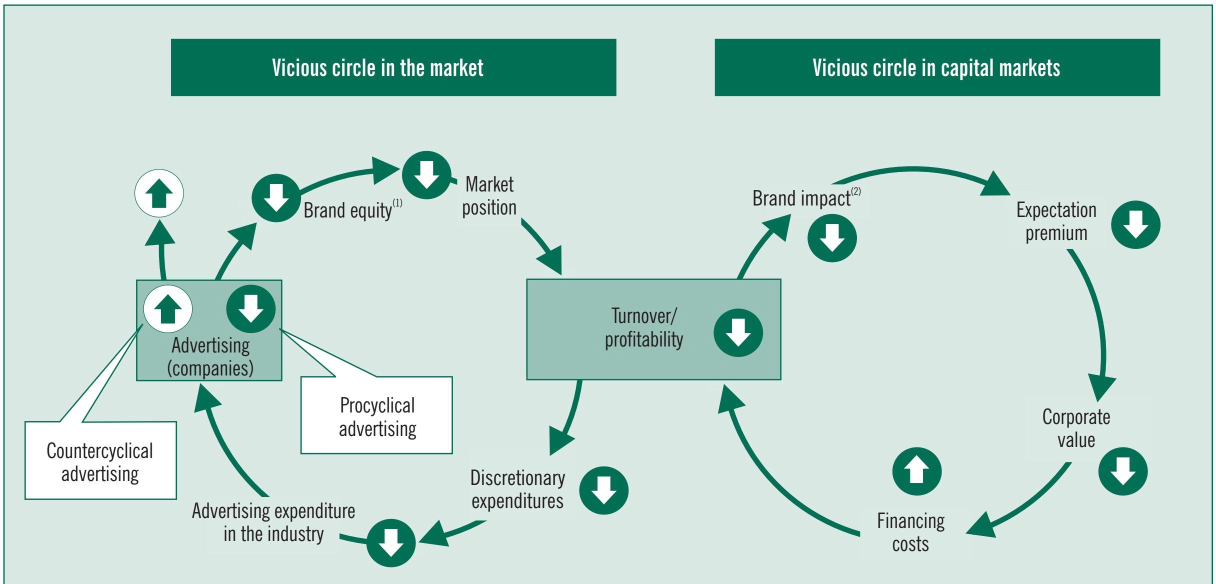
This process can lead to a double vicious circle both in the market and in capital markets.

The vicious circle in the market always has the same point of origin (diagram 11):

1. Industry turnover and profitabilities fall.
2. Companies reduce discretionary expenditures including advertising spending under pressure from controllers.
3. Total overall advertising investments in the industry are reduced.
4. Managers tend to follow familiar patterns: cut advertising spending in step with the industry, while maintaining a constant ratio of advertising costs to turnover.
5. Brand equity suffers as a result: brand awareness erodes, brand individuality becomes blurred, and customer loyalty collapses.
6. Market positioning is adversely affected.
7. Both turnover and profitability deteriorate further.

The risk of entering this vicious circle is particularly great for medium-sized companies and can have dangerous long-term consequences. Costs are simply shifted into the future, when the brand, weakened during the crisis, needs to be revitalized by employing high levels of capital. Since we have ascertained that it is the brand that creates value, a weaker brand has a direct impact on corporate value.

DIAGRAM 11



(1) BCG has coined the term "brand equity" which describes relative brand strength and can be broken down as awareness, desire, intention, purchase
(2) Main elements of brand impact: product, sales, and advertising
Source: BCG analysis

THE RISK OF PROCYCLICAL BUDGET CUTBACKS: DUAL VICIOUS CIRCLE

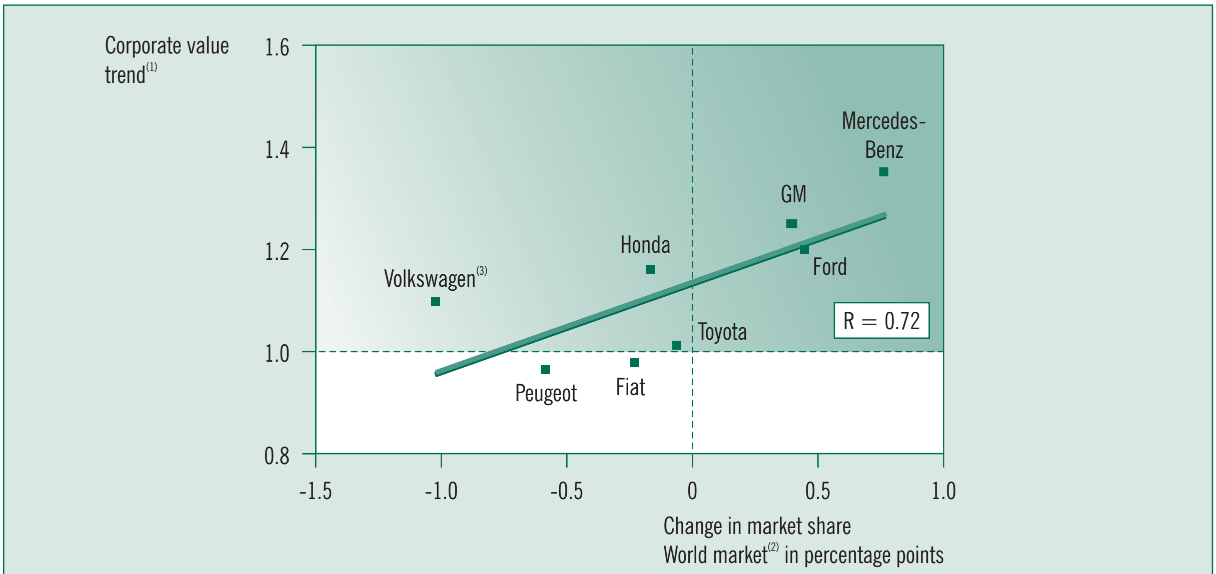
The vicious circle in capital markets begins when brand impact, which is influenced by a strongly growth-oriented strategy, falls as a result of procyclical action in the market. The crisis then develops as follows:

1. Turnover and profitability are reduced.
2. Brand impact falls.
3. As a result, the expectation premium as a price premium on the fundamental company value falls.
4. Corporate value falls.
5. Financing costs rise in capital markets.
6. Profitability deteriorates further.

The connection is clear: cost cutting may improve a company's profitability in the short term but may prove shortsighted from the perspective of corporate value. The apparent way out—presenting better figures to capital markets with the help of rapid profit maximization—proves, in fact, to be a trap. The pressure exerted by the capital reporting system to distribute successful news on a quarterly basis can drive a company directly into the double vicious circle described above. This may happen at a time when it is least able to deal with such a situation. Possible consequences include interruptions to continuous brand cultivation and adverse effects to shareholder value in the medium term.

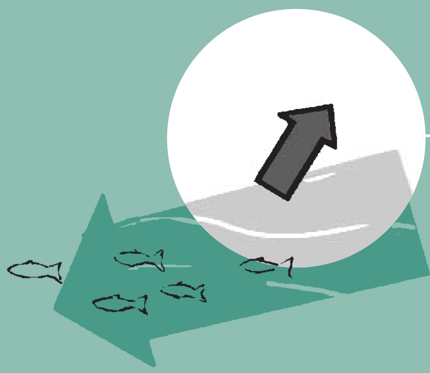
Companies with strong brand-driven growth are generally better performers in capital markets (diagram 12). This is demonstrated by the example of the automotive industry in the crisis year of 1993. At this time, both VW and Peugeot were hit by considerable reductions in sales in the global market. The result: market capitalization also lagged behind the competition. Mercedes-Benz, on the other hand, significantly increased its market share and reported strong performance in capital markets. Naturally, this principle is not automatic. Monocausal explanations generally do not tell the whole story in our highly complex modern economic systems. Completely ignoring the causal connection seems negligent, however. The risk of entering the double vicious circle through a communications strategy oriented exclusively towards costs is significant. The solution: countercyclical advertising.

DIAGRAM 12



(1) Corporate value trend: market capitalization 1994 ÷ market capitalization 1993
(2) Change in market share: SoM 1993 compared to SoM 1992
(3) Strong fall in sales due to management change (beginning of Piech era, President VW America, required to resign)
Source: Datastream; BCG analysis

CAPITAL MARKETS REWARD MARKET SHARE GAINS—INDUSTRY EXAMPLE OF THE WORLDWIDE AUTOMOTIVE MARKET IN CRISIS, 1993



4 RECOGNIZING OPPORTUNITY IN CRISIS:

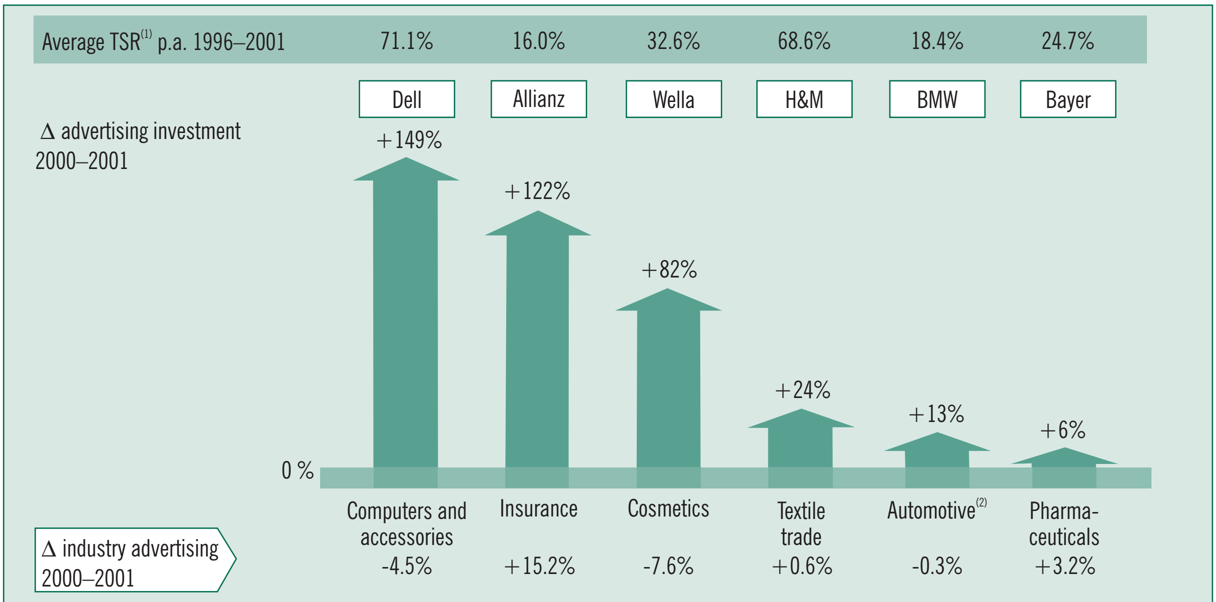
SOME EXAMPLES OF COUNTERCYCLICAL ADVERTISING IN 2001

Market leaders and aggressive opportunists demonstrate that efficient brand cultivation strengthens a company's position in the industry and in capital markets particularly in times of economic downturn. They are among the winners of the 2001 crisis.

In 2001 the vast majority of companies in Germany made dramatic cuts in advertising spending, leading to a 6.3-percent slump in total advertising investment compared to the preceding year. Some companies, however, recognized the risk of the double vicious circle and viewed the crisis as an opportunity to make a lasting improvement to their market position. In first place come top performers, such as Dell, Allianz, and Wella, all of whom drastically increased their advertising expenditure: Dell by 149 percent, Allianz by 122 percent (far above the average industry increase of 15 percent due to the one-time effect of the "Riester pension"), and Wella by 82 percent (diagram 13).

Once again, parallels can be drawn between continuously high investments in the brand and the value of the company: the average total shareholder return (sum of increase in share price and dividend distribution) for the years 1996 to 2001

DIAGRAM 13



(1) Total shareholder return (TSR) defined as average increase in share price plus average dividend distribution per year
(2) Figure for BMW adjusted to account for mini SoA (share of advertising) investment in industry
Source: AC Nielsen; BCG analysis

SOME TOP PERFORMERS TAKE COUNTERCYCLICAL ACTION—BUDGET CHANGES IN CRISIS YEAR 2001 shows a considerable increase in the corporate value of these top performers.

While this increase appears at the end of a long causal chain, the influence of countercyclical advertising on a company's competitive position within the industry is immediate—for both market leaders and brand developers.

Countercyclical advertising offers the following:

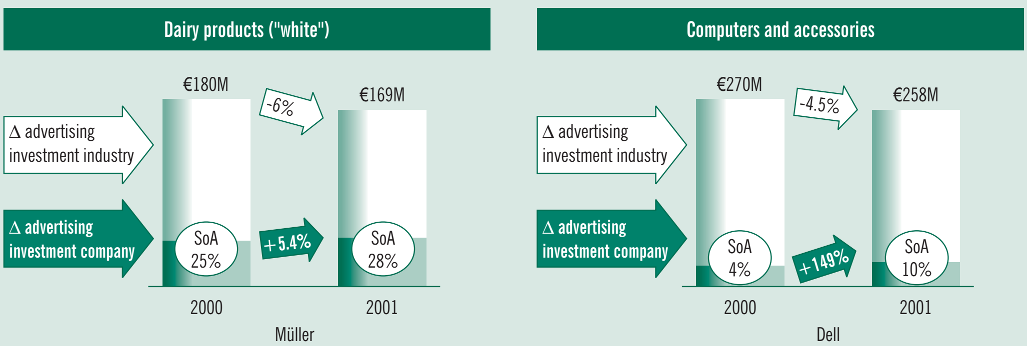
- Efficiency benefits: As a company's share of advertising[1] rises, its brand assumes a more prominent position—with comparatively little capital employed. As a result, innovations can be positioned more cheaply in the market.
- Opportunities for growth: Market leaders can make lasting improvements to their market position, while opportunists can conquer new ground in the industry.

A number of different examples demonstrate the success of countercyclical advertising (diagram 14). For example, Müller, the market leader in the segment of “white” dairy products, increased its advertising spending by 5.4 percent, raising its share of advertising across the industry as a whole from 25 to 28 percent. As a result, it was able to launch its new “Crema di Yogurt” product cheaply and efficiently and strengthen market share in specific segments—fruit yoghurt, for example, where its share rose from 10.9 to 11.7 percent.

In the computer industry, Dell was able to increase its SoA from 4 to 10 percent of total market spending on the strength of a 149-percent rise in ad spending. The company's success was resounding: a 20-percent turnover increase in Germany, up from fifth to fourth place in terms of industry turnover, and a strengthening of the brand image as price leader.

Success stories, such as Dell or Müller, are by no means individual cases. As can be seen in diagrams 15 and 16, companies in entirely different industries have experienced similar degrees of success in strengthening their market positions. These have included both market leaders and opportunists. The conclusion: countercyclical advertising works. In the context of falling advertising investments, even constant levels of spending contribute to raising the share of advertising. At many companies, however, recognition that it is cheaper to advertise during crises is not the sole motivation for increasing the advertising budget. There is frequently another driving force behind intensifying

DIAGRAM 14



Market leader: strengthening of position
- Cheap, efficient introduction of innovations (Crema di Yogurt)
- Strengthening of market share base (e.g., increase in fruit yoghurt segment from 10.9 to 11.7 percent)
- Cost-efficient brand cultivation

Brand developer: market share capture
- In Germany, 20-percent turnover increase
- Capture of share in market, up from fifth to fourth place measured by turnover
- Strengthening of brand image as price leader

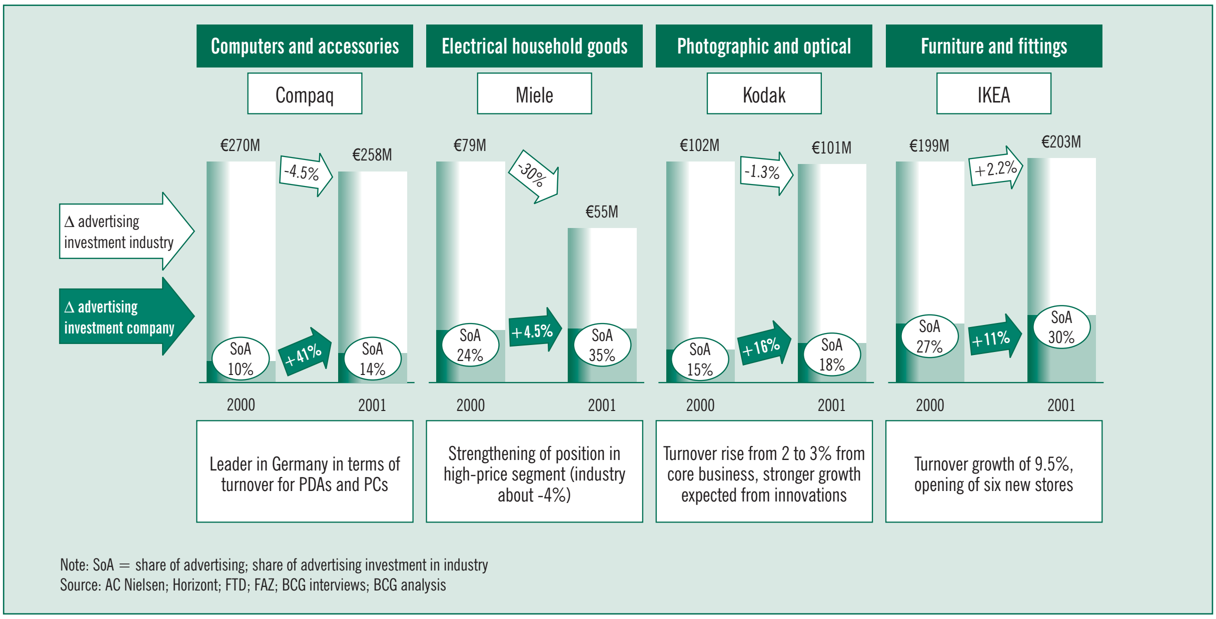
SoA: share of advertising in industry
Source: AC Nielsen; BCG interviews; BCG analysis

COUNTERCYCLICAL ADVERTISING OFFERS OPPORTUNITIES TO MARKET LEADERS AND OPPORTUNISTS

(1) Share of Advertising (SoA): share of advertising investment of a company in total advertising investment of industry

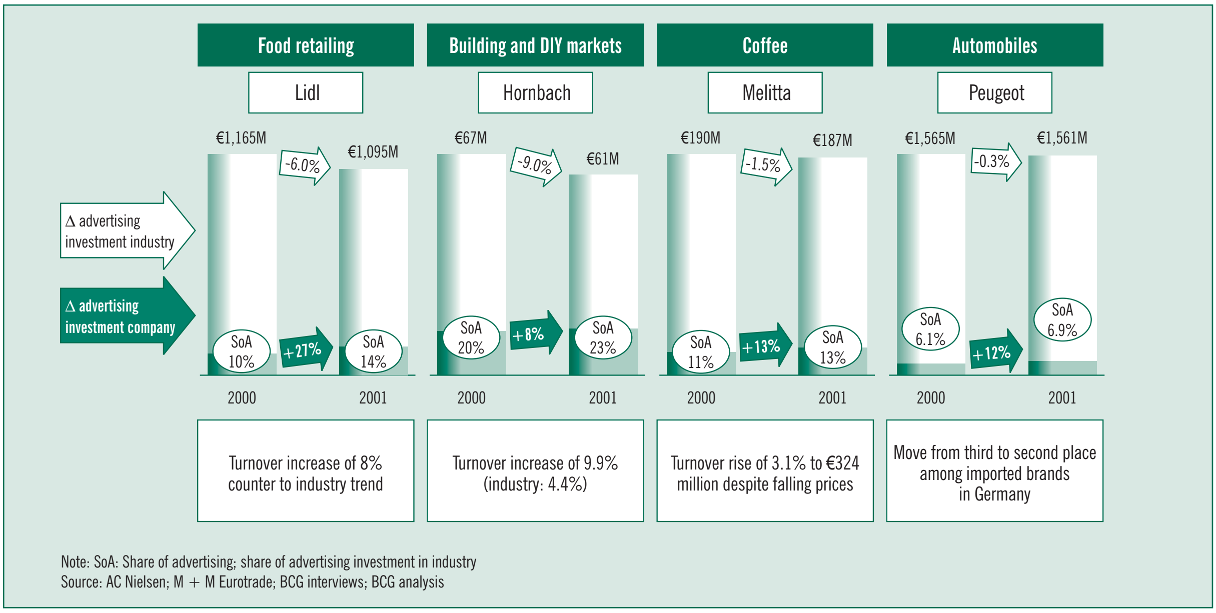
communications—the introduction of a new product. The company Wella, which increased advertising spending by 82 percent in 2001, explained its communications strategy with new product initiatives requiring appropriate advertising support. Justus Schneider, vice president for marketing communications at DaimlerChrysler, also stresses this requirement: “Once the car is ready, it has to be advertised. There's simply no room for short-term thinking, even when there is profitability pressure.” Countercyclical advertising investment is especially suitable for those strategic communication themes designed to cultivate brands. “Communications aims are achieved more efficiently during periods of crisis.” There is opportunity for change in this area. Hans Sartor, advertising manager at Peugeot, confirms that his company's advertising efforts have been extremely effective during periods of general advertising restraint.

DIAGRAM 15



MARKET LEADERS STRENGTHEN THEIR MARKET POSITIONS—EXAMPLES OF COUNTERCYCLICAL ADVERTISERS IN 2001

DIAGRAM 16



OPPORTUNISTS GAIN NEW GROUND IN INDUSTRY—EXAMPLES OF COUNTERCYCLICAL ADVERTISERS IN 2001

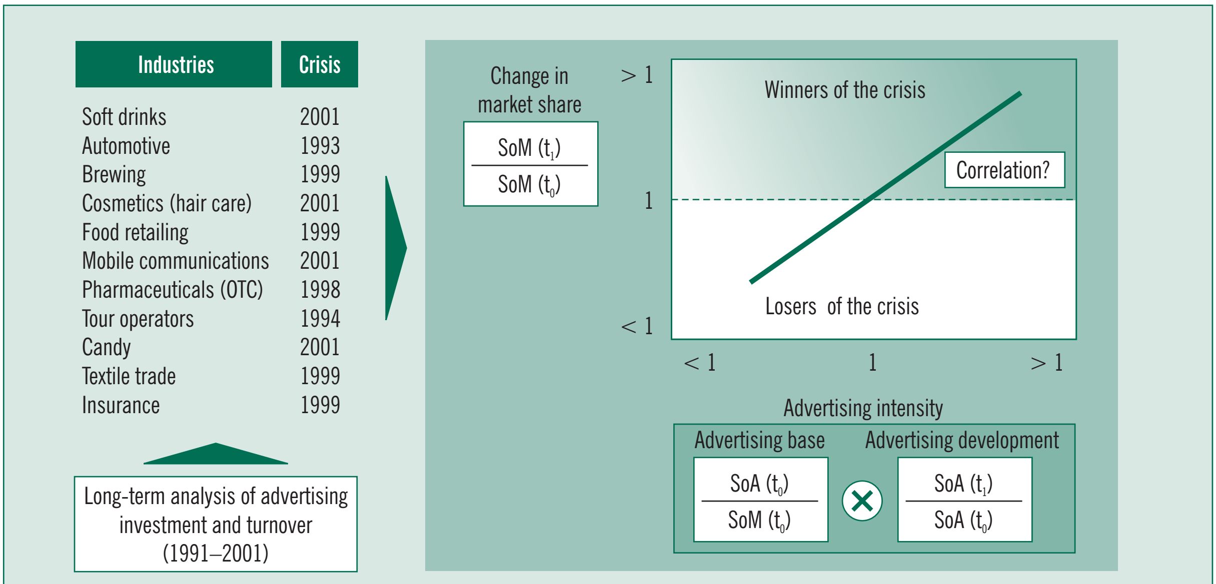
5 IMPROVING MARKET POSITION DURING PERIODS OF CRISIS:

INDUSTRY ANALYSES 1991–2001

Offensive advertising strategies are proving a powerful weapon in the fight for market share, particularly in times of crisis. This was demonstrated in an industry-specific study of the German market.

The examples provided in the previous chapter have shown that countercyclical advertising is a preferred method for market leaders and opportunists to make lasting improvements to their market positions. The Boston Consulting Group examined the effect of high levels of advertising intensity in eleven different industries in order to back up these findings with a broad analytical base. The industry examples presented include the segments of consumer goods, consumer durables, and services. A period covering the past eleven years was examined for crises and cyclical downturns. Crisis years are defined as those in which significant reductions in turnover and/or total advertising investment by industry occur: 1993 in the automotive industry, 1999 in the brewing market, and 2001 in mobile communications (cf. diagram 17).

DIAGRAM 17



Note: t_0 = year preceding crisis; t_1 = crisis year; SoA = share of advertising (share of advertising investment in industry); SoM = share of market; both relate to the defined industry sample; SoM is defined by value, with exception of automobile industry (by cars sold) and mobile communications (by connections)
Source: BCG analysis

One expression of offensive or defensive use of advertising is the “advertising intensity” formula developed by BCG. This combines two different factors:

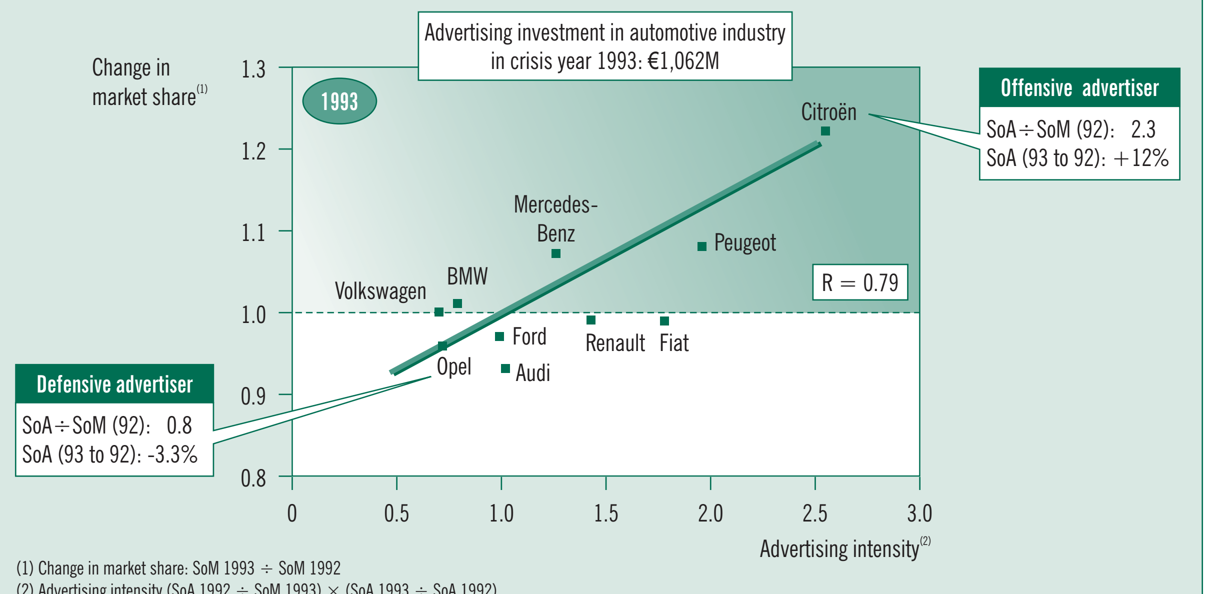
1. Advertising base: the ratio of the share of advertising to the company's share of market, which is an expression of the strategic stance towards advertising. A value of below 1 shows a company advertising defensively, whose share of advertising is smaller than its market share. Where the value is above 1, the company is an offensive advertiser.

2. Advertising development: this indicates the increase in share of advertising in the crisis year compared to the preceding year.

Multiplying the advertising base by the advertising development provides us with a value referred to as the advertising intensity. This is greatest amongst companies coming from a high advertising base and increasing investment in a countercyclical manner during the period of crisis. As the analyses show, there is a clear positive correlation between advertising intensity and change in market share during crisis periods. A value of below 1 indicates a loss in market share. The more the value exceeds 1, on the other hand, the more the company has been able to increase its market share.

Example from the automotive industry (diagram 18): We have identified 1993 as the crisis year in which industry turnover collapsed following the reunification boom in Germany. Opel was a defensive advertiser in this crisis year, with an advertising intensity value of 0.7. This was the result of below-average use of advertising compared to market share and a share of advertising reduced by 3.3 percent. There was also a downward trend on the market side, with Opel's market share falling from 21.4 to 20.9 percent. The picture is quite different for Citroën: although the French car manufacturer was an offensive advertiser, with an advertising base value of 2.3, it increased its advertising development value by 12 percent, achieving a final advertising intensity of 2.3. Market share increase proves the strategy correct: the factor is 1.2.

DIAGRAM 18



(1) Change in market share: SoM 1993 ÷ SoM 1992
(2) Advertising intensity (SoA 1992 ÷ SoM 1993) × (SoA 1993 ÷ SoA 1992)
Note: SoM = share of market; SoA = share of advertising
Source: AC Nielsen; BCG analysis

ADVERTISING INTENSITY JUSTIFIED IN THE FIGHT FOR MARKET SHARE (I)—POSITIVE CORRELATION CONFIRMED—AUTOMOBILES

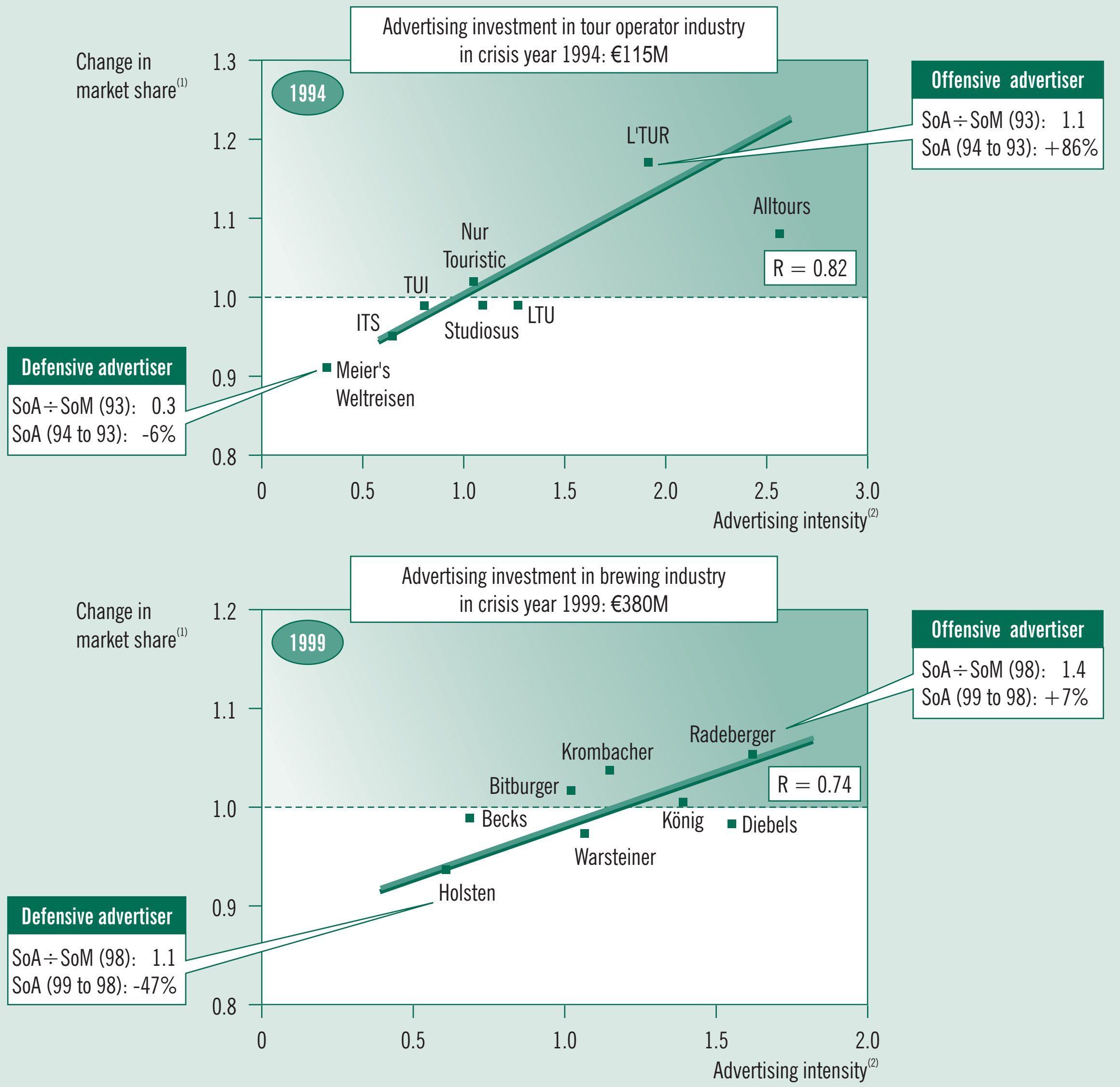
Example from the tour operator industry (diagram 19, upper table)

In the crisis year of 1994, Meier's Weltreisen, with its advertising base of just 0.3, was a strongly defensive advertiser whose share of advertising was reduced by an additional 6 percent. The company's low advertising intensity was forced further down by a market share change factor of 0.9. By contrast, L'TUR, with its advertising intensity of 1.9 based primarily on a significant increase of 86 percent in its share of advertising, achieved a factor of change in market share of 1.2.

Example from the brewing industry (diagram 19, lower table)

In the crisis year of 1999, Holsten had below-average advertising intensity. The change in market share is negative. Radeberger invested above average in advertising and succeeded in gaining additional market share.

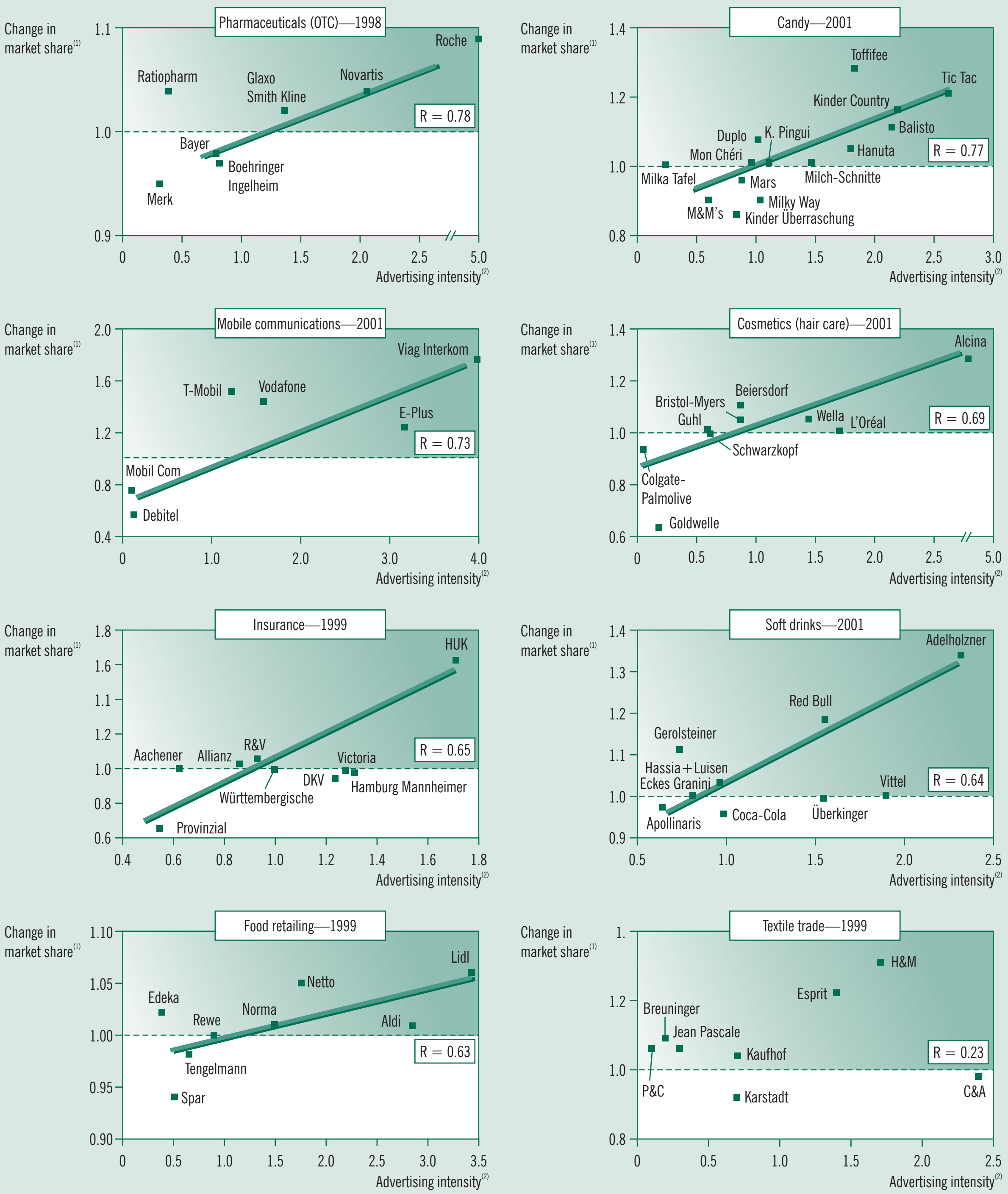
DIAGRAM 19



(1) Change in market share: SoM 1993 ÷ SoM 1992
(2) Advertising intensity (SoA 1992 ÷ SoM 1993) × (SoA 1993 ÷ SoA 1992)
Note: SoM = share of market; SoA = share of advertising
Source: AC Nielsen; FVM; Büro van Dijk; Deutscher Brauerbund; BCG analysis

ADVERTISING INTENSITY JUSTIFIED IN THE FIGHT FOR MARKET SHARE (II)—POSITIVE CORRELATION CONFIRMED—TOUR OPERATORS AND BREWING

DIAGRAM 20



(1) Change in market share: SoM 1993 ÷ SoM
(2) Advertising intensity (SoA 1992 ÷ SoM 1993) × (SoA 1993 ÷ SoA 1992)
Source: Institut für Handelsforschung; Datamonitor; Hoppenstedt; Mobile Communications; Textilwirtschaft; annual reports; BCG project experience; BCG analysis

ADVERTISING INTENSITY JUSTIFIED IN THE FIGHT FOR MARKET SHARE (III)—POSITIVE CAUSAL CONNECTION CONFIRMED IN PHARMACEUTICALS, CANDY, MOBILE COMMUNICATIONS, COSMETICS (HAIR CARE), INSURANCE, SOFT DRINKS, AND FOOD RETAILING

DIAGRAM 21

Industries examined	Crisis/ downturn	Correlation (R)	Causal connection
Tour operators	1994	0.82	✓
Automotive	1993	0.79	✓
Pharmaceuticals (OTC)	1998	0.78	✓
Candy	2001	0.77	✓
Brewing	1999	0.74	✓
Mobile communications	2001	0.73	✓
Cosmetics (hair care)	2001	0.69	✓
Insurance	1999	0.65	✓
Food retailing	1999	0.64	✓
Soft drinks	2001	0.64	✓
Textile trade	1999	0.23	⊖

Source: BCG analysis

ADVERTISING INTENSITY JUSTIFIED IN THE FIGHT FOR MARKET SHARE (IV)—SUMMARY OF RESULTS OF INDUSTRY ANALYSES

High correlations between advertising intensity and increase in market share during crisis years is common to all the industries surveyed here (diagrams 20 and 21). Only the textile trade (year examined: 1999) does not feature this positive causal connection.

Overall, all industries show the same pattern in the crisis years studied: As a general rule, companies that gain market share in the tighter competitive environment do so by means of above-average use of advertising. There is a tendency for their share of advertising to be higher than the share of market, while advertising behavior is more likely to be countercyclical.

The risk of the crisis is also clearly shown: competitors with low advertising intensity who also reduce their share of advertising during the crisis regularly fall behind and lose market share.

There is substantial opportunity to emerge as the winner in a crisis by coming from a high advertising base and using countercyclical advertising.

6 CONCLUSION:

SEIZE THE OPPORTUNITY—ACT COUNTERCYCLICALLY

Companies taking countercyclical action to increase advertising budgets during periods of crisis will profit in the longer term. It is easier to conquer market share and thereby increase corporate value more rapidly.

In times of crisis, companies should take action. Many competitors look to established industry patterns during downturns and reduce advertising budgets in step with the industry as a whole. However, there are excellent opportunities for prescient managers to strengthen market position through countercyclical investment in the company brand. This leads to an improvement in the company's growth platform, which in the long term is rewarded by capital markets with increased corporate value. Every crisis produces winners in the market and in capital markets. The winners regularly include those companies that retain confidence in the power of advertising, even during crises.

This analysis by The Boston Consulting Group has proven this connection. For the first time, a comprehensive study has shown that in times of crisis a positive causal connection exists between advertising investment, increase of market share, and creation of corporate value. The study has shown that strong fundamental corporate data alone are insufficient to project the development of corporate value. Companies that work consistently on their growth, however, are also in a better position in the eyes of capital markets. We refer to this share of fundamental value relative to the growth of the company as the "brand impact". Those companies with superior product innovation, more efficient sales channels, and continuously high investment in advertising will enjoy the highest brand impact in comparison to their particular industry. According to the study, the higher a company's brand impact, the stronger its opportunities to achieve above-average performance in the capital markets. Current examples include L'Oréal, H&M, and BMW. The market values those companies that continuously cultivate their brands.

The crisis year of 2001 shows, however, that many companies reduced their communication budgets in an effort to achieve short-term improvements in earnings. The collapse in advertising investment was dramatic: in Germany, advertising spending fell, for the first time since 1981, by 6.3 percent compared to 2000. Nearly all industries and the majority of advertisers cut advertising spending dramatically. Frequently they adhered unquestioningly to established models, oriented themselves towards constant advertising cost-turnover ratios and the advertising behavior of their competitors, or simply capitulated in the face of pressure from analysts to achieve positive quarterly results.

Such procyclical behavior appears dangerous, however. There is a strong risk of companies being drawn into double vicious circles in the market and in capital markets.

As the present study by The Boston Consulting Group shows, it is dangerous to reduce advertising budgets as this course of action can damage brand individuality and weaken market position. This can in turn lead to further deterioration in turnover and declining profitability. The downward spiral of the industry, and especially of the company acting procyclically, continues to gain strength. Such a vicious circle occurs on two levels. The reduced use of brand power leads directly to a fall in brand impact, putting unwelcome pressure on corporate value. Subsequent increased costs of financing put additional pressure on profitability and limit the maneuverability of the company.

One solution to this double vicious circle is the use of countercyclical advertising.

The analysis of a number of prominent individual examples from 2001 and the extensive study of various German crisis years in 11 different industries all arrive at the same conclusion: crisis also provides opportunity. Companies which use countercyclical advertising and maintain a significant share of total advertising spending in their industry will emerge from crises as winners. Market leaders will strengthen their positions, while opportunists will gain new ground in their industry. The passivity of their competitors offers significant advantage in terms of efficiency; just by holding levels of capital at a constant level, they already increase their “share of voice”, the perceived prominence of their brand presence. Where such companies increase their advertising on a countercyclical basis, such companies become even more prominent.

As our analyses have illustrated, the opportunity to gain market share during crises by means of countercyclical advertising is especially high when this increase in market share is working from an already high starting point. Despite the clear benefits offered by countercyclical brand cultivation, many companies have great difficulty throwing off the restraints of the crisis and using the particular conditions to their own advantage. Pressure on profitability often forces change within organizations, with financial controllers and analysts assuming decision-making roles.

Undifferentiated cost cutting, however, is fatal for a company's brand. Our study shows that brand cultivation during times of crisis is one part of a correctly understood, long-term shareholder value approach. Companies that pass up such value creation potential in favor of short-term improvements will rarely be working on the basis of sound advice: since companies are naturally affected to differing degrees by crises, there is an acute risk of short-term actors being overtaken by market leaders and smaller opportunists thinking and acting on a countercyclical basis.

Growth and market value drive corporate value. According to the analyses of The Boston Consulting Group, countercyclical brand development is easier and more efficient to accomplish in times of crisis. There is no doubt that an offensive advertising strategy in the face of a fall in profitability requires real courage. The need for such inner strength is nothing new, however. It was over a century ago that Carl von Clausewitz, the legendary strategist, noted: “There are times when taking the greatest risk can be considered the wisest course of action.” His insight remains valid to this day.

METHODOLOGY

By examining the commercial behavior of companies in 11 industries, the present study analyzes the connection between advertising investment, change in market share, and the creation of increased value.

The following industries were selected: soft drink, automobile, brewing, cosmetics (hair care), food retailing, mobile communications, pharmaceuticals (OTC), candy, tour operator, insurance, and textile trade. These industries cover the sectors of consumer durables, consumer goods, and services.

Advertising investments are based on information from AC Nielsen Werbeforschung; changes in market share are based on trade panel data, as well as national and international market, industry, association, broker, and company reports.

Corporate values and the changes therein were calculated using data from Thomson Financial Datastream. Details of fundamental value and expectation premium were provided by the BCG Database Value Manager. More information on this topic is available in the BCG study "Value Creators 2001: Dealing with investor's expectations". The level of brand impact of the individual companies was calculated using balance sheet accounts and profit and loss data and was incorporated into the largest database of this type.

By establishing the period under examination, years of crisis or downturn were derived from the course of industry-specific advertising investment and turnover.

A causal connection between advertising and change in market share was determined in all industries reviewed. A sample of companies was selected to include the most important suppliers and brands in a given industry sector. The highest correlations were found to exist between the factors of advertising intensity and change in market share. Advertising intensity is the result of the product of the advertising base [share of advertising (t_0) divided by share of market (t_0)] and the advertising development [share of advertising (t_1) divided by share of advertising (t_0)].

Numerous expert interviews were carried out in order to supplement the analyses and verify the models and findings. The basis was a preset questionnaire covering the topic areas of advertising, market position, and corporate value. Our highly respected interviewees included executives, managing directors, and marketing managers at leading brand companies (Beiersdorf, Coty, DaimlerChrysler, Dresdner Bank, Hannen Brauerei, Henkel, Nestlé Nespresso, Tchibo, Tengelmann, Visa, and Wella).

CREDITS AND CONTACTS

Publisher:	The Boston Consulting Group GmbH Gruner + Jahr AG & Co, Hamburg IP Deutschland GmbH, Cologne
Conception and content:	The Boston Consulting Group GmbH
BCG project team:	Dr. Berndt Hauptkorn Dr. Antonella Mei-Pochtler Oliver Merkel Sabine Ruff Dr. Claudia Tourneau Dr. Jens Willenbockel
Text:	Dr. Berndt Hauptkorn Sven Rohde, Editorial Office, Hamburg

For further information on this study, please contact:

Dr. Antonella Mei-Pochtler: mei-pochtler.antonella@bcg.com

Dr. Berndt Hauptkorn: hauptkorn.berndt@bcg.com

BCG Germany and Austria

The Boston Consulting Group
Dircksenstraße 41
10178 Berlin

Tel: (+49) 030-28 87 10

The Boston Consulting Group
Stadttor 1
40219 Düsseldorf

Tel: (+49) 0211-30 11 30

The Boston Consulting Group
KölnTurm
Im Mediapark 8
50670 Köln

Tel: (+49) 0221-55 00 50

The Boston Consulting Group
Chilehaus A
Fischertwiete 2
20095 Hamburg

Tel: (+49) 040-30 99 60

The Boston Consulting Group
Sendlinger Straße 7
80331 München

Tel: (+49) 089-23 17 40

The Boston Consulting Group
Kronprinzstraße 28
70173 Stuttgart

Tel: (+49) 0711-20 20 70

The Boston Consulting Group
Frankfurter Welle
60422 Frankfurt am Main

Tel: (+49) 069-91 50 20

The Boston Consulting Group
Am Hof 8
1010 Wien

Tel. (+43) 01-537 56 80

COOPERATION PARTNERS

Gruner + Jahr AG & Co
Postal address: 20444 Hamburg
Visitors address: Am Baumwall 11
20459 Hamburg

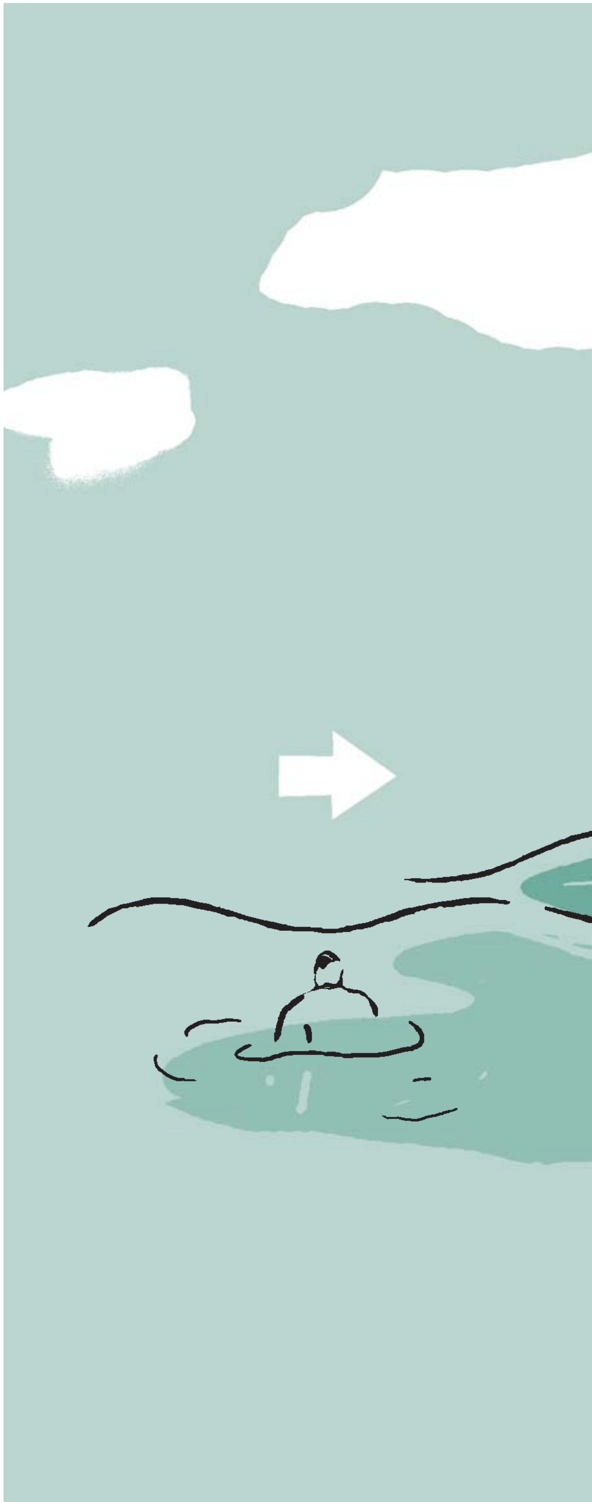
Tel: (+49) 40 3703 0

IP Deutschland GmbH
Aachener Straße 1042a
50858 Köln

Tel: (+49) 221 5886 0

BCG THE BOSTON CONSULTING GROUP

Amsterdam
Athens
Atlanta
Auckland
Bangkok
Barcelona
Beijing
Berlin
Boston
Brussels
Budapest
Buenos Aires
Chicago
Copenhagen
Dallas
Düsseldorf
Frankfurt
Hamburg
Helsinki
Hong Kong
Istanbul
Jakarta
Köln
Kuala Lumpur
Lisbon
London
Los Angeles
Madrid
Melbourne
Mexico City
Milan
Monterrey
Moscow
München
Mumbai
New Delhi
New York
Oslo
Paris
Rome
San Francisco
São Paulo
Seoul
Shanghai
Singapore
Stockholm
Stuttgart
Sydney
Tokyo
Toronto
Warsaw
Washington
Wien
Zürich



www.bcg.de