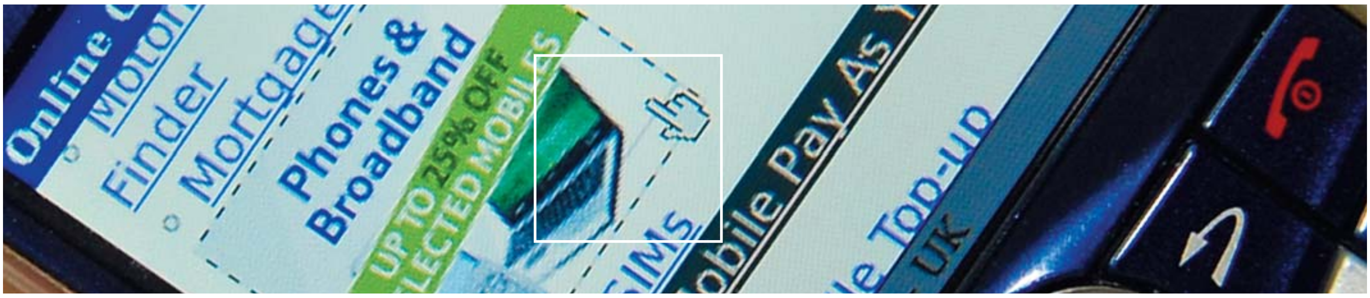
A Mobile Playground…

How mobile operators can monetize mobile advertising *May '08*



Value-creation and business models for advertising and mobile communication markets are undergoing significant shifts across the world. Advertisers see their audiences increasingly using mobile devices and the services of mobile operators and are looking for new ways to differentiate their own service offering. It is therefore not surprising that advertisers and mobile operators are preparing for mobile advertising as the next step in the evolution of online advertising. This paper offers a high-level strategic review of how this potentially sizeable and attractive market can best be developed.

Mobile advertising is a further evolution of online advertising

Advertising messages have traditionally been communicated through channels such as billboards, TV and radio spots, newspaper ads and outdoor advertising signs. A few years ago the internet became a complementary advertising channel, with online advertising appearing on web sites, web TV, IPTV, communities and portals. Today, mobile handheld devices offer advertisers a new opportunity to reach consumers in a direct and targeted way.

Although mobile advertising/marketing is commonly viewed as a new and different way of communicating advertisers' messages, we view mobile advertising as the next step in the evolution of online advertising. This is because mobile advertising leverages the interactivity made possible by IP technologies and mobile-device features, such as cameras and local information, while using specific formats and transmission paths (SMS, MMS, opt-in, banners etc.) to deliver its message. As a result, we believe mobile advertising will eventually become a sub-segment of the overall online advertising market, although it will extend the range of players and possibilities enormously.

We use the terms "mobile marketing" and "mobile advertising" interchangeably to cover any formats already known from the online advertising field and new formats such as sponsored messaging and services and push SMS/MMS.

Mobile advertising will bite into the total advertising market

Researchers and industry players agree that the mobile advertising market has a promising future. However, forecast figures vary, in some cases by more than 1000%, primarily due to the fact that the market is completely new, making it hard to come up with a solid prognosis. Another reason for the uncertainty about size and growth is that standards for mobile advertising formats are still unclear and agencies and media buyers have not yet figured out how to exploit mobile advertising effectively. They still face difficulties in persuading advertisers to shift spending from traditional media such as television to online, let alone mobile. However, we expect the European mobile advertising market to grow by roughly 60% annually from 2007 until 2012.

Growth in both online and mobile advertising is driven by the more precise targeting options they can offer when compared to traditional channels and by the shift towards online and mobile media consumption:

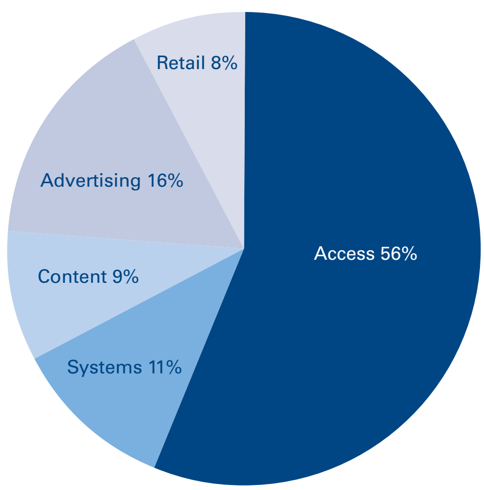
- **More precise targeting options than traditional channels:** Specific targeting methods allow advertisers to reach a certain age group, gender, region, user profile or even to deliver personalized advertising. Precise targeting yields higher revenue per eyeball and provides efficiency-measurement metrics across different channels, including online and mobile.

- **Shift towards online and mobile media consumption:** The reach and attractiveness of any communication channel for advertisers is driven by media consumption. Given the current high level of media consumption (recent figures show a media consumption of 420 minutes per person per day in Germany, for example), we expect total media consumption to stay roughly constant until 2012. However, the erosion of traditional channels including TV, radio and print media will continue and online and mobile usage is expected to capture a growing share of total consumption. (By 2012, this could reach 16% and 10% respectively in a German context.) Notably, online usage has already surpassed TV consumption in terms of minutes of use among the younger generation.

Implications of mobile advertising for mobile operators

The development of the mobile advertising market makes it interesting for all players involved – mobile operators in particular would like a piece of the cake. While historically, they hold a prime spot in the value chain, controlling the user interface and the customer relationship, this begins to look a bit different in the new world. In fact, on average, advertising currently accounts for less than 5% of overall revenue for mobile operators. Given that advertising in the wider TMT world (telecoms, media and technology) currently accounts for about 16% of the industry's EBITDA, the need to change this becomes obvious for mobile operators.

Figure 1: Telecom's EBITDA share in different revenue sources, Europe 2006



Source: Arthur D. Little, Exane BNP Paribas

However, mobile advertising is still at an embryonic stage and the positioning of mobile operators, online players, agencies etc. is rather fragmented, making it hard for any advertiser to launch a mobile advertising campaign. The main challenges exist because:

- none of the players seems able to serve as a single point of contact;
- standardized services and formats are still missing;
- players are not yet able to present inventories to advertisers in an accessible form and currently offer a weak user experience since formats are, by and large, limited to SMS and banner advertising, with mobile search only beginning to emerge as an opportunity.

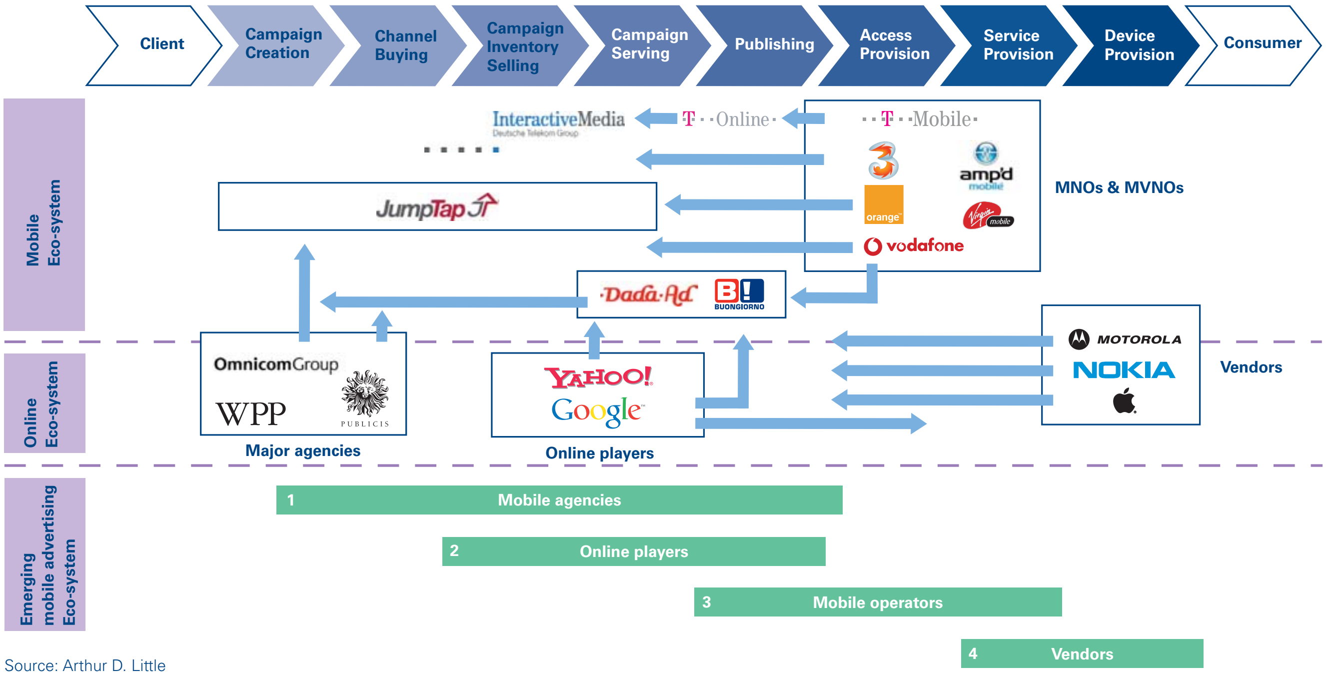
To overcome the challenges and to find the right position in the mobile advertising value chain the key stakeholders are currently pursuing different "land grab" strategies. Some are forming partnerships (Android) to get a bigger chunk of the revenue pie while others have acquired specialist companies (Nokia/Enpocket). The question as to who will be successful depends very much on who is best able to serve clients' (i.e. advertisers') needs. However, it is obvious that there are already some overlaps within the value chain. (Please see figure 2 on page 3).

As they seek the ideal position, mobile operators and online players will experience particular challenges:

- Mobile operators will have to fight to achieve monetization of advertising models against the well-recognized "online crowd-magnets", such as Google or Yahoo. For the mobile operators, the risk of being left out of this game is quite high if online players manage to push advertising services directly to customers. Additional threats come from device manufacturers who are starting to approach customers with their own offerings, hence grabbing the advertising audience by offering services directly to the users.
- For online players on the other hand, mobile advertising is still uncharted territory. Google, the most prominent player in the online advertising industry, has geared up to enable mobile advertising to run on mobile devices through its Android software platform. However, the outcome and penetration is still unclear, as leading manufacturers of mobile handsets may not choose to run the Android software.

What unifies all parties is the will to monetize their customer relationship/data through ad-based models. However, their inventories and business models are neither thoroughly designed nor proven to work on a broader scale.

Figure 2: Competitive moves of players in the mobile advertising value chain



Source: Arthur D. Little

The first mobile players are beginning to substitute paid mobile services with advertising-supported business models. One example is Blyk, a UK-based virtual operator that launched ad-based mobile services in August 2007. Building on communities and popular brands, Blyk caters to a youth segment and advertising is primarily based on messaging.

Handset manufacturers, previously not engaged in providing (software) services to end customers, are also entering the advertising playing field. Nokia's ovi platform is one example of new competition in the market. Although currently a pure service delivery platform it could soon become an advertising platform.

Strategic recommendations for mobile operators

Mobile operators should strive to maintain and extend their competitive position by developing practical responses to the different challenges posed by mobile advertising:

- **Leverage customer data in a win-win for customers and advertisers:** The greatest area of untapped value in mobile service provision is customer data. Mobile advertising can offer a combination of relevance and location, age and gender targeting that no other platform can match, and this could represent real value for advertisers. Consumers perceive a huge disparity in value between unwanted, negative contact experiences and positive, user-initiated relevant marketing. Mobile operators should take into account the fact that consumers tend to start with a positive disposition towards any service they have requested or to which they have "opted in".
- **Define mobile advertising/inventory:** Standard mobile advertising is still centred on SMS advertising and web banners. Additional formats are required in order to create greater value. Defining standard inventory categories will give advertisers and advertising agencies confidence in a manageable number of services from which they can expect measurable returns. The resulting transparency will be critical in overcoming the "marketing confidence gap" that will otherwise continue to limit the potential of mobile advertising.
- **Combine advertising platforms for the fixed and mobile space:** The ability to integrate mobile with other fixed (online) advertising channels will be crucial if significant marketing budget is to be dedicated to the mobile industry.
- **Build technical platforms for ad serving and inventory management:** This includes deciding whether to build in-house or to acquire or partner with players that own the required capabilities to deliver the adjacent elements of the advertising value chain. Key components in terms of revenue capture are ad selling, ad serving and publishing via a prominent portal site.

It is paramount to initiate or continue collecting insights from customer pilots and exploratory real-life test beds and to accustom users to new forms of advertising in different online channels. The technical expertise required to combine fixed and mobile channels – including back-end operations – needs to be built, enhanced and leveraged.

Outlook – the day after tomorrow

Mobile advertising has the potential to capture a substantial share of the total advertising market. It has many attributes that play directly to advertisers' requirements for ever-greater precision in the targeting of their advertising spend. However, operators cannot count on grabbing all this revenue themselves in the face of competition from media agencies, internet players and device manufacturers.

Mobile players that want to take a serious bite out of the advertising market need first to implement a strategy that gives them reach on a scale that matches or is at least visible when compared with the established internet portals. The same is true for online players and publishers with respect to the mobile sphere. In effect, the mobile industry needs to work co-operatively with the advertising industry to realize the opportunities presented by mobile advertising and ensure both parties achieve fair returns.

We believe that only a handful of global advertising platforms will emerge, such as Google or Microsoft. Microsoft's recent bid for Yahoo! is a prime example of the increasing concentration in the market. Operators will face a fierce fight to gain a place at the table and will probably need to partner with the global advertising platforms. Overall, the moves being made by the large players in this market show that the online advertising market is not a game for small or inexperienced companies.

Players striving to create a sustainable revenue source from mobile advertising must embrace both fixed and mobile advertising. We do not believe that mobile advertising will remain a stand-alone revenue source in the medium term. Advertisers will request multi- and cross-channel advertising campaigns, and with the continuing convergence of fixed and mobile services, online and mobile advertising are likely to become a single marketplace before long.

Arthur D. Little value added

Fast and analytically rigorous support in dealing with the challenges discussed in this Viewpoint and in initiating adequate action is available from Arthur D. Little.

Arthur D. Little has profound expertise in the field of telecoms strategy – providing market analysis, strategy development and evaluation. We support leading mobile and fixed operators in defining and reviewing their business models and strategy. Our deep understanding of the telecoms industry and of network technologies and their implications for innovation management, marketing and regulatory strategies is unrivalled.

Our experts have deep industry knowledge and offer thought leadership. Arthur D. Little is the leading consultancy in innovation.

Blyk

Blyk, a UK-based virtual operator recently announced that it has, on average, a response rate of 29% to its mobile advertising campaigns. On average, Blyk claims that this translates to a cost of 0.53 GBP per response. This should be significantly below the average of other mediums, such as online which claims to cost around 1.5 GBP per response at a response rate of 0.5%. Blyk's success is clearly based on its focus on defined target groups and its insights into user data and habits (which become even more precise over time as a result of the user's reactions to advertising) which make it possible to display relevant advertising to its users.

www.blyk.com

State of the art advertising formats

Online and mobile advertising is still dominated by search and display formats such as banner, pop-up and sponsored links. More action-driven or interactive formats in the pipeline are pending realisation – e.g., service call waiting or idle-screen ads. Push ads via SMS/MMS are another dimension, although reliant on opt-in by users and therefore problematic in some countries. Ad-funded voice, SMS or other communications also have high revenue potential, but operators still grapple with how to make them happen without cannibalising core service revenues. A plethora of other innovative ad formats such as ads in mobile TV, VoD, bill inserts, voicemail or games are not pushed forward primarily due to low revenue expectations. No player can currently offer a full range of formats in mobile and fixed media to their advertising clients – a real opportunity for full-service operators given advertiser needs.

In 2012, we expect online advertising to be dominated by search and display advertising (54% and 41% respectively), with other services achieving a 5% share. At the same time, mobile advertising will see a number of formats taking off strongly: ad-funded voice/SMS (36%), search ad (24%) and display ad (18%), plus significant revenues from idle screen ads (7%), service call waiting ads (6%) and push SMS/MMS (5%). All other formats will contribute the remaining 3%.

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