THE BUSINESS OF ADVERTISING

An Address by
Mr. Brian Monahan

My colleague, Phillip Adams, believes he has traced advertising back to the days of Pompeii. His research has shown that in those days, the prostitutes of Pompeii wore sandals with studs in the soles that spelt out a message in the sand that said “follow me”.

But whilst advertising has been a part of the world scene for thousands of years, the real boom started shortly after the end of the second world war. The total volume of advertising expenditure in Australia in 1950 was only $58 million whilst in 1984 it was $3 billion or nearly $200 per head of population.

Advertising is a vital and integral part of our free enterprise society. Whilst it has many critics (some of whom have legitimate complaints), there can be no denying it is an essential tool for the management of practically every business I can think of. Indeed, even in your own conservative businesses of banks, brokers and accountants, we now find our newspapers and magazines full of advertising for Price Waterhouse, Arthur Andersen, Arthur Young, McIntosh’s and Rothschild, to name a few. Even lawyers and doctors are soon to be allowed limited forms of advertising. The sandals of the girls of Pompeii have been replaced by the neon lights of the massage parlours in St. Kilda Road and 6 pages of advertising in this week’s Truth newspaper for Cheeky Chats, Caesar’s Retreat, Asian Fantasy, Black Velvet and Peninsula Poppets.

Advertising is a growth business and whilst it suffers, like most, economic downturns, it tends to out perform inflation and the general growth in G.D.P. even in recessionary times.

What do we mean by advertising?

A short definition is to “describe publicly, goods or services, with a view to increasing the sales of those goods or services”. Or, as my hero the late Bill Bernbach, put it — it is the gentle art of persuasion. Unfortunately, not so gentle in most cases.

Thus any outdoor sign, bus sign, television commercial, newspaper ad, skywriting or studs on the soles of somebody’s sandals is the business of advertising.

Most people at this luncheon are familiar with our major media companies. Companies such as News Limited, The Herald and Weekly Times, John Fairfax and Australian Consolidated Press. They are companies which sell advertising space or time to advertisers and the revenue they generate from the sale of that space or time tends to form the bulk of the income that those companies receive.

You have all watched with interest, the media takeover battles here and overseas. Recently we have seen Alan Bond’s purchase of QTQ-9 Brisbane, the Quintex purchase of TVQ-0 and Roslyndale’s purchase of Country TV Services Ltd., to name three examples and those companies attracted high multiples.

Obviously, those purchasers foresee substantial increases in advertising revenue occurring in these companies over the years. Although I am sure they see other benefits in owning a media organization, I make the point that they rely totally on advertising revenue for their existence.

A rough breakdown of advertising revenue to circulation revenue for the major newspaper groups in Australia is about 70/80 per cent advertising to about 20/30 per cent circulation. But with electronic media such as TV stations and radio stations, 100 per cent of their income is from advertising revenue.

Let’s now consider where this advertising revenue comes from.

It comes from companies who make and sell products and services and that includes just about every company I can think of. It’s not just the major manufacturing companies like Colgate Palmolive, Unilever, Philip Morris, BHP, Coca Cola, General Motors, Heinz and so on. But it extends to include companies selling such unlikely things from acne lotion to zinc oxide.
But let's look at some of the more traditional advertising companies and try to give you a feel for the significance those companies attach to advertising.

A list of the top 50 marketing companies in Australia showing the estimated ad budgets and the bottom line profit was published in B & T Weekly just before Christmas.

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<thead>
<tr>
<th>COMPANY</th>
<th>PROFIT</th>
<th>AD BUDGET</th>
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<tbody>
<tr>
<td>AMATIL</td>
<td>$47.92m</td>
<td>$30.0m</td>
</tr>
<tr>
<td>G.J. COLES</td>
<td>$107.60m</td>
<td>$40.0m</td>
</tr>
<tr>
<td>COLGATE-PALMOLIVE</td>
<td>$3.03m</td>
<td>$16.3m</td>
</tr>
<tr>
<td>FORD</td>
<td>$72.80m</td>
<td>$14.0m</td>
</tr>
<tr>
<td>RECKITT &amp; COLMAN</td>
<td>$17.70m</td>
<td>$17.5m</td>
</tr>
<tr>
<td>TELECOM</td>
<td>$309.00m</td>
<td>$11.0m</td>
</tr>
<tr>
<td>UNILEVER</td>
<td>$15.24m</td>
<td>$40.0m</td>
</tr>
<tr>
<td>WESTPAC</td>
<td>$222.20m</td>
<td>$11.0m</td>
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The wild fluctuations in advertising expenditure vis a vis their bottom line profit, can be seen and also how the advertising budget in most instances is a very significant percentage of the profitability of the company.

Put another way, in many cases, advertising is the greatest single item of overheads of these companies after salaries and raw materials.

It might be an over-simplification, but one could go so far as to say that without it, the majority of those companies would not survive.

To put the advertising business in Australia into context, at $3 billion the value of the business is nearly 1½ times the turnover of the oil and gas industry and twice the size of the iron ore industry.

However, I should make a point on the size of the turnover of the ad agencies.

Terry McCrann of The Age commented correctly when he wrote about our float. He said the advertising agency business is not a large as we would have you believe.

When we say that we are going to bill $130 million this year, that means that the total amount of money spent by our clients is $130 million. However, our gross income is roughly 18 to 20 per cent. Therefore it could be argued that the size of our business is around $25m, rather than $130 million.

Indeed, if an advertising agency’s income is compared to other service industries such as large firms of accountants or lawyers, then our income should be compared to their income, not our total billings to their income.

Nonetheless, we are entrusted with $130 million worth of expenditure, $130 million goes through our bank account and we are responsible for the payment of $130 million worth of bills to the media and production suppliers.

It might be anachronistic to describe our turnover like that but the ad agency business always likes to talk big. I guess we are simply exercising our artistic licence.

I hope these few comments might give you a better understanding of the size and importance of advertising.

So what is the role of the ad agency in all this? Our job is to create and produce ad campaigns for TV, radio, newspapers and all other media.

After we have been briefed by our client as to the advertising objectives for the particular product or service, we than set about the task of using our skills and expertise to produce commercials that are going to persuade the consumer to buy the product. The gestation period between the time we might first talk to a client about a product and the actual ad appearing on the television screen can in many instances be 2 to 3 years, particularly if we are talking new product development.

Even so, in the case of existing products, we are usually talking lead times of 3 to 6 months from the time we are briefed until the commercial goes to air. (The exception is our Retail Division, where very often ads are produced overnight.)

**MDA: EXPANSION - DOMESTIC AND INTERNATIONAL**

When we went public, the most commonly asked question was “why are we doing it?”

I would answer by giving about 4 or 5 reasons: The more often I did that, the more I realized there is one major reason and a number of important subsidiary reasons.

The major reason is this.

We are a growth orientated advertising agency and have grown substantially, as is shown in our prospectus, over the last 20 years. We want to continue to grow aggressively over the next 20 years and believe our growth opportunities in Australia, whilst they are substantial, are not going to fulfil our requirements in the long term. Therefore our real future for major expansion lies off-shore.
By going public, the company has become stronger financially and has certain financial resources that it did not previously have. With those additional resources, it is our intention to expand by means of acquisition and investments, both in Australia and internationally; that, in a nutshell, is the major reason why we went public.

We had a passion to stay Australian and we want to become the first truly Australian multi national advertising agency.

The other reasons of course are the more obvious reasons, but they are also very important.

By going public it has provided the opportunity to involve everyone on staff as shareholders in the agency. About 70 per cent of our staff are now shareholders.

We can develop share option schemes, yet to be worked out, for the key players of our team. This is most important not just to existing staff but it is something we can offer in recruiting executives.

I don’t think any other agency in Australia can put together such an attractive proposition, and, of course, it provides a vehicle for shareholders to capitalize their investment in due course.

Let me briefly discuss the situation with some of the publicly listed agencies in London and New York, and compare that to MDA.

Whereas Madison Avenue was once considered the home of advertising, London has now usurped that position. Creatively, and strategically, English agencies are streets ahead. At the bottom line they also tend to make a higher profit/billings ratio than their American counterparts.

US agencies return between half a per cent and one per cent after tax whilst UK agencies are likely to be double that figure.

Here is Australia MDA ranks No. 7 of all agencies in billings and No. 5 in profit/billings ratio.

However our figure of 1.28 per cent profit after tax is less than both George Pattersons and John Clemengers, at 2.05 per cent and 2.29 per cent respectively.

Why you may well ask? I suggest there are three reasons.

Firstly, in the profit figures we have shown to date, you must remember we were trading as a private company.

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<thead>
<tr>
<th>Agency</th>
<th>Net Profit $</th>
<th>Profit Billings Ratio %</th>
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<tbody>
<tr>
<td>George Patterson</td>
<td>4,099,417</td>
<td>2.05</td>
</tr>
<tr>
<td>Clemenger Australia</td>
<td>3,820,000</td>
<td>2.29</td>
</tr>
<tr>
<td>Ogilvy &amp; Mather</td>
<td>1,930,000</td>
<td>1.77</td>
</tr>
<tr>
<td>USP Needham</td>
<td>1,500,000</td>
<td>1.43</td>
</tr>
<tr>
<td>Monahan Dayman Adams</td>
<td>1,130,000</td>
<td>1.28</td>
</tr>
<tr>
<td>Foote Cone &amp; Belding</td>
<td>410,789</td>
<td>0.83</td>
</tr>
<tr>
<td>Young &amp; Rubicam Coudrey</td>
<td>392,283</td>
<td>1.41</td>
</tr>
<tr>
<td>SSC&amp;B:Lintas</td>
<td>389,535</td>
<td>0.87</td>
</tr>
<tr>
<td>McCann-Erickson</td>
<td>338,055</td>
<td>0.32</td>
</tr>
<tr>
<td>Doyle Dane Bernbach</td>
<td>98,873</td>
<td>0.41</td>
</tr>
<tr>
<td>D’arcy MacManus &amp; Masius</td>
<td>98,242</td>
<td>0.81</td>
</tr>
<tr>
<td>J. Walter Thompson</td>
<td>48,354</td>
<td>0.07</td>
</tr>
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Secondly, over recent years, the company has made very substantial dollar investments into its EDP system and the cost effective benefits of that investment will start to accrue to the agency over the next few years. The investment in that technology, I believe, has given us a major advantage over our competitors, but we are not seeing the financial benefits just yet.

Thirdly, there has been an active expansion programme over the last few years. We have invested in new divisions and offices, both in Australia and overseas. Many of those divisions and offices are only now starting to contribute to our profit. I would be confident over the next few years that all divisions and offices will contribute the required level of profitability or they will be closed down.

Also I am not sure on what basis Pattersons and Clemengers have determined their billings. Unless all billings figures submitted use the same criteria then we may not be comparing apples with apples.

So whilst I have to be careful what I say in terms of our future profit growth for fear of misleading you, I am quite confident in saying that our profit as a percentage of billings, will increase over this year’s figure.

**INTERNATIONAL EXPANSION:**

I mentioned earlier that the main reason for going public was to help our expansion plans, both domestically and overseas.

At the moment MDA have offices in every capital city in Australia, except Adelaide where we work through an affiliate. There are offices in Singapore, Hong Kong, Wellington and Auckland.
We are currently exploring other markets in south east Asia although whilst the markets represent growth opportunities, the actual size of the advertising market in some areas is not great. The ad billings for instance, of the total Singapore market is about the same as the total billings of the MDA Group, that is $130m.

So we can’t get too carried away about huge profit earning potentials in south east Asia.

Nonetheless, it is an area that is vital to us. Most of our major clients are of course well represented in those areas. They require the services of an advertising agency and most of the major multi national agencies have offices throughout the areas mentioned.

We believe that south east Asia is an important regional area and the possibility of extending into Japan will be closely examined over the next year or so.

Beyond that it is our intention to explore opportunities for expansion in the United Kingdom and the east and west coasts of America. I am sure the question in your minds is “How are we going to achieve entry into those markets?”

MDA has a very firm policy that it will never again start an office from scratch and believes that to send a key executive from the home office, possibly with an account or two tucked under his belt, is the wrong way to go about it. The right way, is to identify the market, then to identify the best agencies within that market and then to take an equity position.

There are a number of exciting projects on the drawing board and we will be actively pursuing opportunities in London and New York. Several discussions are already in hand and those discussions will be progressed throughout the year. The agency is committed to growth and it will remain so.

I mentioned earlier our attitude towards growth. As is the case with most businesses; unless you grow, you go backwards.

MDA has always been aggressive in the new business area and our growth rate of 30 per cent per annum compared to other agencies is testimony to our success in that area. There is no magic formula to getting new business. However, some agencies do it better than others.

We have learnt a lot of does and dont’s over the years and have an on-going and active new business programme. We have an extraordinarily good kill rate and also have been fortunate enough to retain most of our major accounts on a long term basis. We do not have a situation of an account coming in the front door and others going out the back door. We wholeheartedly subscribe to the theory that our first obligation is to look after our existing clients; if we do that successfully, we will succeed.

I would expect that over the next few years, MDA’s growth will come roughly a third from existing clients, a third from new clients and a third from acquisition. Whilst in the past we have been involved in some modest acquisitions with smaller agencies, we have not really been in a position to acquire a sizeable agency.

Given we will be embarking on an aggressive acquisition campaign, we would hope to see some results for that over the next few years.

In our domestic market, we now have an excellent blue chip list of clients. We are represented in many major advertising categories, but there is still room for growth in a number of areas where we are not well represented. These areas have been identified quite clearly and they will be the subject of fairly aggressive activity from us over the next few years.

How successful MDA will be with new business gains and agency acquisitions, is not known, but we are confident the increases in billings we have shown over the last decade should continue in the next decade. Parallel with that, we are confident our bottom line profit will be in the upper quartile of agencies and one which will compare favourably with industry averages.

Before I conclude, I would like to remind you of one more commercial. It’s a Qantas commercial and the words say “who was it that started out so small, who started with a dream, that’s all. It was you, an Australian like you.”

Apart from being one of my favourite commercials, we have considerable empathy with the message. We too started out small, so small in fact we had no accounts. We too had a dream and that’s all we had, because we had no money and we too are Australian.

And now like Qantas we are about to spread our wings.