Co-op Advertising:

Digital's Lost Opportunity?

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Introduction

Digital advertising revenues hit a historic high in 2011, a record $31 billion, according to the most recent IAB/PwC study. Notably, retail advertisers account for more than a fifth of this spending, having invested $7.1 billion in Internet advertising last year.

While optimism is more than warranted when year-over-year Internet advertising growth continues to smash records and achieve double-digit growth, there's a sector of this economy that's underdeveloped, overlooked, and generally outright ignored: co-op advertising.

Co-op advertising may not be the most innovative, creative, or cutting-edge sector of the market. It gets little notice either from Madison Avenue or Silicon Valley. This ignored terrain is vast—bigger, even, than Internet advertising itself.

It's extremely difficult to quantify the value of co-op advertising in this country. Estimates for annual spend in the United States range from $50 billion to a staggering $520 billion *worldwide* per year (*sources: Co-op Advertising Programs Sourcebook, NRP and Trade Promotion Management Associates,* respectively). To put those admittedly disparate numbers into perspective, GroupM estimates that this year, U.S. ad spending will reach $153 billion. It must therefore be noted that co-op advertising estimates take into account in-store elements such as display and merchandising. While it's all but impossible to break media out of these estimates, it's not difficult to see that that manufacturers' investment in co-op advertising is nowhere near insignificant.

Yet only a negligible portion of that spend flows into digital media channels—by one estimation, "significantly less than one percent," a discrepancy that must be addressed not only online by the digital advertising ecosystem, but also by the manufacturers behind co-op advertising programs and the retailers and e-tailers who stand to benefit from these programs.

Co-op Advertising, Defined

Dates back to the 19th Century

Co-op advertising refers to an agreement between a manufacturer and a retailer to share advertising costs, while at the same time create brand name awareness.

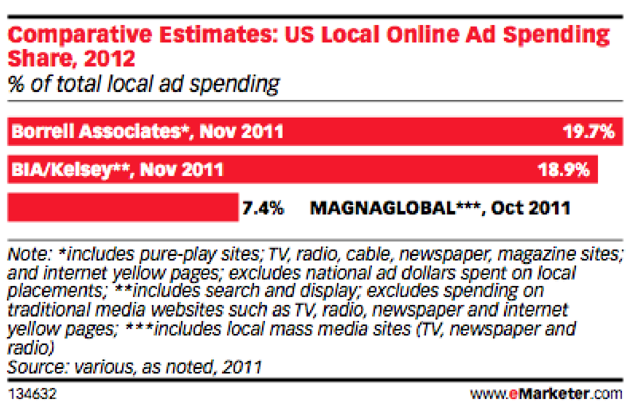
Policies differ from manufacturer to manufacturer. Most pay a portion of media costs and supply the retailer with creative elements to use in the ad. Sometimes, they furnish the ad itself.

> Typically, manufacturers underwrite from 30 to 50 percent of retailer advertising costs, though contributions from 75 up to 100 percent aren't uncommon.

Co-op advertising benefits numerous parties. Manufacturers get increased exposure at a lower cost. Retailers of all sizes benefit from brand name product associations, with many smaller retailers who might not otherwise be able to advertise affording to do so thanks to co-op dollars. Agencies and media companies can increase billings, while media companies can more easily fill ad inventory.

Even in the traditional areas of print and broadcast, however, co-op advertising is often little understood and frequently under-leveraged. Smaller retailers can be unaware co-op dollars exist, while publishers and agencies may also overlook the sector.

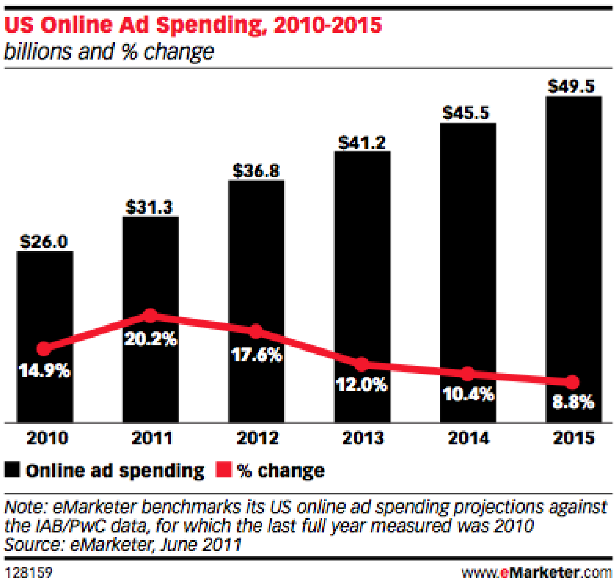
The Missed Digital Opportunity



Co-op may be one of the less visible forms of traditional advertising, yet it's a juggernaut. With a conservative estimate of $50 billion in annual U.S. revenues, it both dwarfs Internet advertising and at the same time, practically ignores it. Fewer than 33 percent of manufacturers take Internet advertising into account in their co-op advertising policies (*source: Advertising Checking Bureau (ACB) "Online Co-op Advertising Study," Sept. 2011*). Of the 1000+ co-op advertising programs, representing over 1700 brands, maintained in a Local Search Association database, only 223 allow some form of Internet advertising in their policies, while 35 manufacturers expressly *forbid* using co-op dollars in online advertising channels.

> Yamaha Co-op Policy Excerpt: "No - Internet Advertising and/or website setup fees and costs are not eligible for co-op except for the official Yamaha/Boattrader.com program."

Those programs that do permit Internet advertising tend to be extremely limited in scope, permitting only display and paid search advertising as a general rule. It's the exception rather than the rule to permit advertising in channels such as email, social media, online coupons, or mobile channels, although all are pillars of local online advertising, and local is the bread-and-butter of co-op advertising.



Bob Houk, executive director of the Trade Promotion Management Associates (TPMA), estimates that "much less than one percent" of co-op ad dollars flow into online channels.

The Growth of Local Online Advertising

The traditional goal of co-op advertising programs is to drive consumers to local merchants to buy manufacturers' products. As audiences for local print and broadcast media decline, local continues to be one of the hottest sectors for growth in digital channels. GroupM's annual global advertising forecast predicts local advertising will be the single most robust sector in the U.S. ad market in 2012.

BIA/Kelsey's U.S. Local Media Forecast (2011-2016) predicts strong growth in the digital segment of local advertising through 2016. The firm forecasts that local online/interactive/digital advertising revenues (including mobile) will climb from $21.2 billion in 2011 to $38.5 billion by 2016, a compound annual growth rate (CAGR) of 12.7 percent.

Comparative Estimates: US Local Online Ad Spending Growth, 2011-2014
% change

	2011	2012	2013	2014
BIA/Kelsey*, Nov 2011	16.5%	13.3%	13.3%	13.0%
Borrell Associates**, Nov 2011	15.9%	18.0%	17.1%	14.2%
MAGNAGLOBAL***, Oct 2011	11.1%	8.5%	8.1%	8.1%

*Note: *includes search and display; excludes spending on traditional media websites such as TV, radio, newspaper and internet yellow pages; **includes pure-play sites; TV, radio, cable, newspaper, magazine sites; and internet yellow pages; excludes national ad dollars spent on local placements; ***includes local mass media sites (TV, newspaper and radio)*
Source: various, as noted, 2011

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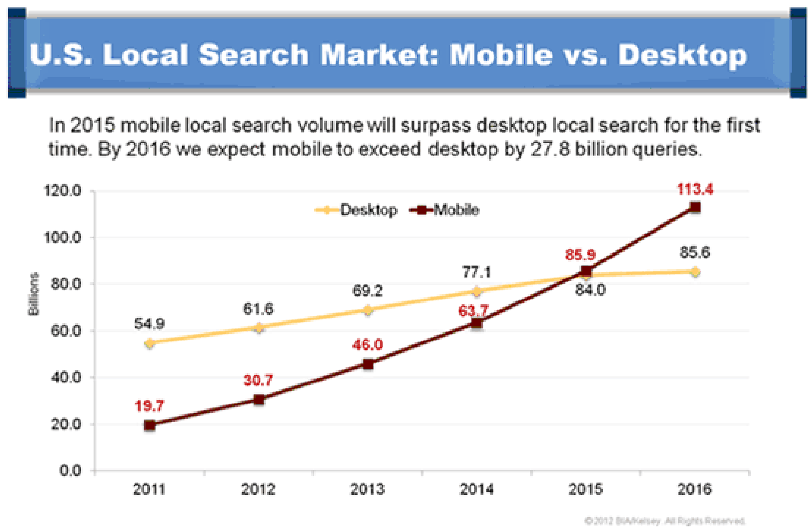
Search and Coupons

BIA/Kelsey's outlook for local search is equally rosy, and mobile local search queries are rising with ad revenues following suit:

- Desktop local search revenues will grow from $5.7 billion to $10.2 billion (CAGR: 12.1 percent).
- BIA/Kelsey forecasts mobile local search revenues to grow from $400 million in 2011 to $3.2 billion in 2016 (CAGR: 160.4 percent).



Establishing a local search presence gives national advertisers a competitive advantage. MarketingSherpa found that 41 percent of U.S. marketers said having a local search presence was important, if not critical, for achieving search marketing objectives. Google's Vice President of Location and Local Services Marissa Mayer announced at the May 2011 TechCrunch Disrupt Conference that 20 percent of all Google searches were local. On mobile devices, that number doubled to 40 percent.

Coupons are a relatively minor part of co-op advertising, and print circulars are in decline. Meanwhile, daily deals and group-buying sites are surging in popularity:

US Group Buying Metrics, 2011-2015

	2011	2012	2013	2014	2015
Users (millions)	53	83	98	106	114
Average purchases per year	1.75	2.00	2.50	3.00	3.50
Average deal value purchased	$35	$35	$35	$35	$35
Average percentage fee of deal price	50%	50%	50%	50%	50%
Revenue (billions)	$1.61	$2.90	$4.30	$5.58	$7.00

Source: William Blair & Company, "The Future in Digital Media," May 16, 2011

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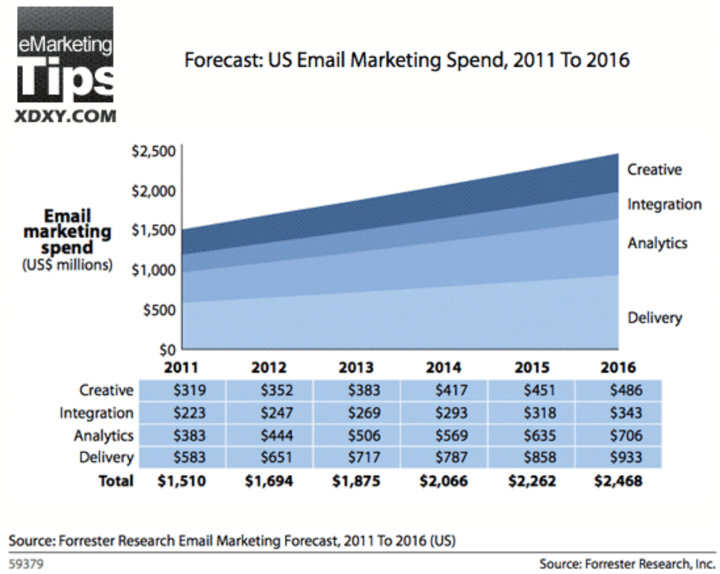
- By August 2011, online survey provider Zoomerang found more than half (51%) of U.S. Internet users had used a daily deals site.
- In May 2011, William Blair and Company estimated the number of consumers using group-buying sites like Groupon and other daily deals sites will reach $53 million this year. By 2015, that number is expected to more than double to $114 million.

Estimates of the value of this burgeoning market, whose players include companies such as Groupon, Living Social, Google Offers, and Amazon Local, range from $1.61 billion (*William Blair and Company*) to $2.67 billion (*Local Offer Network*). According to comScore and the Local Search Association, Groupon had 11.5 million unique monthly U.S. visitors in March 2011, while LivingSocial had 7.1 million.



Email is another channel that helps to drive not only local retail, but also ecommerce. It's particularly attractive to retailers as a low-CPM channel. U.S. email marketing spend for 2011 will be around $1,510 million, and will grow to $2,468 million in 2016, according to Forrester Research's *Email Marketing Forecast, 2011 to 2016 (US)*.

Quantifying the Potential Value of Digital Co-Op Advertising

It's virtually impossible to quantify the amount of co-op advertising dollars available in online channels, but it is safe to say it currently hovers at more than $1 billion. A recent study by Borrell Associates (*Online Co-Op Advertising, May 2012*) estimates the online co-op market currently has $1.7 billion available, but guesses $450 million is left on the table "for lack of participation." Couple this with the majority of co-op programs that preclude allocating spend to digital channels, and the potential value of this market could very quickly exceed $5 to $10 billion per year.

Who would benefit from online co-op advertising?

The entire online advertising ecosystem stands to benefit from billions of co-op dollars flowing into online channels. Obvious beneficiaries include:

- **Technology vendors**: Email marketing, ad serving, targeting, retargeting, SEM services
- **Agencies**: Creative, media
- **Publishers and media:** Newspaper sites, local sites, directories (e.g. Yellow Pages), social and local networks (e.g. Facebook, Foursquare)

- **Online coupon/Daily deal providers**: Groupon, LivingSocial, Gilt, etc.
- **Search**: Search engines and search marketing providers (see vendors above)
- **Mobile**: Display, Social-Local-Mobile (SoLoMo), search, etc.

Additionally, the core co-op advertising players—manufacturers, retailers and, now, their e-tailer brethren—stand to gain from increased branding and advertising in the digital channels in which their target consumers spend increasing amounts of time.

Stumbling Blocks

Changing consumer media and buying habits, combined with a rapidly maturing digital sector with a panoply of channels, products, and services that can be seamlessly applied to existing co-op advertising models, would seem to make shifting a significant portion of co-op dollars to digital a logical step. Yet, two-thirds of co-op programs don't accommodate interactive. In fact, a very substantial portion of co-op advertising programs outright prohibit all Internet advertising.

Key questions to answer:

- What are manufacturers' objections to expanding co-op advertising programs into digital channels?
- Where are the disconnects?
- What are the barriers to those few programs that permit paid search and display advertising from moving into channels such as email and social media?

Barriers to the adoption of co-op advertising in digital channels fall into two categories: those that are perceived, and those that are real.

The Perceived Barriers to Online Co-Op Advertising

Resistance to change. Change is as formidable a barrier to co-op advertising adoption on both the manufacturer and merchant sides, and a particularly stubborn obstacle in this sector. Speak with professionals in the industry, and, again and again, you'll hear phrases such as, "we just aren't there yet," "the way we've always done it," or a very blunt, "co-op advertising hasn't historically been the home of very creative people."

According to industry insiders, retailers and manufacturers alike cling to the old ways of doing things, even in the face of compelling reasons to adopt new skills, channels, or technology.

Candice Geers, the Boston Globe's co-op advertising manager who began her career in television, draws a corollary with the early days of cable TV.

“It’s history repeating itself,” she says. “While co-op programs were allowing money for broadcast TV, they would not allow it for cable. Co-op departments were very reticent to change. Because we were still talking about television, ‘cable’ television was not an accepted medium. Fifteen years later, *every* manufacturer who is providing co-op for TV is providing it for cable too.”

> *“Twenty years ago, I was running into, ‘they didn’t know how to do radio,’ from retailers. [It was] too bad if research proved radio ads were more effective for that product category. They’d done newspaper for 40 years, and that was what they were going to keep doing.”* –Bob Houk, of retailers

Campaign pre-approval requirements. According to an ACB benchmarking study, 40 percent of co-op advertising programs require retailers to receive manufacturer pre-approval for online ad campaigns, an “extra step” that can be a barrier to time- and resource-strapped businesses. It should be noted this poses a barrier in traditional campaigns as well. Many industry experts assert that up to half of all available co-op funds are left on the table annually due to this burden. However, in traditional media, many larger publishers, broadcasters, outdoor media providers and service providers assume the pre-approval burden on behalf of their retailer clients.

Attribution and verification. Virtually every co-op program requires merchants to submit certified proof that each campaign was actually executed. While a small handful of manufacturers now accept screenshots, online lacks a broadly accepted system of “verifiable, third-party proof of performance” for click-through, impressions, and other online metrics, many of which are unfamiliar terms to merchants and retailers alike.

> The most common documentation requirements for dealer-paid search (according to ACB and LSA) are:
> - Co-op Advertising Claim form
> - Prior Approval form
> - Screenshot of banner ad or PPC ad
> - Website URL or keyword listing
> - Invoice: costs, run dates, click-throughs and number of impressions

As with the issue of pre-approval, print, outdoor and broadcast media have long had processes in place to take this burden off of retailers by submitting tear sheets or certification of broadcast spots directly to manufacturers. It’s ironic that while online is touted as the most measurable and accountable form of advertising in history, this remains a stumbling block.

Innovation and creativity. Manufacturers are often accused of not striving to find online corollaries for many offline co-op advertising products. Rather, according to one industry veteran, co-op is an “administrative function.” Dealer listing ads are one example. In print, an appliance manufacturer might run an ad in a local paper that lists the local retailers who carry that brand. This type of ad unit could, for example, be targeted by IP address in an online environment, yet no online version of this type of offline advertising yet exists.

E-tail. Because co-op is inherently a local form of advertising, manufacturers remain unable to address challenges inherent in supporting e-tailer programs that, by nature, are not circumscribed by regional geography.

The Real Barriers to Online Co-Op Advertising

Complexity and multiplicity of digital channels. Unsurprisingly, on both the manufacturer and merchant sides, the sheer amount of knowledge required to advertise in digital channels is a formidable barrier.

Lack of infrastructure in co-op advertising industry. On the manufacturer side, co-op advertising sometimes falls under the auspices of marketing, but more frequently is a function of either the sales or the finance department, areas inherently unlikely to be versed in digital marketing strategies or tactics.

Lack of Guidelines & Requirements. Co-op advertising program rules around issues such as logo usage, the mention of competitive products, and general branding requirements have long been established in traditional advertising channels. Internet advertising brings with it new challenges, e.g. manufacturer rules around bidding on brand or trademarked terms in search engine marketing. ("We're driving each other's bidding up," says HP's Senior Manager of Search Engine & Mobile Marketing Florence Su, "HP's perspective [is] we don't think co-op is that positive if we're all going after the same term.") When such issues aren't addressed, nor guidelines established, it becomes difficult to impossible to create online co-op advertising programs.

Encouraging More Co-op Spend in the Online Advertising Ecosystem

Online advertising can, and almost inevitably ultimately will, benefit from an infusion of millions of co-op dollars into the ecosystem. Because potential revenues are as high as the barriers to entry, it's necessary to undertake a variety of measures to address the many obstacles preventing co-op ad spending in digital.

Recommendations

Awareness: Just as manufacturers and retailers are unaware of the potential benefits of online advertising, not to mention the actual tactics and techniques for executing digital campaigns, so too is the digital ecosystem largely blind to the potential and the workings of co-op advertising. Creating awareness among all constituencies is an obvious first step toward addressing this imbalance.

Education: Once the digital advertising ecosystem is aware of co-op's untapped revenues, the motivation to self-educate will be strong. It will be a greater challenge to teach manufacturers and retailers about online. Channels, metrics, targeting, and the like are close to a foreign language for, say, a mom 'n' pop retailer unversed in SEM.

Standards and best practices: Small, online co-op advertising does exist, particularly in automotive and durable goods. Closer examination of how successful programs in these verticals function can lead to case studies and ultimately help create templates on which broader co-op programs in different industries can be based.

Technology: Development of platforms that enable workflow automation would go far to make the co-op advertising process easier for manufacturers and the often over-burdened merchants who run co-op campaigns. Desirable features include: mechanisms to facilitate the creative approval, verification, metrics, and communications between retailer and manufacturer. Also useful would be a database of co-op programs and digital asset management for logos, creative executions, and brand elements, which are offered by a few service providers today.

Publisher initiatives: According to the Boston Globe's Candice Geers, publishers are eliminating co-op ad specialists on the print side as traditional ad revenues shrink. It may be time to consider re-establishing the co-op ad manager role, this time with a view toward online display advertising. The previously cited Borrell study recommends "a consultative sales approach that probes into each advertisers' co-op program."

Cooperation with co-op ad management companies: Many legacy co-op program management companies have expanded into the digital, yet are unconnected with mainstream publishers and industry trade groups. The online ad industry would benefit and learn from association with organizations such as Owner IQ, Ansira, ACB Coop, MultiAd, Balihoo.com, IAB, LSA and the TPMA.