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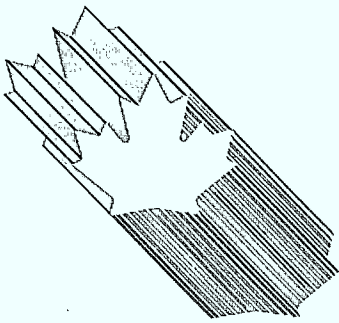


Industry, Science and
Technology Canada

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Advertising Services

Canada



INDUSTRY PROFILE

ADVERTISING

DEPARTMENT OF REGIONAL
INDUSTRIAL EXPANSION
SERVICES
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1988

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FOREWORD

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In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

Minister

1. Structure and Performance

Structure

Advertising is a means of communication. Its function is to market the products and services of producers to potential buyers in an effective and persuasive manner. The seller determines which product or service is to be advertised. The media (electronic, print, outdoor or other) carry the message about the product or service to the attention of potential buyers. The link between the seller and the media is the advertising services industry.

The industry can be divided into four sub-sectors: *advertising agencies*, which are primarily engaged in creating and placing advertising with the media; *media representatives*, which sell time and space for various media; *outdoor display and billboard advertising companies*, which rent space on signs, displays and billboards; and *other advertising services*, which include firms providing such services as commercial art, copy writing, direct mail advertising and research. Not included as part of the industry, but often required in the production of advertising, are the services of photographers, commercial production studios, photo-engravers, printers, models and others.

One measure of the size of the advertising market is the total amount of media advertising revenue*, which was \$7.7 billion in 1987. Newspaper advertising accounts for 31 percent of this total; radio and television for 25 percent; catalogues and direct mail, 23 percent; periodicals, 13 percent; and outdoor and miscellaneous advertising for the remaining eight percent.

Local advertising represents about one-half of all media advertising, which, as mentioned above, was \$7.7 billion in 1987. This advertising is usually placed directly by the advertiser with the assistance of media sales departments. The local advertising of national retail and franchise chains is often handled by agencies.

National advertising, which accounts for the bulk of the industry's revenues, is initiated by large businesses such as automobile manufacturers or soft drink companies which market their products and services nation-wide. It is aimed at creating product awareness and serves to prepare the market for the sales efforts of local retailers. Television is the primary, but by no means exclusive, medium for national advertising. While the leading national advertisers are generally large companies, government accounts, particularly in Canada, are very significant.

National advertising is co-ordinated by agencies which create the message, develop media plans and ensure the proper production and placement of the advertising. Their income is derived primarily from a 15-percent commission rebated by the media on space and time sold, or from a fee negotiated with the advertiser. An additional source of revenue to the agency comes from the sale of special services such as market surveys and counselling services.

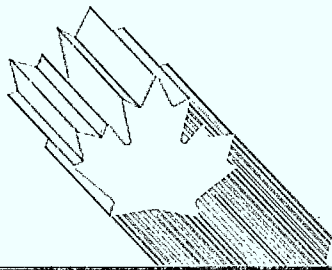
* There is no comprehensive source of statistical information about the advertising services industry. Much of the data presented is estimated.

Canada



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In 1987, there were some 3500 firms engaged in providing advertising services in Canada, employing approximately 23 000 persons. Of these firms, 625 were advertising agencies, employing about 6000 persons. These agencies co-ordinated media billings (i.e., revenues) in the order of \$3.5 billion, and earned commissions and fees on these billings of \$480 million. As advertising agencies are the dominant component of the industry, the remainder of the profile will concentrate on this sub-sector.

Agencies operate out of all major cities in Canada, but by far the largest number are located in Toronto, where the head offices of most larger agencies are found. About 65 percent of sub-sector revenues are concentrated in Ontario and 22 percent in Quebec.

The top 12 agencies in Canada had gross billings in 1987 of almost \$1.7 billion, or about 48 percent of total sub-sector billings. The agency with the largest single share of the market had billings of approximately \$180 million, or 5.1 percent of the industry total. It is estimated that the top 25 agencies were responsible for more than two-thirds of overall billings. More than half of these agencies are foreign-owned (mostly American).

Large firms which advertise internationally usually deal with multinational agencies. As a result, there is a tendency for Canadian subsidiaries of foreign advertising agencies to serve a high proportion of large foreign-owned clients, as these clients are served in their home country by the parent agency. Widely known as the "common account" phenomenon, this practice has featured in the expansion of U.S. advertising agencies worldwide.

Trade in agency services is relatively limited. In 1984, Canada imported \$64 million worth of services, of which \$23 million were by U.S.-owned subsidiaries. Exports amounted to \$46 million, or 1.5 percent of the sub-sector's estimated gross income of \$2.9 billion in that year.

Advertising revenues in Canada represent approximately 1.4 percent of the gross domestic product (GDP) as compared to 2.1 percent of GDP in the United States. The Maclean Hunter Research Bureau estimated per capita advertising expenditures in Canada to be \$305 in 1987, compared to \$560 in the United States.

The major customers of advertising agencies are large multinationals such as automotive manufacturers, breweries, food processing firms, oil companies and tobacco manufacturers. In 1986, the 15 largest advertisers together spent \$427 million, or six percent of gross advertising revenues for that year. The largest single advertiser in Canada is the federal government, which has spent between \$65 million and \$75 million a year on advertising over the last few years. Close to \$22 million of this goes to promote tourism, while the remainder serves to inform Canadians of the initiatives and programs of government departments, such as calls for tenders by Supply and Services Canada. Together, all governments and Crown corporations account for some three percent of the overall advertising market.

Companies with very large advertising budgets do not generally concentrate all of their business in one agency. They often engage the services of several agencies, with each being responsible for one product or product group.

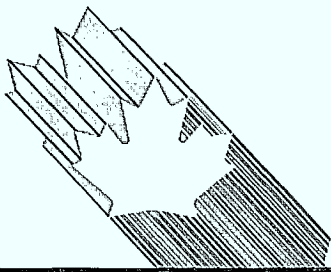
Performance

The performance of the advertising services industry closely reflects the general economic situation. In a buoyant economy, companies increase their advertising budgets and hence the revenues of the industry also increase. The opposite is true in periods of slow economic growth. Over the decade ending in 1981, growth of the advertising industry, measured in terms of gross advertising expenditures in the media, increased at an average annual rate of 14.1 percent. Since 1981, the increase has slowed to about 8.7 percent per year, reflecting, to some extent, the effects of the 1981-82 recession.

Gross advertising expenditures (gross revenues to the media) were \$7.7 billion in 1987, an increase of 6.9 percent from the 1986 level of \$7.2 billion. In 1986, revenues increased 9.5 percent over 1985 levels of \$6.6 billion.

The advertising expenditures co-ordinated by the agencies (their media billings) amounted to about \$3.5 billion in 1987, and the agencies received a gross income in the area of \$480 million. This represents an increase of 6.9 percent over the 1986 income of \$449 million. Between 1985 and 1986, income grew 9.5 percent.

In addition to the slower growth of revenues, the profit margins of agencies have also been declining worldwide, as costs have increased. In Canada, profit margins fell to 1.5 percent in 1985, from about three percent of billings in the early 1980s. In response to slower growth and reduced profits, agencies began to rationalize through mergers and acquisitions designed to reduce costs.



The numerous mergers and acquisitions worldwide have resulted in major changes in the ownership structure of the industry. In Canada, there has been a significant increase in the foreign ownership of advertising agencies. The underlying reasons giving rise to these changes — decreasing profit margins and global marketing account realignment — remain. In mid-1988, two of the largest Canadian-owned agencies announced plans to merge with U.S.-owned agencies. Once these mergers are completed, 11 of the top 15 agencies in Canada will be foreign owned, compared to three of the top 15 agencies in 1960.

2. Strengths and Weaknesses

Structural Factors

Creativity, research and the placement of client's ads in the appropriate media are among the major determinants of agency success in the advertising industry. Measured against these criteria, the industry in Canada ranks on a par with the industry worldwide. However, it has undergone a number of changes in recent years, particularly as a result of account realignments, which have affected the nature and growth prospects of the larger Canadian-owned agencies, as compared with the branch offices of foreign-owned enterprises. Agencies have consolidated their resources, cut back on staff and operated with reduced profit margins. A number of smaller and medium-sized companies have merged, while many Canadian agencies either have been bought out by international competitors, or have disappeared.

Larger advertisers, particularly those who are export-oriented or who must compete with international firms in the home market, are increasingly placing their accounts with the larger, foreign-owned agencies, since they can offer their clients worldwide advertising experience and a full range of services such as marketing, public relations, media planning and the effective production and placement of advertising. Even the largest Canadian-owned agencies tend to be strictly domestically oriented and, consequently, are at a disadvantage in attracting internationally oriented advertisers as clients. Domestic advertising agencies have difficulty in obtaining the accounts of foreign-controlled subsidiaries operating in Canada because of their domestic market orientation and since many subsidiaries use the services of the same agency serving their parents. With some notable exceptions, Canadian firms generally handle smaller accounts.

Competition between Canadian-owned and foreign-owned firms in Canada also extends to personnel. Some multinational agencies can offer better salaries, working conditions and training, plus the possibility of overseas postings, to lure skilled employees. Canadian firms, however, have managed to meet this competition, and are able to offer creative talent and other services which meet industry standards.

Trade-related Factors

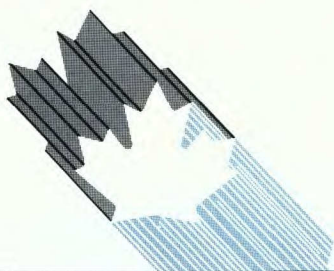
International trade in advertising, in the traditional sense of trade in goods, is limited. The nature of the industry requires an ongoing interaction between an agency, its clients and the local media; therefore, it must have a local presence. While there are exceptions, successful advertising messages tend to be location-specific, tailored to the linguistic and cultural environment at which they are directed. Consequently, the relevant trade issues in advertising are those related to investment and to the right of establishment.

The foreign-owned, in particular U.S.-owned, advertising agencies have operated successfully in Canada for several decades; conversely, Canadian agencies have had limited success in penetrating the U.S. market. Lack of knowledge of the local market, insufficient media and client contact, inadequate financial resources and an inability to attract top local personnel are the primary reasons for this lack of success.

Within the context of the Canada-U.S. market, the advertising industry essentially operates in a free-trade environment, except for certain government procurement practices and a number of other less severe irritants relating to regulation and immigration policies. Both countries have stringent regulations regarding the ability to obtain temporary work permits in the other country. Since the activity of Canadian agencies in the United States is limited, the most frequent difficulties are cited by U.S. employees attempting to enter Canada. However, Canadian workers applying for admittance to the United States also have experienced difficulties. Under the Canada-U.S. Free Trade Agreement (FTA), temporary access by foreign workers will be facilitated. As well, although Canadian and U.S. agencies do not now face any restrictions in establishing subsidiaries or in investing in agencies in the other country, these rights will be secured for the future by the FTA.

Technological Factors

Technological development in the advertising agency sub-sector is largely associated with the adoption of computer technologies in the areas of consumer monitoring, market segmentation and consumer targeting. In general, agencies in Canada have kept pace with technological changes in the industry, although Canadian-owned firms have lagged behind the larger, foreign-owned agencies in the adoption of some of these new technologies, as they tend to be developed and tested first by multinational firms in other countries.



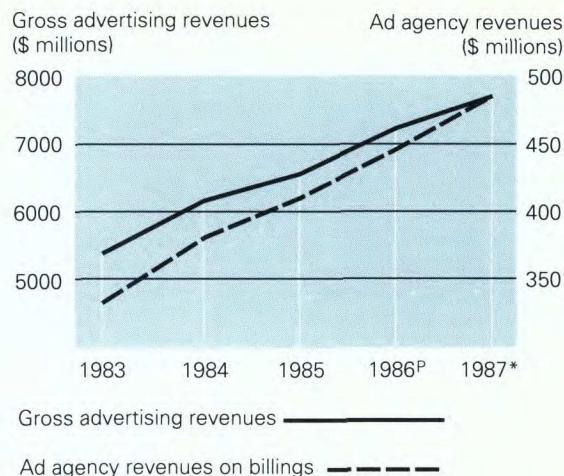
Other Factors

Advertising services in Canada are regulated by governments and the industry itself. Over the years, and particularly with the advent of the consumer movement in the 1960s, governments have established a series of checks and balances to prevent advertising from carrying messages which are factually incorrect, misleading or deceptive. There are also a number of federal and provincial regulations directed to specific audiences or product groupings, in particular relating to food and drug products and to children's advertising. Federally, the Canadian Radio-television and Telecommunications Commission (CRTC) and the Department of Consumer and Corporate Affairs are involved in the regulation of advertising.

In addition, the advertising industry in Canada, as in most countries, has devised a fairly sophisticated system of self-regulation. *The Canadian Code of Advertising Standards*, revised in 1982, is the basis for this self-regulation. The code is complementary to other standards, as well as to federal and provincial legislation affecting advertising. These regulations are regarded by the industry as straightforward and a necessary part of doing business.

Regulatory requirements concerning the content and style of advertisements in both Canada and the United States are basically similar. Procedures for approval of an advertising campaign are, however, somewhat more complex and time-consuming in Canada, due to the larger number of federal and provincial regulatory bodies. It should be noted that the regulatory environments in both Canada and the United States are considerably more open than in many other countries, where market access is rigidly controlled and a high level of domestic content in advertising is required. For example, all advertising shown on Brazilian television must have been produced locally.

In 1976, the Canadian government amended the *Income Tax Act* to prevent a company operating in Canada from deducting, as a business expense, the costs of advertising directed at Canadian audiences, but run in non-Canadian media. The effect of this legislation has been to reduce sharply the flow of Canadian advertising revenues to U.S. media, particularly to U.S. border TV stations and magazines. In response to this action, the U.S. Congress passed similar legislation in 1984. Advertising agencies in both countries indicate, however, that these regulations do not affect the overall size of their billings to any significant extent. These regulations are to be eliminated in both countries, as a result of the Canada-U.S. Free Trade Agreement.



Gross advertising revenues and ad agency revenues

* Estimate

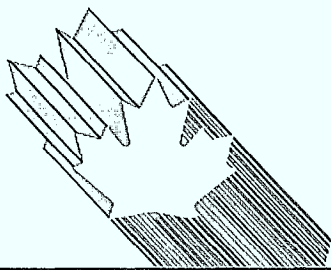
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3. Evolving Environment

The industry in Canada is concerned with what appears to be an ongoing process of account realignment. Multinational advertisers are continuing to transfer their accounts in foreign markets to subsidiaries of the agency handling the account of the parent company in their home country. These include many lucrative and high-profile television accounts. While account realignments have been a feature of the Canadian advertising industry for many years, they have reached unprecedented levels in recent years. In 1984, commercial account realignments exceeded \$200 million, compared to approximately \$150 million in 1983 and \$105 million in 1982.

A second important change in the industry worldwide is the trend to global marketing. Large advertisers are increasingly requesting that their agencies act as total communication agencies, covering a full range of marketing and public relations services. As their clients expand internationally, advertising agencies are expanding as well. Companies, such as U.S.-based McCann-Erickson, have offices in almost every major country in the world. In an attempt to increase their scope, large advertising agencies are establishing holding companies so that independent subsidiary agencies may handle competing accounts without conflict of interest. Canadian-owned advertising agencies are generally not large enough to adopt similar tactics.

Industry experts anticipate that the worldwide trend towards mergers and acquisitions will continue for the next few years, but at a slower pace than recently. Agencies will attempt to grow in size to increase their stability and to place themselves in a better position to compete more effectively in a slowly growing marketplace.



Although revenues are continuing to increase, the rate since 1982 has not matched that of the previous decade. Part of the reason for the slowdown in growth is the increasing use of sources other than agencies to get an advertiser's message across. One major, rapidly growing alternative is the use of direct marketing. Sales generated from direct marketing campaigns in Canada were expected to reach \$7 billion in 1987. (Retail sales were \$140 billion in that year.) In the United States, it now accounts for close to \$200 billion in annual sales. Current spending on direct marketing and catalogues now totals about 24 percent of overall advertising spending, as compared to 19 percent in the mid-1970s. Within five years, this is expected to increase to nearly 40 percent. In an attempt to capture a share of the growing market, many advertising agencies have added direct marketing divisions to their organizations within the past two years.

As the Canadian and U.S. advertising industries have operated for many years in what is essentially a free-trade environment, the FTA will have little immediate impact on the day-to-day operations of the industry. The more open arrangements with respect to temporary access of workers provided by the agreement will be welcomed by all elements within the industry, and will, quite possibly, benefit smaller specialty firms who will find it easier to provide their expertise to clients on either side of the border.

To a large extent, the impact of free trade on the advertising industry will depend primarily on its effect on the client sectors. As the industry serves a broad range of businesses, any increase in economic activity generated by free trade, and having a positive impact on its client sectors, will bring further business to advertising agencies. If current trends persist, however, any movement to increased international activity on the part of either Canadian advertisers in the United States, or American companies expanding into Canada, may result in minimal benefits to Canadian agencies. Export-oriented firms have overwhelmingly chosen the larger multinational advertising agencies. To counter this movement would require aggressive marketing on the part of Canadian agencies, a management with the ability to recruit top-notch personnel and a commitment to remain in the forefront of the most innovative services and technological developments introduced in the industry.

Further industrial restructuring is expected because of the continuation of past trends in account realignment, mergers and acquisitions, plus the effects of free trade. Industry revenues and employment, however, will continue to grow with the expected increases in advertisers' budgets, which some U.S. analysts have predicted may increase worldwide by as much as 10 percent in 1988. Should consumer spending weaken in response to current economic conditions, consumer advertising would be expected to decline.

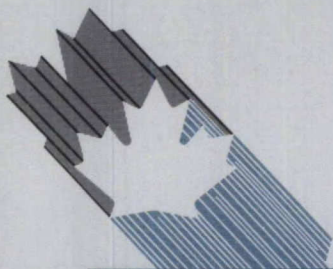
4. Competitiveness Assessment

Advertising agencies in Canada have not generally competed effectively in international markets, which continue to be dominated by large, mostly U.S.-owned firms. In terms of creative talent, however, firms in Canada are as capable as any in the world and, whether independent or as part of large multinational firms, they are well positioned to meet the competitive pressures facing the sector in Canada.

For further information concerning the subject matter contained in this profile, contact:

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PRINCIPAL STATISTICS (Advertising Agencies)

SIC(s) COVERED: 774

	1973	1982	1983	1984	1985	1986 ^P	1987 ^e
Establishments	N/A	N/A	N/A	N/A	N/A	N/A	625
Employment	N/A	N/A	N/A	N/A	N/A	N/A	6 000
Gross advertising revenues (\$ millions)	1 578.4	4 932.4	5 384.1	6 133.7	6 619.3	7 248.2	7 746.0
Ad agency revenues on billings (\$ millions) ^e	99.0	301.0	334.0	380.0	410.0	449.0	480.0

MAJOR FIRMS

Name	Billings (\$ millions)	
	1986	1987
FCB/Ronalds Reynolds Ltd.	—	178.1
MacLaren Advertising	172.0	163.4
J. Walter Thompson Company Limited	147.6	162.0
McKim Advertising Ltd.	160.0	160.0
Ogilvy & Mather Advertising	138.0	145.0
The BCP Group Inc.	—	128.0
Saffer Advertising Inc.	108.0	125.0
Vickers & Benson Companies	116.5	122.4
Baker Lovick Limited	109.0	122.0
Cossette Communications - Marketing	102.6	120.7
Top 10 agencies	1 053.7	1 426.6
Top 20 agencies	1 853.2	2 393.3

e Estimate
P Preliminary
N/A Not available

Sources:

1. Maclean Hunter Research Bureau: *A Report on Advertising Revenues in Canada*. Revised December 1987.
2. Statistics Canada. *Selected Service Industries in Canada*, Catalogue 63-231 Annual.
3. *Marketing*, December 14, 1987.
4. Kristian S. Palda. *The Role of Advertising Agencies in Canada's Service Sector*. The Fraser Institute, 1988.

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