On the horizon

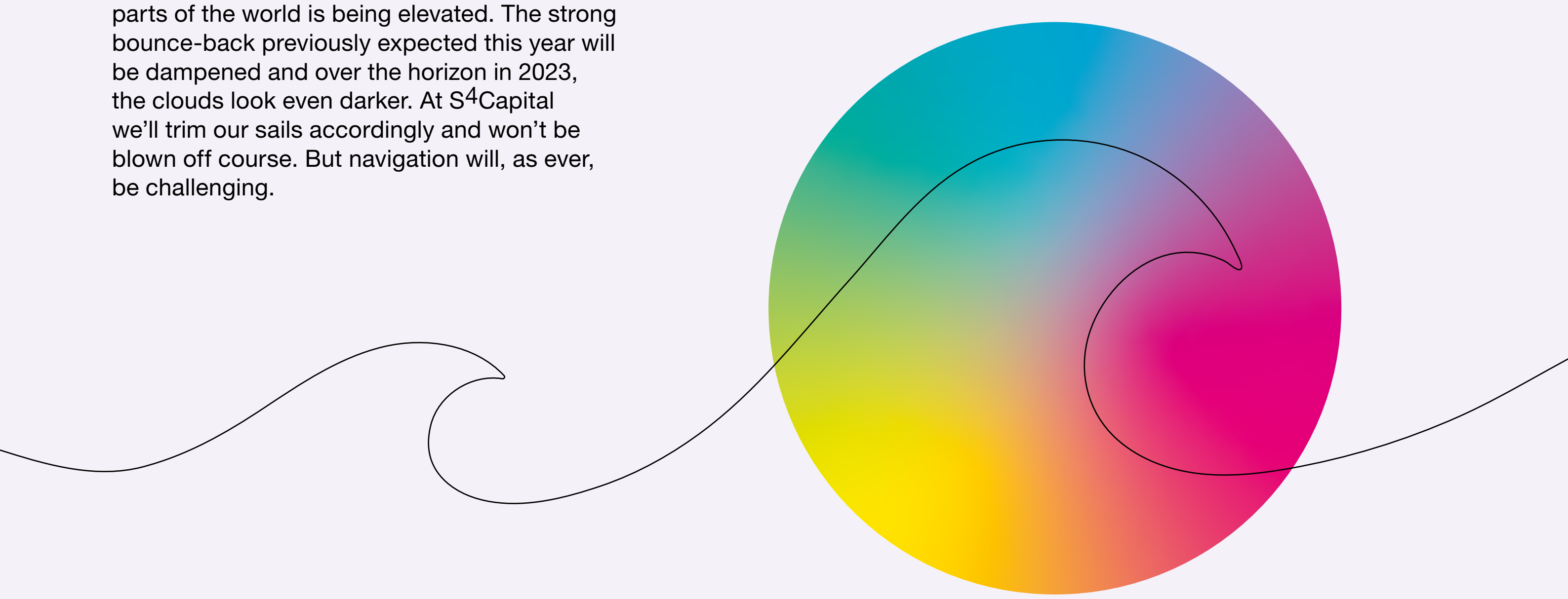
2 Industry outlook

A perfect storm

By Sir Martin Sorrell

We began 2022 optimistically, thinking global GDP growth, at least for 2022, would be 4-5%, on top of 5-6% for 2021, reflecting the bounce-back from the slump in 2020 and driven by the huge, global, co-ordinated covid-19 monetary and fiscal stimulus totalling around $10-15 trillion. In fact, we were moving towards the eye of a rapidly gathering tempest.

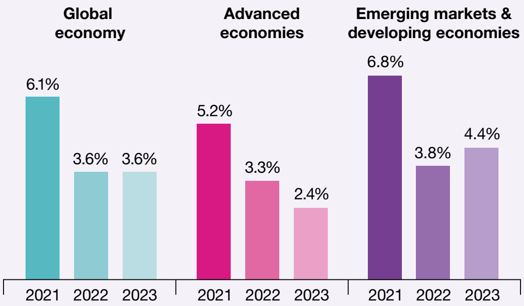
Since then, the economic consequences of the pandemic on supply chains and employment, rampant inflation, increasing interest rates, the bitter and vicious war in Ukraine and new zero-covid lockdowns in China have conspired to create a perfect storm in which growth forecasts are downgraded and risk in some parts of the world is being elevated. The strong bounce-back previously expected this year will be dampened and over the horizon in 2023, the clouds look even darker. At S4Capital we'll trim our sails accordingly and won't be blown off course. But navigation will, as ever, be challenging.



Inflation rising, growth in retreat

The IMF, in common with other forecasters, has cut its projection for global GDP growth this year to 3.6% from almost 5% six months earlier. Behind this move is a sequence of events: the necessary withdrawal of stimulus by central banks in the wake of covid-19; the rise in interest rates to counter a growing surge of inflation; Vladimir Putin's decision to attack Ukraine; and the mounting challenge faced by China's zero-covid policy. The world now finds itself in a more precarious place than most people imagined at the end of 2021; Goldman Sachs has estimated a 35% risk of recession in the next two years. Former US Treasury Secretary Larry Summers was prescient in foreseeing the inflationary effect of pandemic stimulus and central bankers' worries have pivoted from unemployment to rising prices and wages. Spurred by energy prices, inflation in the US this year is tipped by the IMF at 7.7%, its highest level in decades. That is all compounded by labour shortages ensuing from the Great Resignation or Reshuffle and continuing supply chain disruption, especially in areas such as chips for cars. The war in Ukraine means risk for Central and Eastern Europe. But with that comes greater willingness to take risks in other regions – South East Asia, India, Indonesia, Vietnam, Thailand, The Philippines, the Middle East, Africa and North and South America. China's lockdown in Shanghai, meanwhile, has highlighted that country's covid-19 policy and could further exacerbate global supply chain issues. So what does all this mean? Less robust economic growth is important as it's one of the drivers of S4Capital's growth. However, the burgeoning commitment in Europe to increasing defence budgets – Germany is a good example – will pay dividends for tech companies, especially as cyber is now a vital part of military capability, as will the increasing demand for digital transformation as global GDP growth slows. ▶

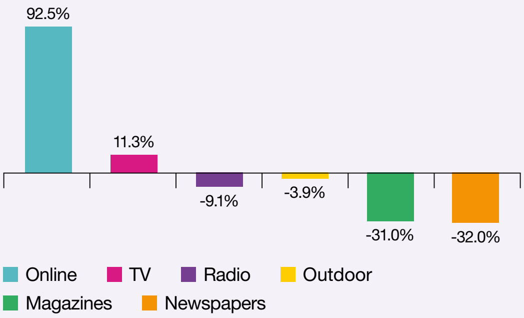
World economic outlook growth projections



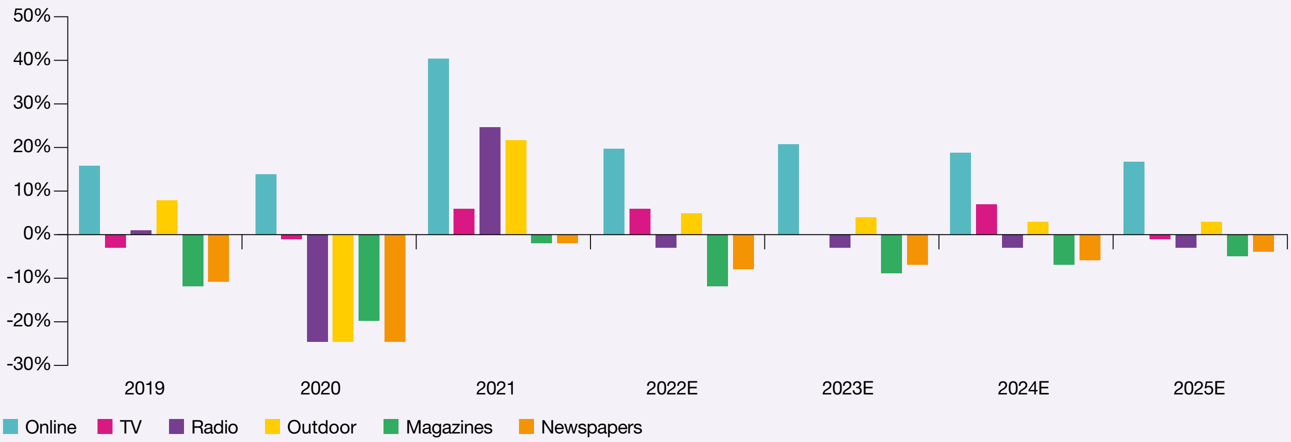
Source: IMF, April 2022

US advertising revenue estimates

Increase in advertising revenue 2022E vs 2019



Advertising revenue year-on-year growth



E: Estimate Sources: Company reports, MoffettNathanson estimates and analysis

A perfect storm continued

Our market

$231bn

Data analytics market - $231bn in 2021, forecast to reach $550bn in 2028 (13.2% CAGR)[1]

23.2%

Virtual events market size was $114bn in 2021 and is predicted to grow to $505bn in 2028 (CAGR 23.7%)[2]

35%

11.2m AR/VR headsets shipped in 2021 with 92% YOY growth. Annual shipments will reach 50m in 2026 with 35% CAGR[3]

16.9%

Global marketing technology software market size of $56.5bn with an 8-year projected CAGR of 16.9%[4]

$6.8trn

Digital transformation: 65% of the world's GDP set to be digitalized by 2022 and direct digital transformation (DX) investments to total $6.8 trillion between 2020 and 2023[5]

$1trn

The market opportunity for bringing the Metaverse to life may be worth over $1 trillion in annual revenue[6]

$113.4bn

World's 25 biggest agency companies had combined revenues of $113.4bn in 2020[7]

62%

Digital advertising spend takes a 62% share in 2021, worth $432bn and growing at 29%[8]

27.6%

Global ecommerce sales rose 16.8% to $4.92trn in 2021[9]

Sources:
1. Big Data Analytics Report, Fortune Business Insights, Dec 2021
2. GrandView Research, Virtual Events Market Size 2021, 8 Jul 2021
3. IDC AR/VR Headset Tracker, Mar 2022
4. GrandView Research, Digital Marketing Software Market Size 2021, 8 Jul 2021
5. IDC FutureScape: Worldwide IT Industry 2021 Predictions
6. The Metaverse, Grayscale Research, Nov 2021
7. AdAge, Mar 2021
8. MoffettNathanson Advertising Spend Model, Mar 2022
9. eMarketer Global eCommerce Update, Jan 21

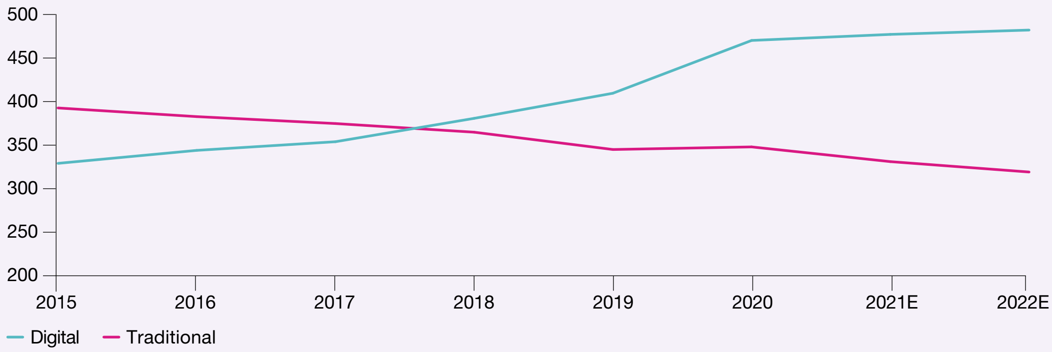
Digital is in control

The global economy drives growth in our markets. The total market we address is worth between $2 trillion and $3 trillion: advertising media is approximately $650 billion; marketing services $550 billion; trade budgets around $700 billion; and digital transformation budgets another $500 billion. Overall, our markets probably grew by 15-20% in 2021, but the significant point is that nearly all that growth was digital. In media advertising, the increase in spending with Google, Meta and Amazon alone was over $100 billion in 2021. At S4Capital our revenues grew by around 52% in 2021, and it looks as though the digital part of the industry will continue its growth trajectory over the next two or three years.

Industry analyst Michael Nathanson has carried out an important analysis which shows that advertising spend as a proportion of GDP shrank from 2% to 1%, over the last 5-7 years, but in the last couple of years it has started to increase again. He forecasts it will reach 1.75% by 2024-25, and all that growth is going to come from digital. The traditional areas of free-to-air TV, network TV, radio, newspapers and magazines will stay flat, or decline, but digital will continue to grow. As we are digital-only we will benefit and we are increasing our share of the market. ▶

Time spent per day with digital vs traditional media in US

Minutes



E: Estimate
Source: Statista.com

Growth in our addressable markets %

	2019	2020	2021	2022F	2023F
Total media spend[1]	5.2%	-1.8%	19.8%	9.8%	**8.8%**
Digital media spend[2]	19.0%	13.0%	29.3%	14.1%	**13.8%**
North American digital spend[2]	15.9%	12.2%	38.2%	19.2%	**20.0%**
Digital transformation spend[3]	18.0%	11.0%	14.5%	20.0%	**16.7%**
Cloud growth[4]	28.8%	33.4%	36.1%	34.3%	**27.9%**
MarTech growth[5]	35.9%	32.6%	37.4%	32.0%	**34.0%**
Holding company growth[6]	0.4%	-8.1%	11.0%	5.4%	**3.4%**
Tech Services growth[7]	27.6%	20.4%	40.3%	35.2%	**25.9%**
S4Capital growth[8]	44.0%	19.0%	44.0%	25.0%	**25.0%**

F: Forecast
Sources:
1. MoffettNathanson
2. MoffettNathanson
3. https://www.statista.com/statistics/870924/worldwide-digital-transformation-market-size/
4. Morgan Stanley for Google, Azure, AWS
5. Morgan Stanley for Salesforce (Subscription), Adobe
6. MoffettNathanson
7. Cowen
8. S4Capital

A perfect storm continued

Our latest three-year plan calls for us to double both top and bottom lines over the next three years, implying annual growth of 25%. If anything, the pace of digital transformation may speed up when the economy slows down, because in tough times, the change agents inside companies are given more oxygen.

Our third pillar

In 2021 we started a new practice area, Technology Services, to sit alongside our existing businesses in digital content; and data, analytics and digital media. We combined with Zemoga, which started in Colombia and now has technology specialists located all across the US, helping companies to digitally transform their business. We've already seen a really encouraging lift in terms of revenues generated from their client base. Technology services moves us into a new market where we are competing with firms like Globant and Accenture, who are rated more highly in terms of stock market value. It broadens our reach into client companies: as well as talking to the CMO or the chief sales officer, we'll now be talking to the CTO and the CIO as well. It means we become involved in systems integration, working with the likes of Salesforce and Oracle as well as with Adobe. Now we can talk to clients about what we do on the sell side, what we do on the marketing side and what we do on the IT side and bring it all together as one.

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Clients and whoppers

I went to a procurement conference recently and I was surprised that the tone was notably cautious, when in fact most clients have had a very good last couple of years. In fact, clients spent heavily in the fourth quarter, notwithstanding supply chain difficulties and other challenges. When I was on the stage at Web Summit last year with two senior marketing executives from Mars and Suntory, both said they are now using larger numbers of agencies and they agreed with our thesis around the importance of agility, and of taking back control. There's a tremendous propensity to experiment. The old days of the fixed TV commercial have gone and it's no longer about having the perfect piece of content. Instead, you develop assets in an iterative process that we see as being like an election campaign; brands have to get elected every day. Our 2020 target – to develop 20 'whoppers' or clients with $20 million of revenue – is on track and last year we added two more, Meta and HP, to our existing group which includes Google, a major tech company (with whom we've signed an NDA), BMW and Mondelez. That's been achieved primarily through our 'land and expand' strategy rather than through competitive pitches. We've identified another 19 that we think have the potential to become whoppers over the next three years. About 50% of our revenue comes from tech companies, and the reason for that is we work more effectively with the companies that look at the sky rather than those who look at their boots. In what we might call 'analogue' companies, people have tended to be more frightened of change in response to events like the pandemic or slowing GDP growth but – ironically – I think they will be more willing to do so in future.

From cookies to consent

Google's resolve on third party cookies and Apple's IDFA decisions have been creating a lot of uncertainty and fog in the digital ecosystem – if there was a VIX index for marketing it would have gone through the roof. It has forced clients to think about alternatives and the implications of what's happening in a more concerted way. Google has made a very astute decision from a privacy point of view, which is to rein back on the sale of third-party data, (unconsented), and focus on first-party data, (consented). And already some of the big retailers, such as Walmart and Target, are building their own walled gardens.

// The single brand emphasizes our **shared heritage** in creative content and data & digital //

For us, this is a big growth area. In our early days, we looked at several big data companies, but we thought they were overpriced, and so we concentrated on building our own capability through merging with around half a dozen smaller analytics companies, including Digodat in Argentina, Datalicious in Korea and Australia, Brightblue in the UK; now we have our own worldwide network. The challenge for clients is that they have pools of first-party data that still aren't integrated. Either they've grown organically and they've had CIOs or CMOs developing different systems; or they've acquired companies with data systems that don't talk to one another. Their challenge is to bring all that data together; the opportunity for us is to be the system advisor and integrator and help them make sure that the data lakes flow into one another.

The one and only

Our unification strategy to bring all our businesses together under the 'dot monks' brand is now fully implemented. Wes ter Haar took the lead and did a brilliant job in execution. (Others have struggled to bring even two brands together.) And that was because we spent a lot of time on it, working with our entrepreneurial leaders and our key clients. MediaMonks and MightyHive became Media.Monks with a dynamic logo featuring MightyHive's iconic hexagon. As a branding device it gives us great flexibility in how we can apply it. You can be anything.monks: tech.monks, lux.monks, data.monks, even China.monks. It's a great way of expressing what you are doing. The single brand emphasizes our shared heritage in creative content and data & digital and brings together our 8,400 digital-first experts under one roof, working as a single P&L across 33 countries. Unification is not an easy thing to do. When the holding companies make acquisitions, the trade is: you retain your autonomy and independence, and the holding companies will look after the back office. What we offer is that in surrendering your brand you become truly part of something bigger. And you have more space in doing that. If you want to develop social inside the company, or if you want to expand into the Americas, then you can do that. The companies we merge with do so for four reasons. They want access to peak talent; and on that score we have 8,400 digital specialists. They want access to geography; so we've made it possible for almost anybody to plug into our platform around the world. They want access to capital, which we have, (albeit not in unlimited supply). And they want access to clients. Whilst we can't promise that they'll win business we can help to develop those relationships so they have every opportunity to do so.

Shape shifting

As a company our business is currently segmented two-thirds content, and one-third data & analytics and digital media. Technology services will be small initially, but we'll try to expand it rapidly. From a geographical point of view, the split is approximately 70% The Americas, 20% EMEA and 10% Asia Pacific. By that measure I'd like to get to a 60/20/20 breakdown. So we need to do a lot more in technology services and put more weight into Asia Pacific. I'd like to double up, triple up, maybe even quadruple up in China – and India is also as important. But one of our biggest commercial concerns remains: how do you viably operate in the world's second biggest economy, an economy that will soon be the biggest? China has changed; President Xi is pursuing a different course, a much more hardline course, just as Presidents Obama, Trump and Biden have done from the US side, which means the countries are diverging in a dangerous way. ▶

A perfect storm continued

And China's Millennials are not as pro-Western as they used to be. What this means is that the structure must be fashioned to meet these new conditions, and that may mean it has to be more local.

After covid-19

Omicron showed that the pandemic is not over completely, but I think it will just push back some of the expectations in terms of growth and recovery by a few months. Going forward, we are going to adopt a hybrid model in how we work. We noticed last year that people were thirsting for more social contact. Productivity remained very good when people were working from home, but the problem started to assert itself and cause some angst. It was not so much about creative spark, as simply wanting to see your confreres or consoeurs and get together with them. We still think we must be very flexible, so the template that we're using as we renegotiate our leases is to take 60% of the space we had before. That implies people will be in the office three days a week; it will be phased, but with considerable flexibility. We think it is important to come in, because we've gone from around 2,500 people before the pandemic to 8,400 now, and many of those people don't know one another, so it's important they get the chance to do so. People have been isolated, and that's not a good thing.

Doing the right thing

The world in which we operate is increasingly dominated by issues such as environment, governance, diversity and social responsibility. We've said that we will be net zero by 2024 with the help of carbon offsets and we are close to that. We're making progress on our objective to achieve B Corp accreditation. We've signed both Amazon's Climate Pledge and the World Economic Forum pledge, among other commitments in the climate and environmental area. In terms of governance, we're having to build out our structures in terms of legal compliance, risk and other disciplines because we've gone from zero to a £1.7 billion/$2.1 billion market cap in a short time. On the diversity and inclusion side, we've implemented our Fellowship programme. We had our first flight of fellows from the historically black universities like Howard and Morehouse and we are expanding it to black high schools.

> // It's a revolution that has **no end in sight** //

We've also put our first flight of some 50 candidates through our S4 Women's Leadership program at UC Berkeley. If you look at our diversity it is broadly balanced, but at the top levels it's only one third female. And from an ethnic point of view, we are 40% people of colour – we do very well on Hispanic and Asian American ethnicities, but we are around 6% or 7% black, whereas to represent the community in the US it should be 13%. In California we are representative, in New York we are not yet. But we are making progress.

The metaverse and beyond

Technology is fashioning an exciting new world in the form of the metaverse. We were heavily involved in the Meta Connect conference where Mark Zuckerberg launched the group's strategy and its change of name, and with the likes of Apple and Microsoft joining in we think the metaverse throws up tremendous opportunities. One key area is ecommerce: a company such as Nike or Adidas will create a virtual store, and through your avatar you will be able try on the shoes, see what you look like, and order them. The workplace is another area where the metaverse will lend itself to application because of the fact that you can be anywhere. Last October S4Capital held its first Executive Committee meeting in our 360 degree boardroom in the metaverse, using VR technology. We are heavily involved in exploring the potential of other nascent technologies such as Epic Games' Unreal Engine.

S4Capital was established with the ambition to be the leading player in the new era of tech-led, digital-only advertising; it's a revolution that has no end in sight. ■