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Evaluation of the Canadian Radio Advertising Model

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1. Objectives

The objective is to create a clear and comprehensive picture of the following:

- How advertising dollars are allocated to radio, and how radio competes with the other ad supported media.
- Radio's strengths and weaknesses relative to the other media as seen by advertisers, media planners, buyers and sellers, and radio commercial writers and directors.
- The future advertising revenue prospects and vulnerability for the medium as a whole and segmented by large and small markets, and national versus local ad purchases.

2. Methodology for the Study

As discussed below, the radio advertising marketplace is a diverse and dynamic environment populated by a wide range of buyer and seller decision makers. The foundation of this analysis is the opinions of eighteen of these decision makers drawn from:

- *Advertisers.*
- *National media placement companies.*
- *Specialized media buying companies focusing largely on the radio medium.*
- *Creative Directors, both supportive and unsupportive of radio.*
- *Sales directors from major radio broadcasters representing both English and French Canada.*
- *National radio rep organizations.*
- *The Radio Marketing Bureau.*

The "rules of engagement" for the decision maker interviews were that the report would not connect specific comments and opinions to the individuals who provided them. As a result we were impressed by the depth of insight and information provided and by how candid were the responses. We would however specifically recognize David Bray, Sr VP at Hennessey and Bray. David is intimately connected to the radio industry as a media planner and buyer, commercial producer, consultant and commentator. He is very involved with the audience measurement aspects of radio through his continuing contribution to BBM Canada's member committees. David has provided some of the analysis and insight that has gone into this report.

As with any opinion based study there is little if any unanimity among the opinion providers. In many cases there are substantial

countervailing viewpoints. We have reported these disparate positions. However to help judge the veracity of the positions, we have provided a statistical overview of the Canadian advertising revenue landscape against which opinions and predictions can be tested.

Finally, we have woven the pieces together and have provided a number of key observations as to future advertising revenue potential for radio.

3. Key Observations

Positive Factors for Radio

- Radio will continue to benefit from advertisers' concerns about the efficacy of television.
- The growth of specialty television has limited television's effectiveness as a local medium. This is a competitive advantage for radio.
- Radio will also continue to benefit from a struggling newspaper industry.
- Radio's lower media and commercial production costs will continue to make it an attractive ad medium.
- Radio is increasing its share of revenue within its highest potential advertising categories. This trend should continue.
- Radio's effectiveness is being tested in both Canada and the U.S. Results of these studies are very favorable to radio and provide strong support for radio's use, particularly for non traditional advertising categories.
- Similarly, there is growing evidence that more than one advertising medium is more effective than a single medium.

Radio's Vulnerabilities

- Radio's ad revenue performance is very sensitive to retail sales changes. Most predictions are for a decline in retail sales growth.
- Advertising creative writers and directors on the whole are not knowledgeable about or supportive of the radio medium. This is seen by all industry participants, including creative directors, as a major inhibitor to radio's growth.
- There continues to be among decision makers a broad based perception that television is the "primary" medium, while all others including radio are secondary. Radio runs a greater risk of being dropped when ad budgets are cut.
- Specialty television is a cost effective advertising option for retailers with national geographic coverage.



- The growing influence of the large media buying agencies is a threat to radio's ad revenue. They put increased pressure on pricing. Their planning and buying processes often commoditize radio. They do not necessarily buy and schedule radio in the most effective manner. Their decision makers are not readily accessible to the radio broadcasters.
- The radio industry is seen by many advertising decision makers to be focused on station share of revenue rather than promotion of the medium as a whole. The station share sales pitches may deliver negative commentary towards competitors and create some negative perception for the medium as a whole.
- Satellite radio is seen by advertising decision makers as a serious threat to conventional radio. Small radio markets may be most vulnerable.
- The increase in ad inventory created by any incremental licenses will put downward pressure on radio ad pricing.

4. Radio Advertising Revenue Framework and Analysis

The following charts have been prepared to show historical trends and relationships. While radio ad spending and retail sales have been published for 2005, data for the other media have not. Therefore multi-media comparisons and trends are up to and including 2004. The underlying data comes from a variety of sources. We have found variances in similarly reported data. These appear to be due either to slightly different reporting criteria from source to source or data sources that require some level of estimation within. The variances do not affect the conclusions drawn from the data.

4.1. Canada versus the U.S.

Key Comparisons

		
2004 major media spending, \$(millions)	\$8,020	\$136,134
Major media spending per capita	\$251	\$465
Radio spending per capita	\$38	\$59
Major media spending as % of retail sales	2.5%	4.0%
Radio spending as % of retail sales	0.4%	0.5%
Radio's share of major media spending	15%	13%
Radio as a % of television	41%	31%
Radio - average weekly time spent listening	22.2 hours	19.8 hours
TV - average weekly time spent viewing	27.7 hours	32.7 hours

Major Media Spending = TV, Radio, Newspapers, Magazines, Out-of-home, Internet
Sources: TVB published data. Additional data supplied by Canadian Broadcast Sales
Hours tuned are per capita for Adults 18+

Observations

Canada has and will trail the U.S. in per capita advertising spending and in ad spending as a percent of retail sales. However radio is a relatively stronger medium in Canada than in the U.S. Canadians spend more hours with radio, and radio enjoys a larger share of ad spending in Canada.

The U.S. has more than twice as many radio stations per capita than Canada. It would be reasonable to conclude that despite the greater format choice in the U.S., the resulting fragmentation is a comparative weakness of the U.S. radio system.

4.2. Media Share of Revenue

Share of Revenue (%)

Medium	1995	1997	1999	2001	2004
Television	37	36	37	36	37
Radio	15	15	15	15	15
Newspapers	38	40	37	36	33
Out-of-home	3	3	4	4	4
Internet	0	0	1	1	4
Magazines	6	6	7	8	8
Total %	100	100	100	100	100
Total \$(millions)	\$4,956	\$5,797	\$6,539	\$7,043	\$8,020

Source: TVB published data

Observations

During the past ten years we have experienced unprecedented changes.

- The Internet has profoundly changed consumer behavior in many ways. (However most internet service providers have not been successful at generating ad revenue sufficient to cover their investment.)
- The newspaper medium's ad revenue has been most adversely affected as a result of the internet's intrusion into its lucrative classified advertising revenue stream.
- Television has experienced a dramatic increase in fragmentation as a result of the growth of specialty television.
- Radio has seen a reduction in advertising competition within its sector as a result of multiple station ownership.
- Finally, the outdoor industry has seen dramatic growth in competition and in new product forms including giant video boards.

There are two powerful conclusions for radio from this trend analysis:

First, an increase in available advertising inventory does not lead to an increase of revenue into the medium. For specialty television the prices

that advertisers are paying for advertising exposure as measured by cost per thousand audience exposure (CPM), are substantially lower than the prices paid for conventional television. Similarly, the outdoor industry is experiencing severe cost discounting in the face of a proliferation of ad availability. The fact is advertising time and space are heavily influenced by supply and demand. These economic factors are the key determinants of ad pricing stability and growth.

The second somewhat surprising observation is that, despite all of the change of the past ten years, television's and radio's shares of advertising revenue have remained absolutely consistent. This may speak to these media's success at adapting to change and to regulatory policies that have allowed them to do so. However we think it speaks most emphatically to advertisers' and media planners' decision-making stability with regard to advertising investment. As noted above the amount of investment will vary in line with business and economic conditions. But changes to the media mix occur slowly, and notwithstanding the rhetoric, in a risk avoidance atmosphere.

The conclusion is that in assessing the advertising model and how this will affect advertising revenue to radio, changes will likely occur in small increments over time. We should be very wary of dramatic change predictions.

4.3. Revenue Trending - radio versus other media advertising options

Percent change versus previous year

Year	Retail Sales	Radio	Television	Newspaper	Major Media
1996	3%	6%	7%	3%	5%
1997	8%	8%	6%	18%	11%
1998	4%	9%	10%	3%	9%
1999	6%	4%	3%	2%	4%
2000	6%	5%	3%	6%	6%
2001	4%	5%	4%	(3)%	1%
2002	6%	3%	2%	-	3%
2003	4%	9%	9%	1%	7%
2004	5%	2%	4%	3%	4%
2005	6%	8%			
2004/1995	+57%	+61%	+60%	+37%	+62%
2004/2001	+15%	+14%	+15%	+4%	+14%
2005/2001	+22%	+22%			

Major Media Spending = TV, Radio, Newspapers, Magazines, Out-of-home, Internet
Sources: TVB published data, Statistics Canada

Observations

In framing predictions of advertising revenue growth it's important to note that over time, generally two years, advertising revenue tends to follow retail sales. This situation may be disrupted by an unusual product or service category development. For instance, a number of years ago, the mutual fund industry invested in advertising far beyond its means. More recently internet start ups did the same. But invariably the dust settles and ad expenditure increases moderate.

Radio had a banner year in 2005. Radio ad revenue increased by 8% versus previous year. As best as we are able to determine at this time, radio will lead all major media in growth. We think it would be wrong to project a continuation of this type of radio revenue growth on the basis of current year growth. Such a prediction would require both continued strong consumer spending and a continued increase in share of ad revenue for radio. Neither of these is assured.

4.4. Regional Radio Revenue Variations

Regional Analysis

Region	% Radio Revenue	% Population	Index Rev/Pop	% Retail Sales	Index Rev/R.S.
Maritimes	6.5	7.3	89	7.2	90
Quebec	18.5	23.6	78	22.7	81
Ontario	37.3	39.0	96	36.9	101
Prairies	8.8	6.7	131	6.4	138
Alberta	14.7	10.2	144	13.3	111
B.C.	14.3	13.2	108	13.6	105

Source: Radio Revenue: CRTC 2005, Population: Stats Can Oct 2005, Retail Sales: Stats Can 2005

Observations

Quebec is significantly underdeveloped relative to other regions. This is discussed in some detail in Section 11.5 - *French Quebec Radio Advertising*.

High Volume Advertiser Category Analysis

Top Radio Ad Spending Categories 2004 versus 2000

Top 20 Categories (Ranked by radio ad spending)	2004 - Radio as a % of total category spending	Radio Growth 2004/2000	Total Ad Growth 2004/2000
Retail	8.4%	20%	3%
Automotive	4.2%	98%	10%
Restaurants	14.1%	38%	25%
Petroleum	25.3%	61%	7%
Financial Services	6.8%	(8)%	(2)%
Travel	6.4%	89%	40%
Alcohol	13.4%	35%	14%
Entertainment	4.1%	(1)%	43%
Telecommunications	7.5%	(6)%	(26)%
Media	8.6%	32%	(3)%
Lotteries	13.0%	69%	47%
Government	13.9%	(7.3)%	(20)%
Food	2.6%	(23.5)%	38%
Drug Products	6.0%	52%	71%
Local Automotive	2.4%	47%	14%
Entertainment Equipment	5.3%	(23)%	80%
Internet Related	10.3%	116%	(11)%
Sporting Goods	11.1%	346%	81%
Farm	33.7%	(28)%	5%
Building Products	9.2%	124%	117%
Real Estate	7.7%	80%	292%

Source: ACNielsen

Observations

Radio has matched television's year over year revenue growth. While television has accomplished this with the aid of some hefty rate increases in conventional television in some years, radio has had to rely to a greater degree on business development. This chart shows that radio has been successful at building its share of ad revenue in its high priority prospect categories, those that generate the most ad revenue for the radio industry.

5. The Advertising Decision Makers and Influencers

Advertising revenue makes its way to the radio medium and then to individual stations as a result of a process in which many individuals may have input. In its simplest and most direct form the process is as follows:

Advertiser Direct Sales

The enterprising radio station or radio station group will call directly on a prospect, typically, a local retailer, and convince him that radio advertising will help his business. The radio station sells the advertiser some air time, produces the commercial and the campaign runs.

The process becomes a little more complicated if the advertiser has a supplier upon whom he relies to design and produce creative. This creative resource can be a powerful influencer as to whether the advertising funds should be allocated to radio and/or other media.

Sales to Media Agencies Working on Behalf of Advertisers

In its most complicated iteration the advertiser will have both a media planning and placement supplier (media agency), and a creative supplier. Traditionally these functions were housed in an advertising agency. However increasingly media planning and creative development are separate suppliers. To confuse things a bit more, the large media planning and placement companies are owned by the large multinational advertising agency holding companies. The media agencies always operate as separate profit centers. They may or may not share the client with a creative agency from within the same holding company.

In these situations the process typically looks like this:

Media Planner

- Is briefed by the client
- Consults with the creative supplier
- Writes a media plan defining media spending by medium and by market
- Presents recommendations to client

Client

- Consults with internal influencers, eg. franchisees, dealers, branch operators, senior management, head office (US or overseas)
- May consult with creative resource
- Directs or works with media planner to incorporate influencer input
- Approves plan

Media Buyer (part of the media agency)

- Negotiates with radio broadcasters and allocates market budget among the appropriate stations in the market.

6. Local versus National

In order to understand the radio advertising revenue dynamics it's important to understand the source of revenue. The commonly used National/Local designations are not necessarily representative.

Reported national revenue tends to be revenue booked by the broadcasters' national rep firm. Reported local revenue is that booked by the stations' local reps. However what is more relevant for this discussion is an understanding of the share of business booked through media agencies. This business includes so-called national clients such as packaged good companies. However it also includes a high proportion of retail/franchise/dealer/storefront business - business that typically would be considered "local". Some of this business is negotiated with the national rep organizations but a substantial part is negotiated directly with the stations' local sales forces. We will discuss the implications of this below. However when discussing the process of media planning and placement and the attitudes of decision makers and influencers it's important to recognize that media agencies place at least 70% of radio advertising dollars, and the media agencies' share of placement is growing.

7. What Decision Makers and Influencers Think About Radio

7.1. The Advertiser Decision Maker

Clearly there is no single advertiser decision maker view point. But there are a number of attitudes that are common to most.

Radio's Positive Attributes

- Advertisers do not have negative perceptions about radio as an advertising medium. This may sound like "damning with faint praise". But it is extremely relevant when radio is contrasted with television. Television is seen to be significantly declining in advertising effectiveness. Rapidly increasing costs, commercial avoidance technology, and dramatic audience fragmentation are three major factors contributing to this view.

"There is a crisis of confidence with television"

- In the face of these concerns, advertisers are increasingly willing to experiment with other advertising options. Radio is a potential winner.
- Client direct business, i.e. advertising sales to advertisers who do not use a media placement supplier, is reported to be growing. Those broadcasters to whom we talked who are having success in this area pointed to more aggressive sales activities as the reason for success.

- Advertisers are increasingly looking for a measurable return on investment (ROI) from their advertising investment. The Radio Marketing Bureau (RMB) has done some high profile studies that demonstrate radio's ROI. The New York-based Radio Ad Effectiveness Lab (RAEL) recently released a study claiming radio's ROI is 49% better than television. There are various studies that show that moving a portion of television dollars out of television into an alternative medium such as radio increases brand awareness and purchase intent. This work is being noticed by advertisers and contributing to positive attitudes towards radio.
- Increasingly US developed television creative is being mandated for the Canadian subsidiary. If, as often happens, the Canadian advertiser has requirements unique to Canada, radio may be used in place of television because the lower production costs can be rationalized.

Radio's Vulnerability

- Advertisers have a continuing stereotypical view of radio's communications value. Radio's value lies in such areas as tactical, promotional, call to action, and price point messaging. Radio is seen to be much less effective for "branding" or "equity" advertising. On the one hand, work such as the RMB is doing is beginning to demonstrate that radio can deliver as a branding medium. On the other hand there is a lot of advertiser commissioned brand and ad tracking research that shows that radio is a relatively poor branding medium. This supports a widely held view by advertisers that television is a very powerful branding tool, notwithstanding the medium's problems. Television can also deliver tactical messages. As a result television often is the default medium at the expense of radio.
- There is often an over-riding attitude that television is a "primary" medium while radio is a "secondary" medium. While this may be purely perceptual, it is a limiting factor for radio. In the same vein advertisers often view television as a leadership medium. Television's cache is important to the advertiser.

"Radio is not a mandatory medium for most advertisers"

- While certainly not universal, there is a concern within the advertiser community that radio is not a strong suit for creative writers. While there are some brilliant radio creative writers, most clients' creative resource does a range of media. There is a passion for television but not necessarily for the other media. This will be discussed in more detail within the "creative influencer" section.

- There is a negative US influence. Radio has a substantially lower share of market compared to television in the US than it does in Canada. And the perception of the medium among large advertisers is less positive in the US than it is in Canada. There are two issues. First, the advertising decision makers for an increasing number of Canadian subsidiaries of US companies reside at the US head office. Secondly, many Canadian subsidiaries have Americans in key management positions. In both cases the advertising decision makers have preconceived, less than positive perceptions of the radio medium.
- The increasing advertiser reliance on media agencies creates some barriers. These are discussed in detail below.

7.2. The Advertiser Influencer

There is any number of people within the client organization that might have the ear of the decision maker. The fundamental barrier for radio is its perception as less “impressive” than television. As one interviewee said, *“nobody ever asks, ‘did you hear that great radio commercial last night?’”* This is not to suggest that client influencers do not bring a reasoned and intelligent view to their advertising campaigns. But the fact is that advertising is part wisdom and part magic. And television is way ahead on the magic quotient.

7.3. The Creative Director

We talked to several Creative Directors, one of whom is a radio specialist. As can be seen in the comments below there is a high level of support for the potential of radio advertising. However this is offset by a number of barriers. We would summarize the comments as follows:

- On balance clients aren’t big supporters of radio.
- Radio has tremendous communications potential.
- Radio is a cost effective advertising medium.
- However, it is very difficult to write excellent radio commercials.
- There are relatively few creative writers who do radio well or, in fact, are interested in doing radio work.

The Positive Attributes

“One of our mantras for clients, especially those that don’t have a lot of money, or that are at a competitive disadvantage, we say don’t do a half-assed job on TV, own radio. Why spend \$200,000 on a TV commercial when you can’t afford enough media for people to see it?”

“Radio can brand like TV, it has frequency, a fantastic way of hitting the target market. If it is women – they drive too! TV is much tougher to hone in on a target, it doesn’t come close to radio”

“It is highly creative and imaginative. When it is bad, it is annoying as hell, but this is a cost effective medium, it is inexpensive, it allows the creative group to keep it fresh because you can produce a lot of it versus one TV commercial.”

“I think most people are receptive because we can demonstrate through our case histories that it works. The best response comes from some of our clients that are small, feisty entrepreneurs, that want to outsmart their competition not outspend them.”

“To be honest you can do wonderful work on radio and the bonus is that you can take calculated risks because agencies don’t do much testing of radio like TV, it is a pure play medium from creative to air.”

“Nothing is more exciting than radio, there is nothing you can’t do. When people buy into the benefits, it always works on radio. We understand radio, we understand how it makes people feel and what makes it effective.”

“You can do way more for so much less. You can go to the moon, under the ocean, inside someone’s intestines – the possibilities are endless.”

Barriers to Radio

“Creative writers that have to do radio have a white knuckled viewpoint – they look at it the wrong way, fearfully – though it is true there are not the tools to hide behind like TV’s great set design, great director, you can’t stand behind fast editing, or fast cutting on radio. The writing is critical”.

“You are so exposed on radio. It is like trying to hide on a squash court.”

“Creatively it needs more work, more attention to great advertising.”

“There is a recurring bias from clients that radio is not great for branding.”

“The big impediment is weaning clients away from the crack cocaine of TV. There is cautiousness to many clients who only believe that you can build verifiable awareness through TV.”

“Some radio advertising is just so annoying, it yells at people – yelling isn’t charming. Some radio creative has no humanity, no charm, and no ‘touch’ to it. Clients don’t realize that you don’t need to force the message down your listeners’ throats.”

“There is also some prejudice, some resistance from agencies that radio is not as glamorous as a page full color in print. However this is also because there is no bench strength in agencies and the fact that radio doesn’t easily ‘fit’ on the reel”

“As an Agency, we are not advocates of radio”

“As a creative department we spend 5%-10% of our time on radio.”

“The other problem is a talent issue with radio creative. Few do it well, and some are afraid of it.”

7.4. Media Agencies - The Planner

The media agencies are now dominant factors in the allocation of advertising revenue among the various media. As noted earlier over 70% of radio’s ad revenue comes through media agencies.

There are many media agencies in Canada, ranging from small boutiques, some specializing in radio planning and placement, to companies investing over \$800 million in advertising campaigns for their clients. The trend, as in most industries, is to consolidation. Seven companies, of which one is Canadian owned, reportedly invest annually over 70% of all Canadian advertising expenditures. Large multi-national advertisers tend to align their North American suppliers. So by default the biggest media spending advertisers end up within a large media agency. These “mega agencies” require some attention in order to understand their impact on radio revenue.

As a broad conclusion, the large media agencies are not a positive factor for radio advertising revenue growth. There are a number of related reasons for this.

Media Agency Compensation

The agency financial model is at the heart of the issue. Low compensation and low margins plague the industry. Media agencies typically are compensated on the basis of a percentage of media placed. This percentage has been declining consistently over the years. This is a function of a competitive marketplace. It is also driven by multi-national agency deals that set fees on a worldwide basis ignoring the inherent complexity of the Canadian media marketplace.

The media agencies have responded by developing ancillary revenue streams such as promotion and event planning. However the increased revenues have tended to go into margin improvement rather than investment into the agency’s product. Interactive divisions have been a boon to the Agencies because fees can be proportionately higher. Of

course these divisions funnel money out of conventional media into internet related activities.

While revenue has been under siege, margin improvement and cost containment have been high on the corporate agendas. The large media agencies are all part of publicly traded companies and are stand-alone profit centers. There is pressure on short term positive financial results. There has been a series of mergers and acquisitions in the past few years, all resulting in corporate imperatives to reduce costs.

Finally the cost and complexity on new business pitches is skyrocketing. Most are now highly formalized driven by client procurement specialists. The cost to the media agencies in terms of manpower and out of pocket costs can be greater than a year's revenue from the assignment.

These financial pressures lead to operational issues which in turn have a significant effect on advertising money invested in radio.

Media Agency Staffing and Structure

There is a recent U.K. study that found that 65% of advertising agency employees were under 30 while only 5% were over 50. While there is a very large processing function in a media agency, much of what gets done relies on the expertise and experience of its people. Fundamentally the media agencies are relying on more junior and less experienced people to make media investment decisions. They also will admit that training may not be a top priority.

Senior managers are increasingly focused on agency management, and often new business pitches rather than the development of client media plans. Media investment decisions are pushed down to more junior staff. The media planning and buying functions are usually separate. The radio "experts" are the people who negotiate the buys, not those who decide whether radio will get the advertising money in the first place. (We would, however, note that there appears to be a trend to have buyers and planners more closely connected on client assignments that have large radio components.)

The traditional advertising agency staff development model had media buyers learning the business by becoming intimately involved in the negotiation and placement of media. Over time, if they had the strategic skills they would move into media planning supervised by senior practitioners. Now media planners start their careers in that function, often without practical grounding and experience.

Radio is a relatively complicated medium. Selling "Theater of the mind" as radio is sometimes described takes a leap of faith. Television has cache

and profile. Planners are comfortable with the medium. Magazines and newspapers are tangible products that the planner can physically put in front of the client.

All of these factors mean that media planners may lack the confidence to recommend radio to their clients.

The Planner/Seller Relationship

In a nutshell there is very little. Planners are overwhelmed. They have very little if any time for supplier contact. Radio, probably more than any other medium, suffers from a lack of exposure among decision makers.

Specialized Retail Divisions

Some media agencies have set up specialized retail planning and placement divisions. On the one hand these are a positive development for the radio. Individuals with a better understanding of both the retail industry and the radio medium are managing the advertising investment. The downside for radio is that these divisions are focused on advertisers who by and large are traditional radio users. The specialized retail divisions do not typically help radio in developing new, untapped sources of radio ad revenue.

Implications for Radio Ad Revenue

The media issues discussed above do not necessarily jeopardize entrenched radio ad investments. Just as media planners will be risk averse in recommending something new, they will be equally risk averse when it comes to removing proven media components.

However media agency planners, on balance, are not advocates for radio. The media planner must sell the client on the merits of her recommendations. She must also sell the creative director and any other decision influencers. Increased spending by virtue of the addition of radio to the plan or of a greater share of spending is compromised by an inexperienced planner. First, radio generally is not the first choice medium of either the client or the creative writer. Secondly, the planner may not have the experience with or the confidence in radio to sell the medium through.

7.5. Media Agencies - The Buyer

Radio buyers do not generally make the spending allocation by medium decisions. So, on the face of it, they are not factors in the growth or decline in radio advertising revenue. However there are several dynamics in the radio buying process that may affect the revenue health of the medium.

Local Sales Force versus National Rep Contact

There is a long-standing convention that media agency buyers will deal with the radio station local sales forces when they are purchasing air time for “local” clients. Local client can mean any advertiser with a store front. But the classification includes the largest organizations such as McDonalds or Canadian Tire. Buyers have pushed for this local buying process for several reasons:

- Historically local rates have been better than national rates. (Today broadcasters claim local and national rates are identical, but the suspicion of rate disparity remains.)
- In the past, buyers who have purchased from the national rep have been embarrassed when a zealous local salesman has offered the local franchisee or operator a better rate.
- Some retail clients insist on this local connection.
- The local sales reps are connected to the market and can more readily provide local market intelligence and promotional opportunities to the buyer.
- For those buyers specializing in retail advertising the “we buy locally” claim is a competitive advantage when pitching for media placement business.

Local radio buying on geographically national accounts places an enormous burden on the media agency’s resources. To put it into perspective we were informed of one radio buy encompassing 198 radio markets and 398 radio stations. The high labour cost to negotiate these purchases puts added pressure on the agency’s margins. While this doesn’t directly impact on media planners’ media choices for individual client campaigns, it does create a stigma for radio that may dampen the agency’s overall willingness to promote radio as a high preference medium.

Radio sales managers in many cases would like their local sales forces to focus on truly local market development but have found it difficult to take away substantial agency business and the resulting commissions from the local sales people. In one of our interviews the sales manager claimed quite dramatic sales increases by focusing his local sales force on truly local sales development. We would conclude that radio’s ad revenue growth potential is being impeded by local sales forces tied up with agency negotiations that may increase the station’s share of business but do not increase spending into the category.

Media Agency Buying Clout

“Clout” is a cornerstone sales proposition of the large media agencies; “*Because we spend lots of money, we get better rates*”. It is a claim for which it is difficult to separate the reality from the hype. However we have strong evidence from our interviews that indeed broadcasters are

moderating rate increases in the face of big budgets and long term contracts. However typically it is the large regular radio advertisers who benefit from lower rates. As a result high volume discounts cost the radio industry revenue from existing advertisers and do little to encourage new advertisers to use the medium.

Quantity versus Quality

There is an increasing amount of “bulk” radio buying. The media planner will direct, and the buyer will purchase a level of weekly market GRP’s for a full season or even a full year with little regard for advertised product, message requirements, or station environment. This is an excellent strategy for price negotiation but it commoditizes radio exposure. It negates several of radio’s communications strengths and flies in the face of much of the learning on how to schedule advertising on radio for maximum communications effectiveness. It stands to reason that poorly constructed radio campaigns may not deliver the appropriate ROI for the client’s business. This could put future radio ad revenue at risk.

8. The Advertising Decision Criteria

8.1. The Media Plan

The media plan will contain objectives defining demographic, geographic, and timing priorities. It may recommend a budget but most often the budget is provided. It will then recommend a budget allocation by medium and provide some execution guidelines for the media buyers. The budget allocation by medium is a bottom up exercise where the planner decides markets, weeks and weekly media exposure. A radio costing will look like the following:

Target Group: Women 25-54					
Market	Weekly GRP's	Cost/GRP	Weekly Cost	# of Weeks	Total Cost
Toronto	150	\$150	\$22,500	10	\$225,000

Definitions:

100 GRP's (Gross Rating Points) = exposure in the market equivalent to 100% of the target group hearing the commercial once. So if Toronto has a women 25-54 population of 1 million, the above plan calls for 1.5 million exposures. However the execution guidelines will specify how those exposures should be allocated. For instance it might specify that ideally 50% of the target group should be exposed on average 3 times. The buyer will then construct a station and daypart mix to meet this goal.

Cost/GRP is the estimated cost to buy one GRP in the market. Planners and buyers use audience delivery as the currency. Cost per spot is meaningless. While there may be some consideration given to radio station environment the planning and buying process is primarily numbers driven.

8.2. How Radio Gets on the Media Plan

Communications Task

Radio has a proven track record for tactical price/promotion messaging and will be a priority consideration for this sort of communications task. 70% of radio revenue falls within this “tactical” category. This is almost all “storefront” type client business. It is radio’s bread and butter.

If the task is identified as “branding” radio has a tougher sales job. Advertisers and creative directors as a group largely believe that radio is not as effective as other media for branding. There is a widely held perception that radio is only half as effective as television at branding. This is often supported by advertiser sponsored awareness and attitude tracking.

There is a massive pool of untapped “national” ad money but it will not be easy for radio to earn it. The research studies conducted by the Radio Marketing Bureau provide strong support for the radio medium in this arena. The big task is to get this information in front of advertisers, creative directors, and media agency planners in a compelling way.

Advertisers’ increasing requirement for ROI may work in radio’s favour. “Branding” is a slow build process. It is also difficult to directly attribute an ROI to branding messaging. This means national advertisers must look to other marketing channels to deliver short term ROI. The case can be made for radio *if* effective messaging can be developed.

Size of Budget

Television continues to be the first medium of choice. Many advertisers will use television if they have a lot of money and only consider radio if the budget is “too small for television”. There have been cases where radio has been used at the outset and successfully built the business. However when the advertiser could afford it, the advertising budget has been moved to television. The rationale has been, “*Radio can only take us so far*”.

Cost and Availability of Television Creative

This issue was raised several times in our interviews. Either the planned media expenditure was too small to support the production cost of a TV commercial, or the available television creative did not deliver the required message. This latter issue came up particularly in the context of US developed creative imported into Canada. We would conclude that the increasing North American consolidation of television creative production is a positive development for radio.

Media Mix

Effectiveness research is showing that two advertising media in combination are better than one in building awareness. This is enhanced by a decision environment of increased experimentation. This creates opportunities for radio to be added to the media plan in a broader range of advertising categories.

Market Specific Campaigns

Television's market specific options are declining as Specialty and regional combinations are increasing. This opens the door for radio.

Relative Media Cost Efficiency

Surprisingly, the relative cost to get the message to an individual is not a key deciding factor in most cases. This works against radio which is substantially more cost efficient than either television or newspapers.

Promotional Support

Advertiser promotional support historically has been an important competitive advantage for radio. Planners still cite promotions as a criterion for using radio. However broadcasters are cutting back on the amount of promotional activity and are creating station focused promotions in which advertisers can participate, rather than customized advertiser promotions. These promotional opportunities are typically offered to the largest customers first. We would conclude therefore that promotional support is increasingly a tool to maintain large client budgets, and perhaps solidify station share rather than a catalyst for new revenue into the medium.

The Cost of the Plan

The decision to put one medium versus another in the media plan generally is not driven by the cost to effectively communicate using that medium. However when this cost comparison is done it does not favour radio. Typically media planners plan fewer GRP's for both television and newspaper in any given time frame. So although radio is more cost efficient in terms of message delivery, this cost efficiency advantage is diluted by virtue of the radio plan requiring more messages delivered than either television or radio. Here is a hypothetical example of this effect:

Medium	Cost/Rating Point (Cost Efficiency)	Planned 4 Week Campaign	Campaign Cost
Radio (30 seconds)	\$100	600 Rating Points	\$60,000
Television (30 seconds)	\$200	360 Rating Points	\$72,000
Newspaper (1000 line 4 colour)	\$130	200 Rating Points (One insertion per week)	\$26,000

As can be seen, radio is twice as cost efficient as television (Cost/Rating Point) but the campaign cost for radio is only marginally better than for television.

There is in fact no scientific support that these varying weight levels by medium deliver equivalent communications effectiveness. By and large the planned weight levels by medium are a matter of convention.

Target Group

This issue is a dichotomy. Radio has traditionally positioned itself as a highly targeted medium. It allowed advertisers to hone in on key prospects, both demographically and attitudinally by carefully picking stations, dayparts and even specific features such as newscasts. Radio has an outstanding industry research study, *BBM RTS*, which provides both buyers and sellers with a wealth of information about consumer media and, more specifically, radio behavior defined precisely by product and service usage.

Yet increasingly radio is imitating television and is being planned and bought on broad demographic target groups such as women 25 - 54, as the following chart indicates.

Radio Ad \$ Targeting by Demographic Group

Age	% of Ad \$'s
25-54	51.4%
18-49	19.0%
18-34	8.3%
25-49	7.2%
18.0	3.1%
Total	89.0%

Source: David Bray, Hennessy & Bray

The reason for this can largely be attributed to the increasing media agency involvement in the planning and buying process. The agency planners are applying television methodology to radio planning. However the broadcasters are exacerbating the situation by promoting run-of-schedule (ROS) advertising campaigns and putting a high cost premium on more specific advertising scheduling that could provide more precise targeting.

The result is that radio is losing its historical targeting competitive advantage, at least among advertising campaigns planned and bought by media agencies. As a result Target Group is not a significant factor in the decision to include radio on the media plan.

Geography

The smaller or more precise the advertiser's geographic coverage, the greater is the advantage for radio. The growth of specialty television has made television much more of a national medium than in the past.

Language

Language is not a significant media choice decision criterion. However French Quebec has a lower per capita share of ad revenue going to radio. This is analyzed below.

Share of Category Ad Spending

There has been a rule of thumb that an advertiser's advertising budget as a percent of total category ad spending should be proportionate to his share of market. This has been overtaken in many cases by the mantra "*We need to do more with less*". Share of spending will usually not be a criterion for allocating budget by medium. However a competitor's success using a particular medium will spawn imitators.

Reach/Frequency/Duration

The science of advertising effectiveness is dominated by message content (creative). Research shows that up to 80% of campaign effectiveness is a result of creative. The other 20% is determined by how the messages are distributed. Message distribution is measured by the number of people who have the opportunity to see or hear it (reach), the number of times they are potentially exposed (frequency), and the duration of the advertising activity.

There are all sorts of theories on what constitutes the right mix of these three factors. And it is generally accepted that the ideal mix varies by product, category, communication task, competitive environment, and medium. Television will often get favoured on the media plan when the

strategy focuses on reach and longer duration. Radio will get favoured when the strategy calls for high frequency over a shorter period of time.

Minimum Thresholds

Media planners work with minimum thresholds of, reach, frequency, and duration. These vary by medium, client and by planning agency. There is a wide range of positions on minimum thresholds based on many different proprietary and industry studies. However the universal tenet is don't employ a secondary medium until you have established threshold levels in the primary medium. Since radio is most often a secondary medium it may not get on the plan simply because there isn't enough incremental budget beyond what's required for the primary medium's minimum threshold.

9. Audience Measurement

Radio audiences are calculated from listener data recorded in diaries for a seven day period. It is a very inexact methodology but is universally accepted. There has been a long simmering debate as to whether more weeks should be measured and whether more sample should be collected during measured periods. The industry has decided to move to more continuous audience measurement in large markets. This benefits the buyers but is of concern to some broadcasters who must contemplate greater marketing budgets to promote their station over a longer audience measurement period.

The measurement system appears to have little if any effect on advertising investment into radio. At the illogical extreme, there are many small markets that do not subscribe to any audience measurement. If media buyers cannot buy GRP's they will default to buying spots. Invariably a "spot buy" will deliver more revenue to a station than a "GRP buy" would have.

The next generation of audience measurement will use a personal people meter (PPM) technology. Survey participants carry a gadget the size of a pager that captures an imbedded signal identifying any radio station within hearing distance. This is a far more accurate audience measurement system. But it will change station shares and tuning levels. There is test activity going on in both the U.S. and Canada which will aid buyers and sellers in making the transition. This new methodology will not significantly affect ad investment to radio. It may however lead to higher marketing costs for radio stations. It will be a more expensive audience measurement system than the diary methodology. The broadcasters will bear most of the cost of this audience measurement investment.

Recently Erwin Ephron, a well known U.S. industry commentator, published a paper entitled "*Reach Trumps Frequency - How Radio Can Build Business in a PPM World*" It makes a compelling case that when radio is planned differently, especially with the help of PPM data, it is an ideal reach medium. Planning for continuous reach is a common practice among national

advertisers. So in the longer term PPM radio audience measurement may be a valuable tool for radio to make greater inroads into the national advertiser revenue pool.

10. Advertising Medium “Trade-off” Analysis

From which media do incremental radio ad dollars typically come? Conversely to which media do advertising \$’s typically go if they are removed from radio?

It would appear that in radio’s largest categories; retail, automotive restaurants, financial services, and petroleum products/auto parts & services, radio’s success has been at the expense of daily newspapers. This conclusion is supported by radio’s significantly higher revenue growth compared to newspapers. We believe this trend will likely continue.

Radio, at least recently, has won ad dollars that otherwise would have gone to television. Lack of appropriate television creative and high cost of TV creative have been cited for this dynamic. We have also discussed above advertisers’ increasing willingness to experiment. But we are in the early stages of this evolution.

We believe radio is most at risk from television. Large retail chains such as Wal-Mart, radio’s key constituency, are embracing television. Radio continues to be more often than not the secondary medium. If budgets are tight or media planners can’t hit minimum thresholds in the primary medium radio is at risk.

11. Key Issues

11.1. The Economy

Fundamentally advertising follows the economy. It does not lead it. Radio as a retail medium is more sensitive than television to changes in retail sales. While this report is not meant to be an economic treatise there are two specific concerns that were raised several times by our interviewees.

Consumer Debt and Interest Rates

A recent Globe & Mail article stated that 60% of Canadian mortgages were renegotiated over the past year saving the average household \$1,900 yearly in mortgage payments. It is estimated that \$7 billion of extra consumer spending resulted from the 2004 rise in housing prices. Additionally, the line-of-credit debt increase was estimated to be \$9 billion. There is broad concern that even modest increases in interest rates will put the breaks on consumer spending, retail sales, and in turn advertising expenditures.

Energy Prices

High energy prices add cost to products and services. In a low inflation environment these costs cannot be passed on to consumers and will therefore cut into manufacturers and retailers margins. Advertising is a variable and discretionary expense and will be adjusted downward to offset lower margins.

If, when, and to what degree these scenarios unfold is a matter of speculation. However we do know that advertisers are very concerned and have their collective hands on the advertising expenditure tap.

11.2. Satellite Radio

“Don’t push the panic button for regular radio” Toronto Star June 6, 2005

“It could lead to the death of the entire AM band” Globe & Mail June 17, 2005

“It will have the same effect as when cable took television beyond 24 channels and they started digitizing their networks”
Globe & Mail June 17, 2005

A survey by Solutions Research Group suggests there could be as many as one million satellite radio subscribers in Canada by the end of 2007.

As can be seen there is much exuberant rhetoric and prognostication surrounding the Canadian satellite radio launch. As a way to make some sense of this we looked at the U.S. experience.

- Since its launch in 2001, U.S. satellite radio’s subscriber base is reported to have grown to 10 million, 9% of US households. A similar penetration rate in Canada would yield approximately 1 million subscribers. We estimate the current Canadian subscription base to be under 100,000.
- In 2001 the U.S. had an unusual ad revenue drop of 9% - consistent across all media. We hypothesize that this was a fall-out from 9/11 during the fall of 2001. From 2001 to 2004 ad revenue growth in the U.S. and compared to Canada is as follows:

Percent Change 2004 versus 2001

	United States	Canada
Major Media Ad Revenue	+13%	+14%
Radio Ad Revenue	+10%	+14%
Television Ad Revenue	+23%	+15%

Source: TVB published data

U.S. radio has had a much weaker recovery since the 2001 downturn and this has coincided with the growth of satellite radio. It would be wrong to attribute U.S. radio's comparatively slower revenue growth substantially to satellite radio. However it would be reasonable to identify it as a contributing factor. Our advertiser and media planner interviewees all identified satellite radio as a potential detriment to the radio advertising medium. However generally there is a wait and see attitude. The conventional radio audience data will tell the story. Having said this we would predict that in the current "high noise" environment, satellite radio will be perceived as a bigger problem for conventional radio than it actually is. This may dissuade some potential radio advertising prospects from testing or experimenting with the medium.

11.3. The Internet and Podcasting

By and large radio broadcasters have a favorable view of the Internet. They view it as a complementary way to connect with their listeners. Additionally tests are underway to use the Internet as a cost effective programming research tool. However it does not appear that anyone has found the formula for substantially recouping Internet costs from advertisers.

Among advertisers and media planners podcasting is not well understood. However it is generally perceived as a positive development that may help the radio broadcasters repatriate younger listeners. We do not anticipate any significant ad revenue implications in the short or medium term.

11.4. The Youth Market & Radio

Clients, media planners, and broadcasters have pretty much abandoned radio as an advertising vehicle for the 12-17 aged market as the following chart shows.

% of Radio Ad \$'s Targeted to Youth

	% of Ad \$'s
12-17	0.3%
12-24	0.3%
18-24	0.2%

Source: David Bray, Hennessy & Bray

Radio is still used for 18/19 - 24 age group, a prime target group for the beer category among others. However there is increasing resistance from media planners and buyers, "*Radio is not the medium of choice*", "*We can't make radio work*".

Cancon requirements were cited as a detriment to youth radio, and in Quebec the 65% French language requirement was cited. Today's youth have access to all available music. These restrictions impede a station's ability to meet the youth market's range of listening expectations.

Will the Youth Radio Defectors return to radio as they age?

The argument "for" is that lifestyle changes will draw the youth back to radio. For instance car ownership will lead to increased driver tuning. Youth tastes will "mature" to embrace more mainstream radio formats.

The argument "against" is that once alternative forms of audio entertainment have become entrenched it will be difficult to get youth back to radio.

Both of these positions have merit and the reality will lie somewhere in the middle. We were struck by a fairly broad broadcaster sentiment that youth tuning is not so much a function of technological developments. Rather it is the result of the fact that radio has not programmed to the youth market because the advertising revenue available for this market would not support such a programming strategy, (witness CFTR). The sense is that ad revenue does and will support programming to older listeners, whatever that programming might need to be to attract them.

11.5. French Quebec Radio Advertising

While French Quebec is participating in the current mini-boom the statistics show that compared to both population and retail sales Quebec radio ad revenue is underdeveloped relative to the other Canadian regions. However this is not a problem unique to radio:

<i>French Quebec ad revenue as a percent of all Canada ad revenue:</i>	
<i>Television:</i>	<i>15%</i>
<i>Radio:</i>	<i>16%</i>
<i>French Quebec Population:</i>	<i>19%</i>

Source: CRTC Data, Statistics Canada and estimates

Radio revenue growth in French Quebec has lagged that in English Canada, but not by a large amount:

Radio Revenue Growth

	2005 versus 2001
Total Canada	23.7%
English Canada	24.3%
French Canada	20.3%

Source: CRTC data, Communications Management Analysis

We can identify several reasons for French Quebec's advertising underdevelopment:

- Historically French Quebec radio and television have both been under priced relative to other regions. Media planners are able to plan the same media weight levels in Quebec at less cost per capita.
- French television loses because French population viewership to English stations is often included in the planned media weight levels. This reduces the need for French language television. This in turn establishes benchmarks for the share of total ad \$'s that should go into French Quebec. These benchmarks get applied to radio as well as television.
- French Quebec is treated as a separate region from English Canada. Often budgets are split between English and French prior to the planning process. The entrenched proportions as discussed above are applied.
- Unfortunately French Quebec can be seen as a low priority area particularly by U.S. based advertising decision makers. A decision, for instance, not to bother with the cost of French creative will cut into French Quebec's share of advertising revenue.

11.6. Small Market Radio Advertising

The following chart compares radio revenue growth by market size. It appears that radio revenue is holding its own in small markets.

Radio Revenue Growth by Market Size

	2004 versus 2000
+500m population CMA's	+18.6%
250m - 500m population CMA's	+22.6%
100m - 250m population CMA's	+25.3%
Other 100m+ population markets	+11.7%
50m - 100m population	+21.8%
Less than 50m (200+ stations)	+18.6%

Source: CRTC data, Communications Management analysis

There was a general consensus among national radio reps and large media agency planners that radio ad budgets are becoming more concentrated in large markets at the expense of small markets. If this is true, small market local sales are offsetting this national decline.

Small market radio is somewhat insulated from ad expenditure declines by virtue of the need for franchisee/dealer support in every market. However it has been pointed out that small market radio stations often cannot drive revenue through rate increases. Advertisers often allocate budget to markets, particularly small ones, based on some ad/sales formula. This means that market spending is fixed. Rate increases simply erode the effectiveness of the ad campaign which in turn could lead to lower sales.

As a secondary issue, one of our interviewees predicted that satellite radio would inflict the most damage on small radio markets.

11.7. AM Radio Advertising Revenue

Media buyers indicate that AM radio has a stigma in small markets and expect the dollars allocated to AM to decline. However there is a sense that AM has a strong positioning in large markets. This is supported by the fact that some AM stations are getting premium pricing from media buyers.

It has been suggested that AM radio may be a stronger advertising medium than FM radio because the foreground programming causes listeners to be more attentive to the advertising.

The following data suggests that while AM ad revenue is doing reasonably well, it is significantly behind FM.

Radio Revenue AM versus FM

	2005 versus 2001
AM	- 2.1%
FM	+34.1%

Source: CRTC data, Communication Management analysis

11.8. Radio versus Specialty Television

It was pointed out to us in two of our media planner interviews that for an advertiser with a truly national market list, and where media coverage is required in every market, specialty television can be used as a lower cost, high profile alternative to radio. The advertising revenue trending data do not indicate that specialty television has had a negative effect on radio's growth. However the fact that specialty television now provides a viable, lower cost alternative for national retailers is a limiter to radio's share of revenue potential.

11.9. The Impact of Incremental Licenses

Media planners and buyers have come to terms with a dramatically more fragmented television marketplace. They have learned to deal with smaller audiences and, in fact, have capitalized on the greater number of targeting options provided by specialty television. A few more radio stations would not cause any concern.

However, media buyers thrive on an increased supply of advertising inventory. The cost per thousand audience delivery that media buyers have paid for specialty television advertising has been less than half that of conventional television. An increased supply of radio inventory will cause the same outcome for the radio industry. Media buyers will negotiate rates down to offset the smaller, more fragmented audiences, and they will negotiate for further discounts if there is an abundance of advertising inventory.

11.10. Radio Station Formats

For advertisers formats are only a means to an end - listener ad exposure. For media buyers, format changes are risky. They generally occur in response to a station's declining audience. And the impact of the change on audience is not measured for some time after the change. Unproven formats and music are most risky. Media buyers expect stations to test playlists and play familiar, proven music. New, unproven music simply presents an advertising exposure risk.

11.11. The Advertising Decision Maker/Broadcaster Relationship

The advertisers to whom we talked have a neutral view of the radio industry. A common sentiment is that they are "far removed" from the medium. Radio is seen as relatively issue free.

Media agency decision makers have a relatively negative view of the radio industry.

- Radio is poor at compensating for audience under delivery.
- Negotiations are far too difficult in small markets.
- Stations aren't willing to customize promotional support.
- Radio is attempting to push through unwarranted big rate increases like conventional television has done in its high demand periods.
- It's a fight to the death among radio organizations. They disparage each other. It's not good for the medium.

"The broadcasters need to stop being ostriches"

12. The Broadcasters' Outlook

Our broadcaster interviewees are broadly optimistic about radio's ad revenue prospects. While various steps are being taken to connect with advertising decision makers, the broadcasters generally agree that more needs to be done. There is a belief that while the Radio Marketing Bureau is doing a good job, there is not an industry effort to sell the medium.

Broadcasters are concerned about creative writers' attitude towards radio and about the lack of radio knowledge and expertise within the media agencies. They are concerned that radio is being commoditized by junior planners and buyers. They understand the buyers' concern that radio is too complicated to buy. They believe that radio may not be put on the plan as a result of the high cost of making the buy.

The consensus is that specialty TV is good for radio, the Internet complements radio, CBC is not a big issue in English Canada, but SRC's aggressive promotion activities in French Canada are a problem. Attitudes towards satellite radio are mixed.