



A reality check for online advertising

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Rising demand for online ad vehicles could surpass supply in the near term.

Internet advertising has recaptured the imagination of marketers, who see an enormous potential to raise the profile of their brands through vehicles such as paid search and online video. But the fact that scarcity is an issue for digital-advertising often gets lost in the enthusiasm. McKinsey research finds that bottlenecks in supply could limit the pace of online ad growth and raise prices over the next 24 months.¹ The study also suggests that a dearth of ad agencies that can manage both traditional and digital campaigns could further slow the shift in spending to online ads.

Our research combined quantitative analysis and more than 50 interviews with leading digital advertisers, ad agencies, and media companies. We compared both current and projected US ad spending for online vehicles—including video, banners, and paid search (ads tied to keywords that consumers enter in search engines)—with the maximum amount of advertising such vehicles could theoretically absorb today. This analysis revealed that the utilization of the most attractive digital-ad vehicles is already quite high and that, without large increases in the level of online advertising

EXHIBIT

Outstripping supply

Type of digital ad	2005, \$ billion		Inventory utilization, 2005, %	Projected spending, 2007, \$ billion
	Spending	Maximum spending possible		
Banner	2.0	4.0–8.0	~25–50	2.5
Paid search and inclusion ¹	4.7	5.0–7.0	~70+	9.0–12.0
Online video	0.3	0.4–0.6	~80	1.4–3.2

¹ Ads tied to keywords that consumers enter in search engines.

Source: AccuStream iMedia Research; ACNielsen; analyst reports; eMarketer; McKinsey analysis

“inventory,” demand could outstrip supply over the next 24 months (exhibit). While prices are a closely guarded secret, our interviews indicate that they are already rising and likely to jump further as advertisers bump up against constrained supply.

Short-term mismatches between supply and demand appear greatest for the video ads that interrupt or precede online content, such as news clips. The inability of consumers to skip these ads and their use of sound and motion—proven tools for driving brand awareness among consumers—make online video highly attractive to marketers. According to many of the video suppliers we interviewed, very little unsold advertising capacity remains today. Assuming that marketers don’t increase the number of ads they place in each video stream, the maximum supply of video ads is currently about \$600 million a year—far less than future demand, which we expect to reach \$1.4 billion to \$3.2 billion in 2007. Help will come from new strategies (such as Disney–ABC Cable Networks’ recent offering of television shows for download and the creation, by Ford Motor’s Mercury division, of a series of short online films), but they don’t seem likely to meet burgeoning demand on their own.

The situation is similar for paid search. Annual growth in the overall number of searches is slowing, from 30 percent in 2004 to 20 percent in 2005. Without significant changes in consumer click-through rates or in the prices advertisers are willing to pay, we estimate—using our analysis of the prevailing cost per thousand impressions (CPM) and Nielsen Media Research figures on paid search—that the maximum current value of paid-search advertising is about \$7 billion. Meanwhile, our analysis of current and forecast page views, ads per page, and CPM rates suggests that advertisers will want to

spend \$9 billion to \$12 billion on paid search in 2007, up from around \$5 billion in 2005. Even without severe supply bottlenecks, there won’t be room to handle rapid near-term growth.

Finally, although the inventory of banner ads—\$4 billion to \$8 billion—appears more than sufficient to accommodate the likely demand of \$2.5 billion, advertisers probably won’t be interested in much of what’s available. The complex task of spreading media spending across thousands of small Web sites, many with different ad formats, means that advertisers tend to return to heavily trafficked sites, where supply is at a premium. Even on the big portals, marketers are leery of having their ads placed near consumer-generated content that might be objectionable. In fact, advertisers currently direct 96 percent of their spending for online display ads to pages that represent just 30 percent of overall Web traffic.

Our interviews highlighted two additional hindrances. First, most advertisers expressed frustration at the small number of ad agencies with the skills to manage both traditional and digital campaigns. Many advertisers have no choice but to employ separate agencies and to coordinate cross-media efforts themselves, which makes it more challenging to manage—and evolve—their marketing mix. Second, the absence of a widely accepted independent metric for digital media (such as the NielsenTV ratings) makes it difficult to compare the results of online campaigns and to measure their impact—an uncomfortable fact for marketers considering major spending reallocations.

Of course, digital advertising won’t be permanently constrained. Consumers will eventually come to spend more time watching video on PCs and mobile devices. By some measures, they already focus upward of 30 percent of their media

attention online—a far higher proportion than advertisers currently spend there. Marketers and media players thus have an enormous incentive to innovate and increase supply, which, along with better measurement technologies, will allow marketers to shift more of their budgets online.

Marketers must build the capabilities necessary to thrive in an environment where audiences and vehicles are highly fragmented, prices change quickly, and advertising's performance differs by customer, vehicle, brand, offer, and message. This transition will require not only new management skills but also a detailed understanding of the marginal economics of products, customers, and customer conversion.

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¹ Spending for online ads reached \$12.5 billion in the United States in 2005, up from \$10 billion the previous year. By contrast, spending for traditional ads totaled \$220 billion in 2005.