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PORTRAITS OF CHANGE:

THE NEW ECONOMY

NOVEMBER 2021

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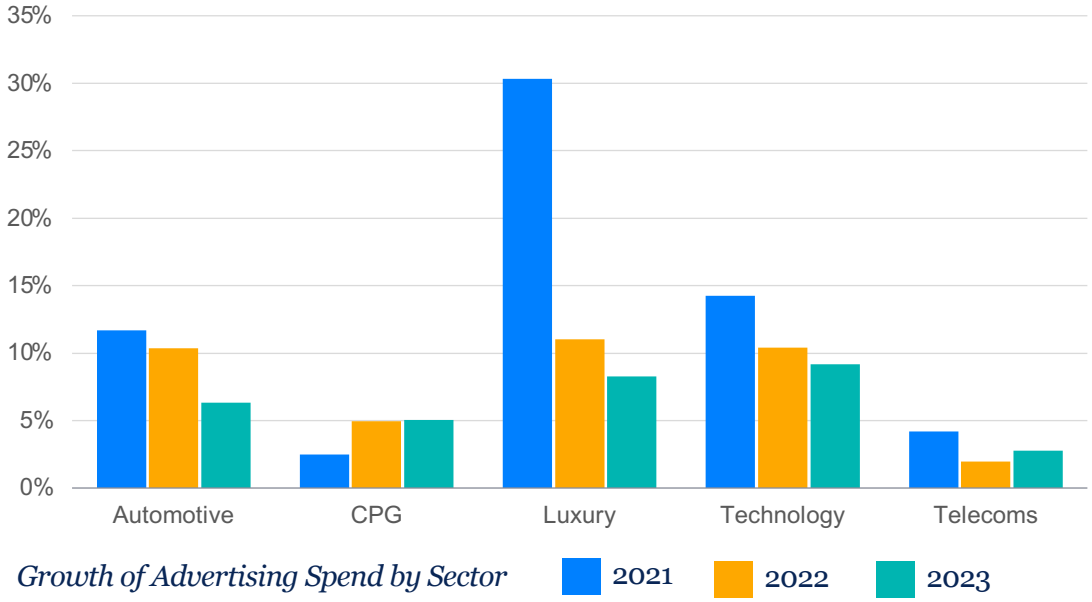
INTRODUCTION

Habits formed during times of adversity have a way of becoming permanent. Children of the Great Depression never outgrew the compulsion to conserve resources, and the women who entered the workforce during World War II never really left. Today, as offices and cinemas reopen and airports prepare for holiday crowds, we are in the exciting position of seeing which consumer behaviors adopted during the pandemic may be with us for the long term and how they will affect our culture, our economy and our industry.

To get the fullest possible understanding, it is helpful to look at the origins of these habits and how they've impacted various economic sectors thus far. This means looking backward so we can see what's coming. While we aim to maintain a consumer lens in our analysis, often the most detailed and accurate information about consumers can be assessed through extensive analysis of financial data from the companies they patronize.

This report focuses on five of the largest marketing categories: packaged goods, luxury, telecommunications, automotive and technology. By evaluating their performance over the past several years, as well as the headwinds and opportunities presented by these unusual times (supply chain changes, product distribution and sales, the capacity to operate digitally), we hope to emerge with the clearest possible picture of how our recent past is shaping the foreseeable future.

Forecast Growth of Advertising Spend by Sector 2021-2023



Growth of Advertising Spend by Sector

COMMON THREADS

The pandemic challenged the long-term trend toward greater global connectedness, between consumers and business but also within and across industries. We saw Covid disruptions in Vietnam create a shortage of apparel and footwear in the U.S. Shipping companies were forced to divert cargo to avoid regions under lockdown. Meanwhile, China is increasingly separating its internet and policy from the rest of the world, despite rhetoric and Belt and Road initiatives espousing greater international cooperation.

As a result, some companies are becoming more tightly connected within markets while concurrently becoming more deeply tied to specific media owners and brand-related choices at a global level.

Looking across our five sectors, we have noted three common threads of shifting company activities as a result of changes in consumer behavior.

Business transformation accelerates

While some consumers and businesses responded ad hoc to unanticipated shifts in the environment, others dusted off or accelerated existing plans that turned out to be well-designed for current circumstances, particularly in cases of digital transformation. Overall, the usually slow pace at which brands develop their portfolios has clearly accelerated. Automotive manufacturers are pushing technology services integration into cars. Telecommunications companies are more heavily prioritizing advanced network deployments. Packaged goods companies are building out their e-commerce strategies. And everyone is looking to control more of their consumer experience in physical and virtual channels.

Businesses are rethinking their dependence on distant markets and companies

Over the past 40 years, China established itself as the factory to the world. Companies of every kind outsourced much that was deemed “non-core” and transitioned their businesses to meet just-in-time requirements of customers. This helped minimize inventory and related costs. These supply chain optimization efforts coincided with the opening of global trade, facilitated by improving international cooperation, falling trade barriers and improving transportation links.

While there were some reversals of this trend before 2020, they were dwarfed by the reversals during the pandemic. With supply chains interrupted, companies that had made themselves too dependent on external entities typically lost more control of their businesses, causing them to question whether the savings they received from outsourcing their global supply chains were worth the benefits.

With these changes in mind, many companies are shifting aspects of their operations and becoming more tightly connected within markets. For example, packaged goods companies are establishing direct store-distribution models, apparel companies are onshoring manufacturing into the markets where goods are bought, and some technology companies are designing and bringing to market their own processors—all while becoming more deeply tied to specific media owners and brand-related choices at a global level. Distribution models are shifting, too, increasingly focused on integrated omnichannel or direct-to-consumer efforts where manufacturers control their sales and much more of the customer experience.

Marketers have opportunities to shift their advertising budgets to reflect these changes

To the extent that companies integrate their businesses more within markets, marketing strategies may become more integrated, too, as commercial results become much less dependent on uncontrollable actions by partners and more dependent on a marketer's own choices.

At the same time, as the dominant media partners are themselves increasingly global and account for growing shares of the global advertising market, many of the media choices marketers make will be strongly influenced by global preferences.

More tactically, while the increased importance of e-commerce contributes toward marketers' preferences around digital media, increasing focus on owned and operated (O&O) sales platforms and controlled distribution models could contribute to increased reliance on performance-based media.

Overarching these changes, marketers can continually look to reinforce the strength of their brands through ongoing efforts to better connect products with consumers in physical and virtual environments. All else being equal, stronger brands should lead to stronger performance and a healthier long-term growth profile.

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AUTOMOTIVE

From the earliest pandemic-driven fears of an economy-wide liquidity crisis to the demand-driven semiconductor shortages and seemingly never-ending supply chain consequences, the automotive industry has had a wild ride these past two years.

At the same time, the industry has seemingly pushed harder and faster than ever to address the threats and opportunities embodied in Tesla's rise, especially in relation to electrification of vehicle engines and better integrations with consumer-facing technologies, which are arguably the two key unique marketing-related issues for this sector at present.

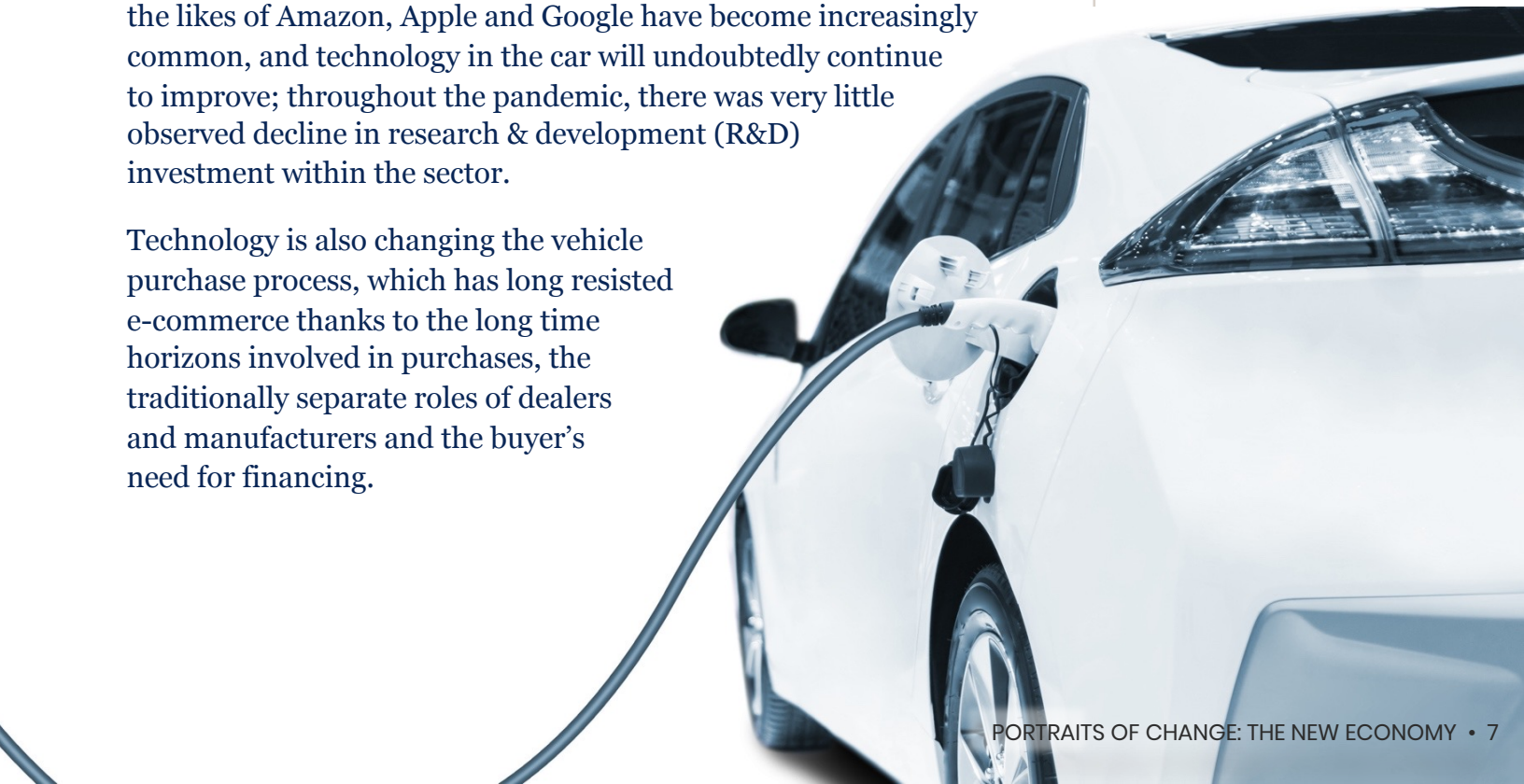
Regarding electrification, most of the industry now is focused on a world without gasoline-powered cars, aided by consumer interest but largely driven by regulators. For example, in July, the European Commission introduced a package of proposals that would require all cars registered in the bloc from 2035 to be zero-emission. According to the European Automobile Manufacturers Association, electric vehicles represented more than 10% of EU passenger car registrations in 2020.

Meanwhile, technology is transforming the automotive business in various ways, most notably through in-the-car experiences and autonomous driving. Many new models have dynamic entertainment systems and beefed-up driver-assist technologies. Partnerships with the likes of Amazon, Apple and Google have become increasingly common, and technology in the car will undoubtedly continue to improve; throughout the pandemic, there was very little observed decline in research & development (R&D) investment within the sector.

Technology is also changing the vehicle purchase process, which has long resisted e-commerce thanks to the long time horizons involved in purchases, the traditionally separate roles of dealers and manufacturers and the buyer's need for financing.

In July, the European Commission introduced a package of proposals that would require all cars registered in the bloc from **2035 to be zero-emission.**

Source: European Commission



MARKETING IMPLICATIONS

One of the key consequences of the current supply-chain issues is that manufacturers are likely to prioritize the production of higher-value vehicles. If semiconductor shortages are going to limit the number of vehicles that can be produced, automakers are likely to make up revenue shortfalls by increasing the revenue per vehicle, which contributes to higher pricing, on average. One could then make the argument for continued investment in marketing and advertising to convert consumers at higher prices now instead of waiting for a return to "normalcy." On the other hand, lingering fears of the virus could prevent consumers from relying on public transit in the near term. Therefore, the need for cars as commuter vehicles paired with ongoing low interest rates could be enough persuasion for some to pay up. Still, the consumer car-buying journey is likely to evolve, especially as wait times expand. This may cause some manufacturers to re-emphasize brand building rather than specific performance.

Looming in the background is Tesla, which, without spending much on advertising at all, has relied on its product and O&O dealer network to influence consumer preferences. That means that manufacturers need to find the right balance of resources that allows them to continue to invest in their own products while concurrently creating a desire for them.

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CPG

The CPG sector saw unusually strong growth through the pandemic.

Across the industry, over the last two years, the world's largest packaged goods companies grew by an average of nearly 5%, substantially above the sub-3% annual growth rates observed in the years immediately preceding 2019. Because so many of the factors driving this growth are unique to the pandemic era—stimulus checks, more time at home, etc.—most companies in the sector appear to be aggressively modifying their portfolios to generate growth rates that exceed pre-2019 levels.

Companies in the sector are always pruning or investing to modify their portfolios of products. The pandemic amplified changes in product preferences in relation to health & wellness, sustainability and comfort. This has informed many of the portfolio management choices companies have made over the past year and a half. In recent months, there were several significant transactions, including:

Mondelēz International

acquiring Chipita for $2 billion

pepsi

announcing it would sell Tropicana and related juice brands for $3 billion

Unilever

purchasing Paula's Choice reportedly for $2 billion and commencing the sale of its tea businesses, reportedly for $5-6 billion

Nestlé

completing its acquisition of The Bountiful Company for nearly $6 billion

14%

The average share of revenue generated by e-commerce for CPG companies.

Source: According to GroupM analysis of company reports.

More generally, the pandemic has caused meaningful input cost inflation, spurred by supply chain bottlenecks and massive swings in demand for everything from commodities to warehouse space to truck drivers. Many manufacturers are trying—or planning—to pass costs along to customers wherever they can. But concerns over inflation and an aversion to raising prices have spurred many CPG companies to focus on Revenue Growth Management (RGM). With this approach, companies prioritize products or categories that are most likely to drive profitable growth. For example, companies may prioritize sales of premium versions of products with a higher price point, or they might adjust the "price pack architecture" by shifting the mix of price points and product sizes or volumes. Insights and data provided by retailers can aid many RGM activities. This data can inform shifts of promotional activity in-store by geography or product line and SKU rationalization, in which a company analyzes which of its products are most profitable based on production, inventory and storage costs, and stability of demand.

The good news for packaged goods companies is that these RGM activities are sometimes synergistic with other externally driven imperatives, like the call for greater sustainability and the shift to e-commerce (i.e., reductions in packaging are both cost-effective and good for the environment). Similarly, a more significant push into O&O e-commerce activities may reduce the cost of testing future product extensions or in testing initially smaller or experimental product opportunities while reducing large retailers' leverage (and associated costs).

MARKETING IMPLICATIONS

While some companies in the sector reduced their spending on advertising as a percentage of revenue during the first half of 2021, most companies generally increased their spending in absolute numbers. At the moment, the sector's marketing priorities seem to be greater addressability and efficiency in their media buys and a desire to recoup the increased investments of recent years.

Given the ongoing march toward the deprecation of third-party cookies on Chrome and additional privacy measures from Apple and others, it is unsurprising that many of these marketers—who ultimately sell most of their goods through intermediaries—are eager to develop their first-party data to apply it to their buys in digital media and television. While marketers in this category are always prioritizing their brand health, a focus on first-party data will continue to take on increasing importance, whether that means developing e-mail lists and subscription services or otherwise finding new ways to maintain a direct relationship with consumers.

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LUXURY

Few sectors were hit as hard by the pandemic restrictions as the luxury apparel, jewelry and cosmetics sector. But following the sharp downturn of 2020, the sector has largely rebounded.

Today, in an absolute sense, the sector can be considered healthy. The industry is growing at a mid- to high-single digit rate on a two-year average basis, which suggests that a significant amount of catch-up spending occurred over the past year.

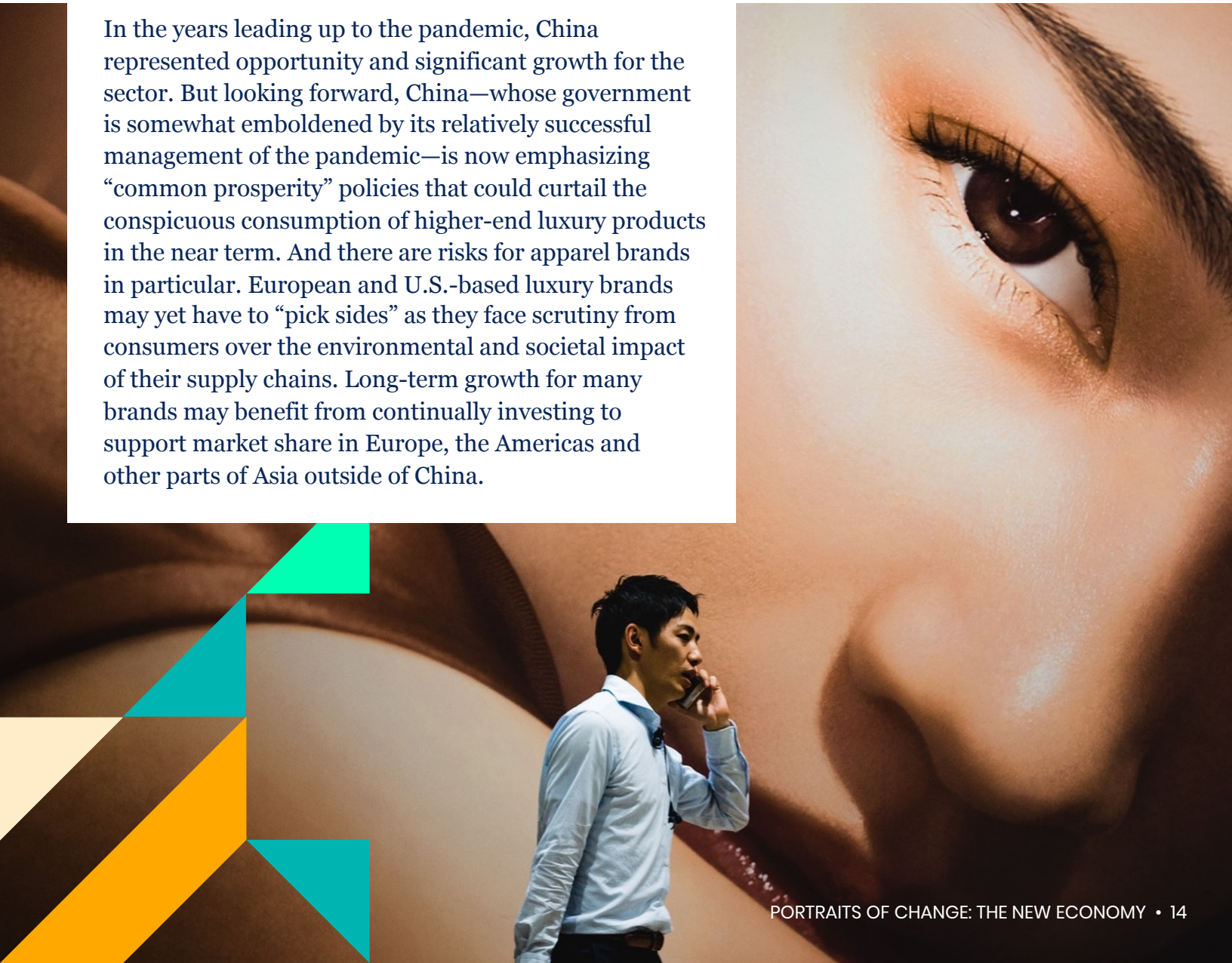
However, the current rate of growth still lags the sector's pre-pandemic rate, which was reliably in the double digits. Faster growth may return when consumers fully resume travel and social activities. Or the market for such goods may be decelerating thanks to slower levels of expansion and changing habits and preferences, particularly in China.

4.5%

Growth in the Luxury sector.

Source: According to GroupM analysis of company reports.

In the years leading up to the pandemic, China represented opportunity and significant growth for the sector. But looking forward, China—whose government is somewhat emboldened by its relatively successful management of the pandemic—is now emphasizing "common prosperity" policies that could curtail the conspicuous consumption of higher-end luxury products in the near term. And there are risks for apparel brands in particular. European and U.S.-based luxury brands may yet have to "pick sides" as they face scrutiny from consumers over the environmental and societal impact of their supply chains. Long-term growth for many brands may benefit from continually investing to support market share in Europe, the Americas and other parts of Asia outside of China.



Regardless of the situation in China, the industry's long-term health could still improve, especially as companies increasingly focus on driving wholesale activities into O&O retail environments, including online and offline concessions where they control the retail experience and capture a larger share of consumer spending within the category. At a practical level, this contributes to the reluctance many companies express in selling goods on a wholesale basis to third-party e-commerce platforms. It is particularly true in the case of higher-value "hard" luxury (higher-end fashion and jewelry), where consumers are more likely to buy the preferred brand wherever they can find it. It will be less true where preferences among consumers are looser, as with lower cost "soft" luxury (cosmetics, for example).

MARKETING IMPLICATIONS

While spending on advertising is unlikely to reverse direction or alter the brand-centric nature of these companies, it is possible that slower growth could lead many luxury companies to focus more on performance metrics and the media that drives them. This would coincide with the increased emphasis on O&O sales channels, allowing companies in the sector to better assess cause and effect in their spending, at least relative to retail sales. Certainly, companies in the sector are investing more heavily in data and analytics capabilities and will be well-positioned to shift their marketing emphasis in that direction.

At a tactical level, as long as travel remains constrained, spending on historically common activities such as advertising within airports will continue to shift toward near substitutes such as outdoor advertising in city centers.

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TECHNOLOGY

The technology sector has benefited from a pandemic-induced shift in consumer spending away from in-person services and experiences toward a reality where things like work and entertainment happen all inside the home, powered by various devices and digital services. Assessing the industry on a two-year average basis, we see historically high levels of growth: PCs and mobile handsets revenues grew by approximately 10%, while TV set manufacturers' businesses grew by nearly as much. Gaming hardware and software fared even better, growing by more than 20% on average. B2B software-focused companies were strong, too, with revenues growing at high single-digit levels. Chip shortages pose risks to growth going forward, but the industry has a history of finding innovative ways to do more with less, shifting features to require less processing power, substituting software for hardware or, if all else fails, building demand for products that won't be available for many months to come.

PC's and mobile handsets revenues grew by

10%

while gaming grew by an impressive

23%

Source: According to GroupM analysis of company reports.

Because growth in the technology sector was partly fueled by government-based stimulus payments, lockdowns and other social restrictions, it remains to be seen how the industry will perform as societies emerge from the pandemic. In some cases, changes in demand may become permanent: Consumers may require more home technology as hybrid learning and working becomes a norm, for example. On the other hand, the large peak of technology purchases over the last 18 months may lead to a more uniform lull in the product upgrade and replacement cycle over the next several years.

All this success has not gone unnoticed by governments and regulators. In the U.S. and the EU, regulators and the courts are weighing action on multiple fronts, including the commission charged to developers in app stores and the incompatibility of device chargers across brands. Any significant changes to mobile device manufacturers' business models or hardware will have a monetary impact, though it is unclear how much of that cost will be passed to consumers, particularly given the increased anxiety over inflation. Chinese technology companies are also under increased scrutiny, with new regulations in that country over the amount of time minors can play video games, for example. These companies will also be expected to contribute more significantly to China's "common prosperity" policy going forward at some not inconsiderable expense.

Similarly, companies operating outside of China will be expected to make more significant contributions to social welfare in countries around the world, as it appears likely that a global agreement placing a 15% floor on corporate tax will go into effect. New costs imposed on companies in the sector are unlikely to meaningfully impact innovation by incumbents any time soon. However, we are always mindful of the unintended consequences that may follow from increased government involvement in any sector of the economy.

MARKETING IMPLICATIONS

Marketing will remain a powerful lever for maintaining brand visibility, especially in a world of product shortages. Strategies will need to evolve, however. Marketers lacking widespread availability of products will need to consider strategies that focus on interim content or product updates.

More generally, to the extent that growth in customer spending continues, we expect the category to remain highly competitive for marketers, mainly because competition is robust across different technology verticals. We see this play out within categories, with advertising budgeted relatively consistently as a percentage of sales. Therefore, rapid industry-wide revenue growth should continue to fuel industry-wide ad spending growth for the foreseeable future.

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TELECOM

Connectivity mattered a lot during the pandemic, and there's no sign it will be any less critical in the future. Whatever shape communication trends take, telecom companies will be at the forefront.

Despite all the ways that connectivity has become more global, the industry continues to be siloed on a country-by-country basis. This is due primarily to the high infrastructure costs and investments required to provide service and the regional nature of communications regulations and spectrum allocations. Efforts to drive synergies from selling bundles of products—mobile wireless and home broadband, for example—or improving network access within countries seemingly produce greater benefits versus operating networks of similar products across countries. Capital appears to generally follow from this idea, as we have seen with M&A activity during the pandemic, similarly more focused within countries rather than across them. In part, this may be due to the relative commoditization of many legacy product offerings and the increased availability of competitive services from new players within countries, such as traditional cable operators and software companies at a global level, which have constrained growth for the industry's incumbents.

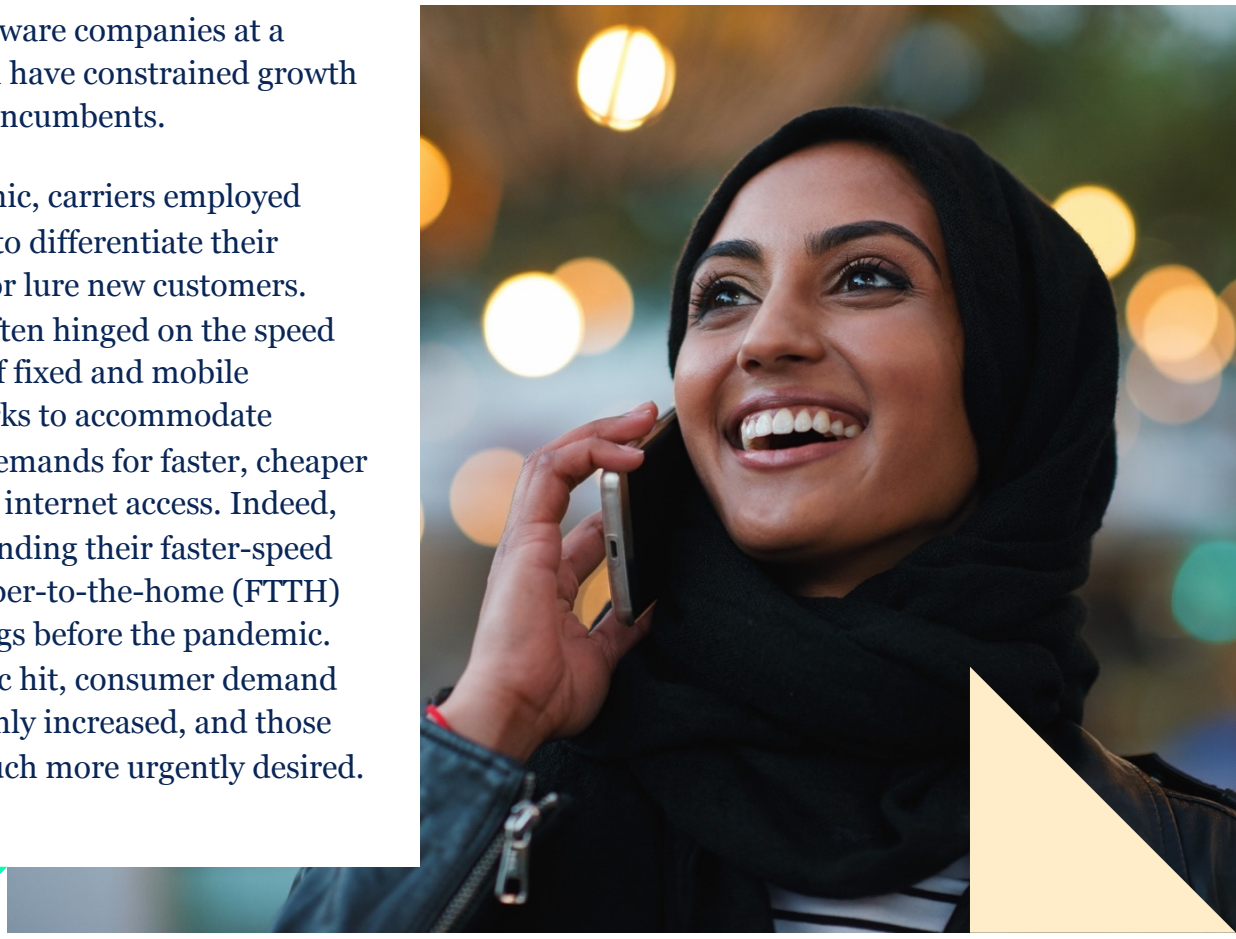
U.S. mobile carriers' plan 5G services for

50–90%

of Americans by 2023.

Source: According to GroupM analysis of company reports.

Before the pandemic, carriers employed various strategies to differentiate their services to retain or lure new customers. These strategies often hinged on the speed and accessibility of fixed and mobile broadband networks to accommodate rising consumer demands for faster, cheaper and more efficient internet access. Indeed, carriers were expanding their faster-speed 5G wireless and fiber-to-the-home (FTTH) broadband offerings before the pandemic. Once the pandemic hit, consumer demand for better access only increased, and those efforts are now much more urgently desired.



By now, many telecom companies view 2022-2023 as prime years for consumer adoption of 5G services following network launches in 2019, expansion in 2020 and a greater focus on device sales in 2021. Across the globe this year, carriers have made sizable gains in 5G subscribers. In China, the three largest carriers now have more than 500 million 5G subscribers, for example. Other markets generally have lower penetration levels but are poised for significant growth. Investments in 5G are mirroring efforts by many carriers with fixed networks to broaden the availability of access to direct fiber connections installed at the household level (known as FTTH).

MARKETING IMPLICATIONS

Wherever advanced services are available, carriers are likely to focus on driving awareness of those services through advertising. Competition between legacy cable companies and telecommunications networks will undoubtedly contribute to those efforts, as well.

The mass shift to remote work during the pandemic caused businesses and their employees to place greater value on high-speed access, and implementation of hybrid workforce models will support ongoing demand in many quarters. Of course, the tech industry is bigger than just remote workers, but until widely appealing consumer offerings that require faster internet access come to market, the industry may struggle to persuade consumers to upgrade. Augmented or virtual reality offerings from entertainment companies, governments or others could provide catalysts. However, there is a chicken-and-egg dynamic at play—companies will hesitate to unveil products that require 5G until consumers commit to it, and consumers will hesitate to commit until enough products are available—that could delay meaningful adoption for the foreseeable future.

WHAT'S AHEAD

"Portraits of Change: The New Economy" serves as an updated outlook on May's "Emerging Stronger: Building Brands in a Transformed World" and November 2020's "The Great Shift" before it. Going forward, the "Portraits of Change" series will provide twice yearly perspectives on how sectors are evolving as result of changing consumer habits, technology and economic trends.

The data and outlooks represented in "Portraits of Change" serve as an accompaniment to GroupM's twice yearly This Year Next Year forecasts, with the next update scheduled for December 6, 2021.

Detailed briefings on any or all of the five sectors covered in this publication are available from GroupM's Business Intelligence team on request. To request a briefing, email: Business.Intelligence@GroupM.com.

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