EXECUTIVE INSIGHTS

Key Investment Themes in Marketing Technology

Marketing technology martech is a large and growing segment of enterprise SaaS. Used by several marketing and related functions to engage customers, martech has been around for decades but continues to evolve with new capabilities. Large organizations often have more than 100 different martech tools in use. But what does this mean for today's martech stack and investment opportunities to capture the next phase of growth?

Despite its relative maturity, we believe today's martech stack offers plenty of opportunity to catch a new wave of growth. In the U.S., spending on marketing and adjacent customer experience and engagement technologies exceeded $50 billion for 2022. And signs point to continued growth: 90% of chief marketing officers (CMOs) are expected to maintain or increase martech investment over the next year.

Will those expectations hold up? Likely yes. Martech is more resilient to macroeconomic conditions than other marketing spend. Part of the reason is that many martech initiatives currently underway are multiyear transformation efforts that require ongoing investment to complete. But CMOs often double down on customer experience during times of economic uncertainty. And many companies want to retain their ability to attract and retain customers so they can emerge from a downturn in a stronger position.

In this L.E.K. Consulting *Executive Insights*, we unpack the key trends and priorities driving martech's growth and what they mean for investors as they weigh their bets in this dynamic market.

Consumer trends and CMO priorities

Seven key trends are contributing to the rise in martech spend.

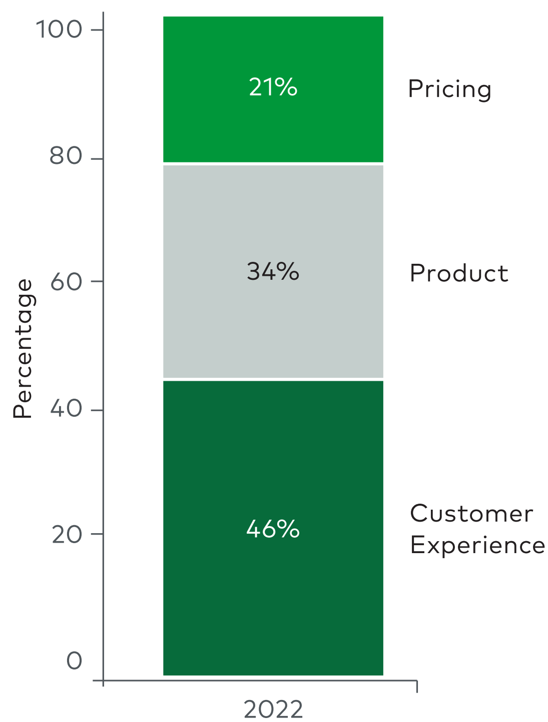
1. The continued growth of ecommerce

Despite a significant pull-forward due to COVID-19, U.S. ecommerce spend shows no signs of slowing down. eMarketer expects ecommerce sales to grow roughly 12% a year, reaching $1.7 trillion by 2026.[1] The boost in sales has led to increased competition from both direct-to-consumer and business-to-business brands, as well as from brick-and-mortar retailers intent on developing omnichannel sales.

2. Customer expectations for personalized, engaging experiences

Investments in customer experience can pay off with greater loyalty, satisfaction and engagement. Research from data-marketing company Epsilon, for instance, reveals that 80% of customers are more likely to buy from a business if they feel their experience is personalized.[2] And 80% of customers in a Qualtrics-ServiceNow survey say poor customer experience has caused them to abandon one brand for another.[3] As a result, customer experience has become a top priority for brands, ahead of product or pricing initiatives (see Figure 1).

Figure 1
No. 1 stated priority for brands in the next five years



Source: SuperOffice; L.E.K. research and analysis

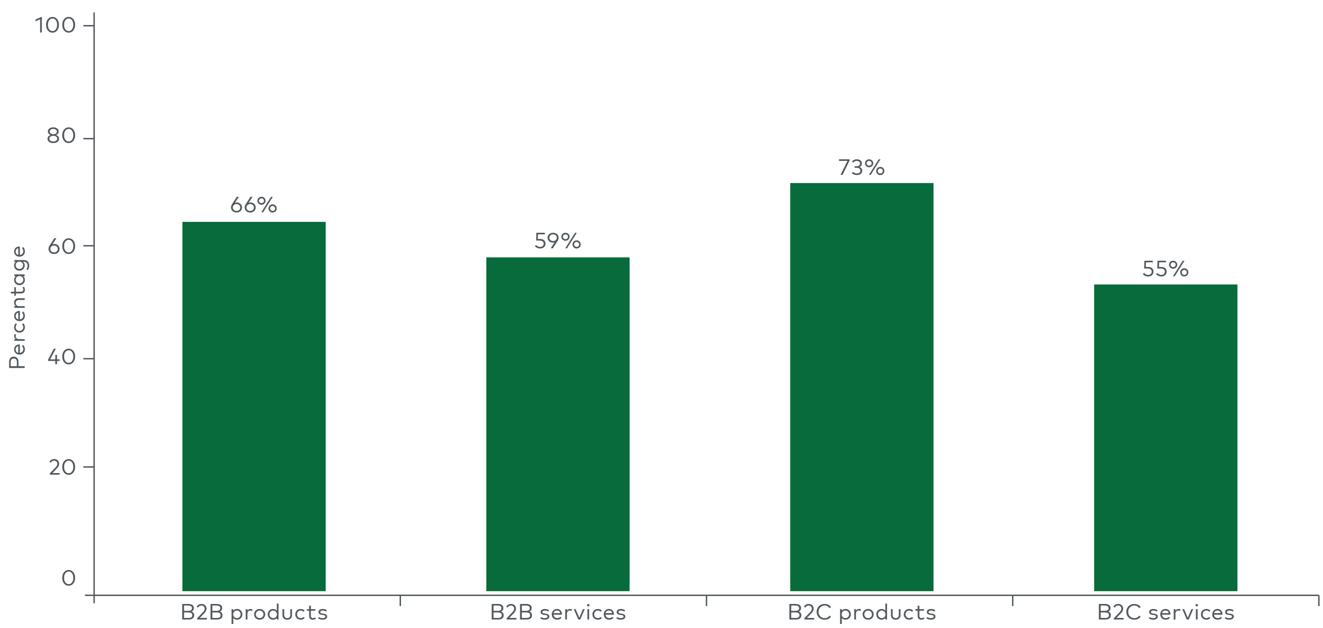
3. The need to reach customers in the moment, wherever they are

Multichannel capabilities are important because consumers now expect brands to meet them where they are. According to a study from payment app Mitto, 90% of consumers would rather use their favorite channel to interact with brands.[4] For two-thirds of Gen Z and millennial customers, that favorite channel is SMS text messaging.[5]

Brands have begun to adapt. Although email remains the most common communication channel, marketers are increasingly using SMS, in-app push notifications and a growing array of social media to reach their target audiences. Nearly half the marketers in a HubSpot survey say they're using at least four channels, while just 8% say they're sticking with a single channel. Data from The CMO Survey shows that this channel expansion is taking place across both business-to-business (B2B) and business-to-consumer (B2C) environments (see Figure 2).

Figure 2

Proportion of CMOs reporting to have increased the number of marketing channels used over the past three years.



Note: CMO=chief marketing officer; B2B=business-to-business; B2C=business-to-consumer
Source: The CMO Survey; L.E.K. research and analysis

4. Social influences directing purchase decisions

More than ever, consumers are relying on social sources to inform their purchase decisions. A whopping 85% check online reviews before they buy. At the same time, just 33% of consumers say they trust traditional media sources. That makes it imperative for brands to establish a strong social presence and manage their online reputations.

According to eMarketer, by 2024 roughly 80% of brands will be on Instagram, 60% on Facebook and 55% on TikTok. Referral marketing platform Referral Rock reports that 95% of marketers say they monitor their brand's online reputation in some way and 79% typically reply to all reviews.

Addressing customer complaints and other issues is one way for brands to maintain a good reputation online. Other ways include frequently posting well-vetted content, working with social media influencers (including micro- and nano-influencers) and encouraging consumer engagement (e.g., likes, comments, reviews) to raise brand awareness.

5. Technology improvements enabling a more orchestrated end-to-end customer journey

Automated customer service is getting better thanks to improvements in natural language processing and artificial intelligence. AI also enables greater personalization by identifying customer behaviors and micro-moments that signal buying intent. Recent developments like generative AI could even help companies personalize the customer journey at scale.

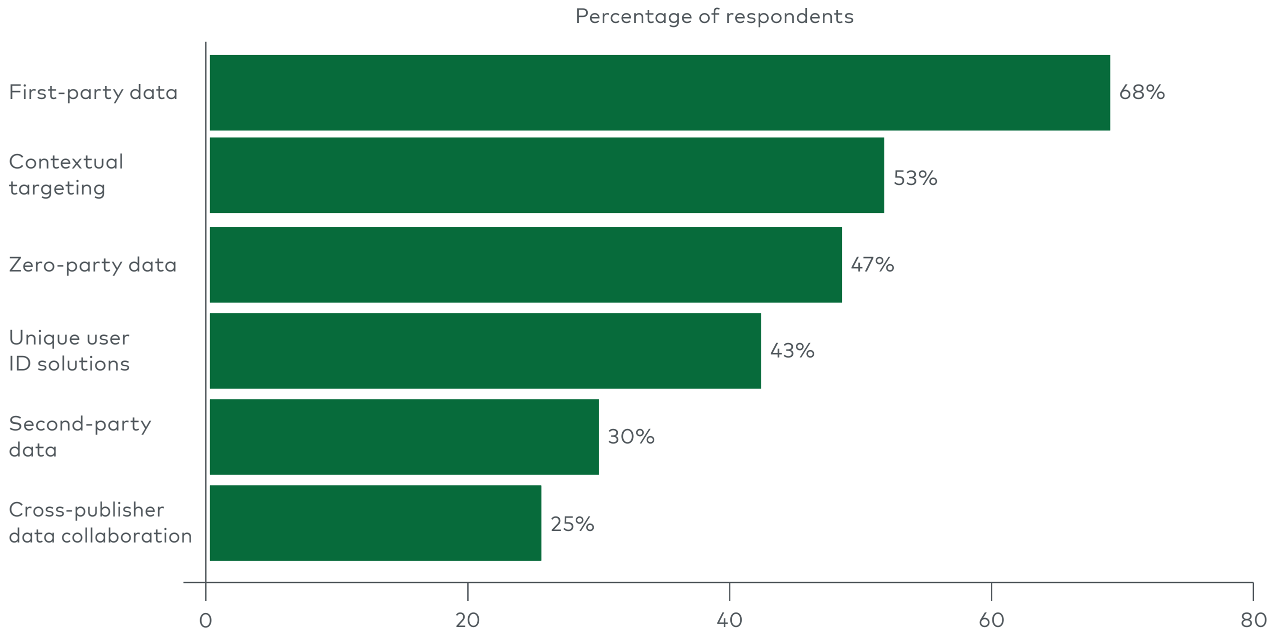
Still, it's a challenge to coordinate automation across different marketing channels and stages of the customer journey. That may explain why, according to Gartner, just 20% of respondents reported that they have successfully implemented customer journey optimization (JO) across the end-to-end customer journey. Within two years, 94% of respondents expect to be pursuing JO (including those that have implemented, are currently piloting and are planning to pursue within the next two years), reflecting the coming saturation of this approach across the customer engagement landscape.[6]

6. Marketing effectiveness amid a shift to consumer privacy

Third-party cookies drive a significant portion of online ad spend today. Brands use them for ad targeting, retargeting, cross-site tracking and more.

But third-party cookies are likely on their way out due to privacy concerns. In response, brands are building out a range of alternatives. These include improved data and analytics (think identity graphs or data clean rooms), the use of first- and zero-party data, and user ID solutions like contextual targeting (see Figure 3).

Figure 3
Strategies brands are pursuing to mitigate the loss of third-party cookies



Source: PubMatic/Digiday; L.E.K. research and analysis

7. A focus on efficiency and provable ROI amid tighter budgets

According to a recent survey by Propeller Insights, 84% of marketing professionals are under pressure to prove return on investment (ROI) to justify marketing spend or budget increases. Such scrutiny tends to increase during times of economic uncertainty.

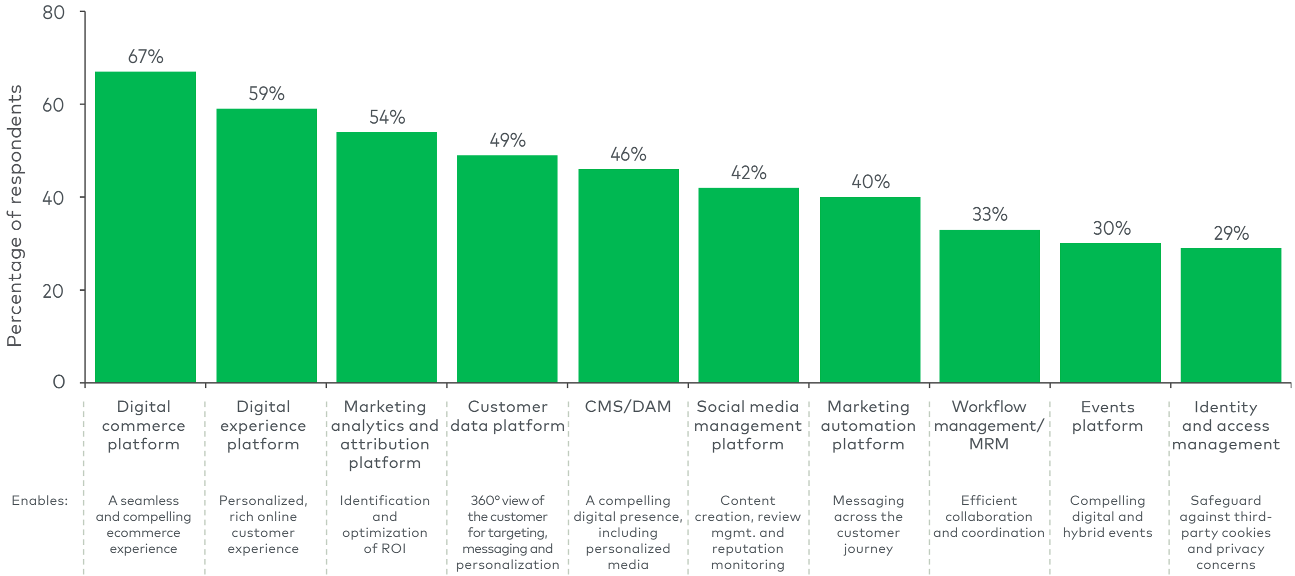
Marketing operations, with their focus on data analytics, can help organizations measure ROI and improve marketing efficiency to boot. That may be why the average marketing operations team has grown 66% since 2020, according to data from Highway Education and Demandbase.[7]

The martech vendor and deal landscape

These trends are prompting CMOs to invest across a range of martech categories and solutions (see Figure 4).

Figure 4

CMOs' key areas of planned investment in next 12 months, by marketing solution type*



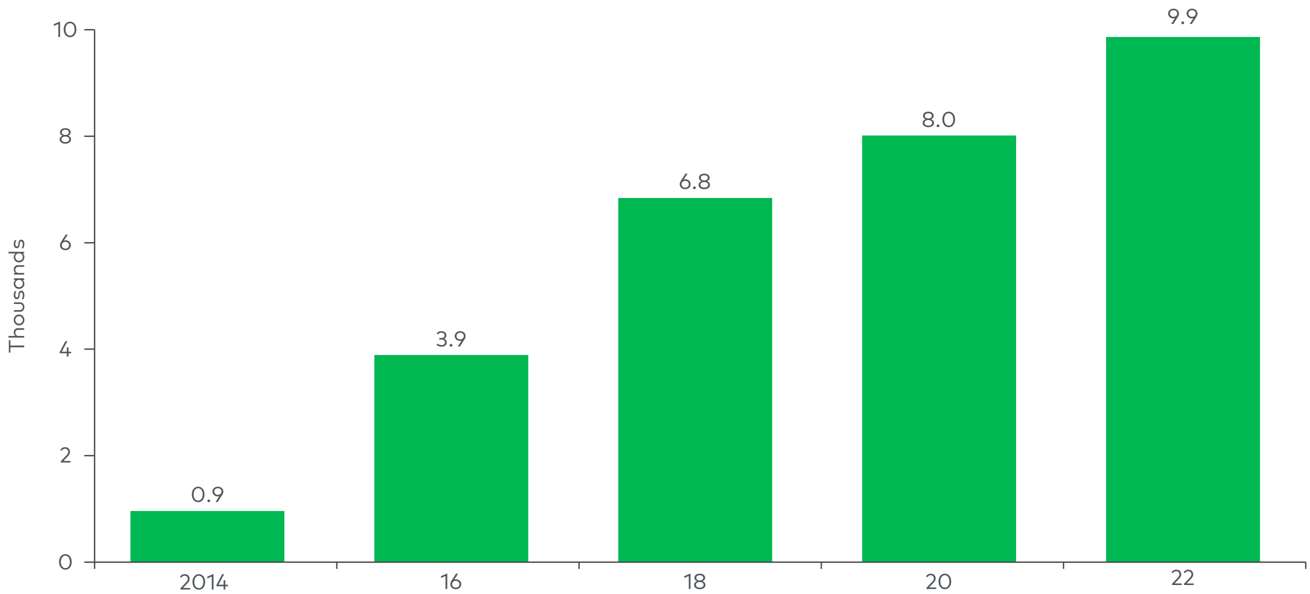
*Includes adoption of new solutions, purchase of additional modules or functionality, and/or switching solutions
Note: CMO=chief marketing officer; ROI=return on investment; CMS=content management system; DAM=digital asset management; MRM=marketing research management
Source: LXA (Survey of 202 CMOs conducted in September 2022); L.E.K. research and analysis

Where companies are spending depends on how mature their marketing organization is.

- **Novice marketers** aim to build around existing solutions for greater functionality and effectiveness. Many use only email marketing, if they use anything. They're also hyperfocused on cost and ease of use, given limited organizational resources. According to IDC, 52% of these companies plan to switch vendors or change their martech stack in the next 12 months.
- **Maturing marketers** are looking to increase capabilities to meet customer needs. Most already have multiple solutions and platforms. They're focused on ease of use and simple integration, with a particular interest in vertical solutions. IDC says that 54% plan to spend more on new martech in the next 12 months.
- **Expert marketers** want to augment their current stack with best-in-class functionality. These companies often have marketing stacks centered around one of the major marketing clouds, with many tools and solutions augmenting functionality for more niche applications. Extensive integrations and customization potential are table stakes for these customers. This aligns with IDC data indicating that more than half of large enterprises expected to increase their spend on martech in 2023.

The market has responded with a proliferation of point solutions. Since 2020, nearly 2,000 new companies have launched. Now marketers have close to 10,000 different solutions to choose from (see Figure 5).

Figure 5
Number of martech solutions on the market

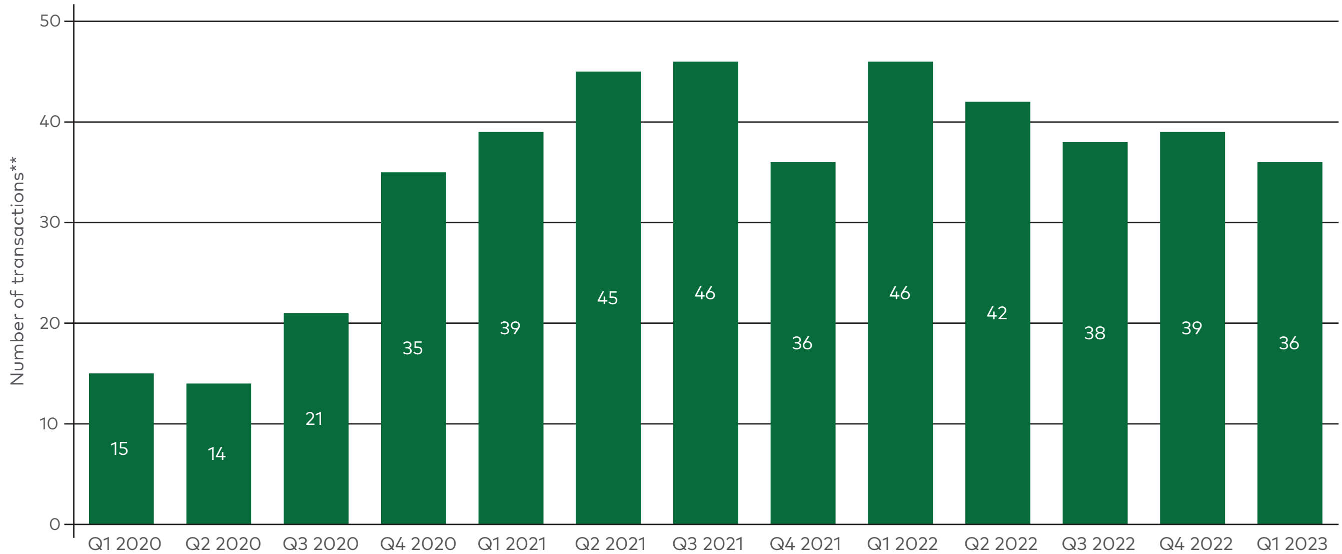


Source: Chief Martec; MarTech Alliance; LXA; L.E.K. research and analysis

In a bid to reduce complexity, many enterprise customers are turning to integrated suites. According to Gartner, 60% of respondents say that they prefer an integrated suite approach today, compared to 42% a year ago. But if the choice comes down to functionality versus simplicity, most customers will choose the former — especially where cost, ease of use or vertical alignment is concerned.

Meanwhile, mergers and acquisitions have boomed, although average deal sizes have trended downward as more and more point solutions are consolidated (see Figure 6).

Figure 6
Martech M&A activity, by quarter* (Q1 2020-Q1 2023)



*Based on Luma Partners LLC 2022 Market Report
**Does not include ad tech or digital content transactions
Source: CabinetM Inc.; Luma Partners LLC; The New York Times; L.E.K. research and analysis

Strategic and financial sponsors are creating new, innovative platforms to meet specific customer needs by combining individual point solutions into more effective suites.
For example:

- Campaign Monitor has acquired capabilities in automation and loyalty through its acquisition of Cheetah
- Constant Contact's acquisition of SharpSpring and Vision6 brings it customer relationship management and lead generation capabilities
- Episerver acquisitions of Optimizely and Welcome add commerce/content management system, personalization and marketing resource management, creating a rich digital experience platform

Investment considerations

What do these tailwinds mean for investors? We believe there are three key areas to focus on:

1. Best-in-class point solutions. Expert marketers will continue to augment their marketing or ecommerce clouds with best-in-class point solutions. These solutions must meet the advanced needs of enterprise customers — including scalability, security, strong customer support and strong integrations with existing clouds. Furthermore, these point solutions

must have a defensible moat such that they are not easily obviated by major marketing clouds.

2. Midmarket platforms. Maturing marketers are rapidly evolving their capabilities and looking for easy-to-use solutions to advance beyond simple ecommerce experiences and email or social marketing. Platforms that provide these customers with broader functionality in an easy-to-use package are well placed to ride the wave of midmarket adoption as customers graduate from disparate point solutions.

3. Industry-specific solutions. Novice and sophisticated marketers alike are attracted to industry-specific tools — from specialized functionality to simple templates and workflows — as an entry point into more advanced functionality. An industry-specific solution can stand alone, or it can be a module of a broader platform. Either way, it must easily integrate with adjacent industry-specific software to avoid unnecessary technical and integration issues.

Despite economic headwinds and a challenging deal environment, the fundamental drivers of martech adoption — changing customer behavior and the need for digital transformation — are still in place. That's left many attractive opportunities for investment. There are many considerations in uncovering those opportunities, but they should all lead to a martech solution that offers measurable, provable ROI plus seamless integration. Those are the ingredients for adoption, satisfaction and stickiness among the companies that use it.

For more information, please contact strategy@lek.com.

Endnotes

[1]eMarketer, "US Retail Ecommerce Sales, 2022-2026." https://www.insiderintelligence.com/chart/257063/us-retail-ecommerce-sales-2022-2026-trillions-change-of-total-retail-sales

[2]Epsilon, "New Epsilon research indicates 80% of consumers are more likely to make a purchase when brands offer personalized experiences." https://www.epsilon.com/us/about-us/pressroom/new-epsilon-research-indicates-80-of-consumers-are-more-likely-to-make-a-purchase-when-brands-offer-personalized-experiences

[3]Qualtrics, "Research: 80% of customers said they have switched brands because of poor customer experience, and poor customer service experiences drove the most people to switch." https://www.qualtrics.com/blog/qualtrics-servicenow-customer-service-research/

[4]Mitto, "Two-Thirds of Gen Z favor text messaging over email during ecommerce interactions." https://www.mitto.ch/blog/two-thirds-of-gen-z-favor-text-messaging-over-email-during-ecommerce-interactions/

[5]Ibid.

[6]Gartner, "Disruptions Derail Progress in Martech Utilization." Benjamin Bloom, VP Analyst; Rob Brosna, Senior Director Analyst; Aparajita Mazumdar, Principal, Research; Michael McCune, Senior Director, Advisory; Amber Boyes, Director Analyst. Sept. 6, 2022. https://www.gartner.com/en/marketing/insights/technology-emerging-trends. GARTNER is a registered trademark and service mark of Gartner, Inc., and/or its affiliates in the U.S. and internationally and is used herein with permission. All rights reserved.

[7]Highway Education and Demandbase, "The State of Marketing Operations Talent: 2022." https://www.demandbase.com/wp-content/uploads/marketing-operations-talent-report-2022.pdf

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