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"Advertising Agency Procurement: Overcoming 6 Obstacles to Achieving Marketing Supply Chain Efficiency and Effectiveness"

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EXECUTIVE SUMMARY

In a recent study by the CMO Council, $1.5 Trillion is the annual global external spend by marketers on marketing communications. This is an upward advertising economic trend and is a large target for marketer procurement to focus on when seeking improvements in how they source, manage and align resources such as advertising agencies and marketing services providers. From our individual assignments, we find there can be a range of a 2.5% to 25% in marketing supply chain efficiency without loss of effectiveness. Applying that to a $1.5 Trillion global annual spend at the midpoint of range, this means $18 Billion in potential annual advertising procurement savings.

Drawing from our experience on client engagements across many industries, the co-authors identify Six Key Obstacles standing in the way of improving Marketing Supply Chain efficiency and effectiveness. They are:

1. Marketer Accountability
2. Absence of a Codified Agency Compensation Methodology and Contract
3. Agency Compensation Tied Only to Inputs
4. Agency and Marketer Alignment
5. Media "Group Think"
6. Cost Containment vs. Value Added

Overcoming obstacles requires fundamental changes to status quo thinking relating to marketing and advertising sourcing, reward systems, communications specificity, media selection, and alignment between agency and client marketing/procurement. Variables include corporate culture, knowledge, and implementation skills. *Resulting benefits are better execution, lower costs, value added, and, importantly, happier supply chains.*

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BACKGROUND

There are many obstacles that prevent marketing supply chains and advertising agency procurement from being more efficient and effective. This paper focuses on six key ones we have observed in our work as external advisors that, when overcome, make a big contribution in terms of money and resources to a marketer:

1. Marketer Accountability
2. Absence of a Codified Agency Compensation Methodology and Contract
3. Agency Compensation Tied Only to Inputs
4. Agency and Marketer Alignment
5. Media “Group Think”
6. Cost Containment vs. Value Added

The following are some of the facts from a recent study by the CMO Council that illustrate the magnitude of the opportunity and the untapped potential of identifying and correcting obstacles of the type discussed in this paper.

- $1.5 Trillion is spent annually on marketing communications worldwide, providing a large target for Marketers to improve how they source, select, manage, and align their agencies and other marketing services providers
- $330 Billion (or 22%) of marketing communications dollars are allocated to the production, management, and procurement of marketing content
- Around two-thirds (64%) of surveyed enterprises have regular collaboration between marketing and procurement and tighter relationships between the CMO and CPO are evolving
- Nearly two-thirds (65%) of surveyed marketers target print production, warehousing, and delivery of marketing consumables for greater sustainability (carbon footprint) for improvement, yet only 17% of them focus on centralizing diverse marketing supply chains as key to pinpointing waste, redundancy, and improved sustainability
- Only 25% of marketers have undertaken a comprehensive audit and analysis of costs and process efficiencies in their marketing and advertising sourcing
- Few marketers conduct a strategic analysis of marketing supply chain responsiveness, audit cost components, review advertising benchmarks, or regularly review supplier performance and yield
- Marketers looking for marketing supply chain improvements look either to the CMO to streamline this (56% did) or procurement (31% did)
- “Creative” design/development is viewed as the area in the marketing supply chain with the greatest potential for process, productivity, and performance improvements - 41% of marketers were recently looking to this area as a source of new cost containment

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The Six Obstacles

For each Obstacle we provide 1) a definition, 2) solutions we have used in the field, and 3) a case example of experience-tested examples on how to overcome the obstacle and enhance the marketing supply chain.

Obstacle 1.
MARKETER ACCOUNTABILITY

Obstacle Defined:

At many observed companies, marketing managers are held to a different standard of accountability than their agency and functional peers are with regard to hitting deadlines and line item budget accountability. As a result, value is sub-optimized.

Solution:

When timelines slip due to unrealistic marketer planning or poor execution, agencies are often expected to absorb the time overages without additional compensation. To compensate, agencies factor timeline slippage into the rates they charge and the hours they quote for task completion, costing the marketing organization more than what is possible.

While there is no place for CIOs to hide when a new system implementation is not up in time for a deadline or when a timeline overrun blows the budget, CMO budget overages caused by timeline slips or lack of execution can usually be hidden and offset by canceling or delaying late-year initiatives and canceling Q4 media runs. To the CEO and CFO, the CMO still comes in "on or under budget." And just as it is hard to quantitatively link marketing activity to revenue generated, it's just as difficult to quantify revenue lost when non-working dollars replace planned working ones, when planned media doesn't run, and when planned initiatives are canceled or pushed out to future quarters.

This Obstacle can be addressed by:

- Tying CMO and marketing personnel compensation to objectives that measure direct outcomes and their ability to execute (e.g. the ratio of working to non-working dollars, CPM efficiency, TRPs planned vs. delivered, etc…) in addition to coming in "on or under budget."

- Negotiating granular contracts, where both marketer and agency have "skin in the game," where aggressive fees on the agency side are matched by aggressive timelines and performance requirements on the Marketing side.

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Case Example:
Situation: A Financial Institution had a sequential approval process for its print ads. If a downstream approver modified something, it went back to the initial approver to start down the path again. Agency personnel expended additional hours as the client went through several iterations.

Action: The agency contract was re-negotiated so the marketer received reduced pricing in exchange for marketer commitment of no more than two approval iterations. After the second iteration, the agency was to be paid for their time at a pre-negotiated hourly rate.

Result: The approval process was re-designed so that all approvers were in the same room at the same time, up front, eliminating iterations. The client saved money. Agency personnel were freed to perform other activities.

Obstacle 2.
ABSENCE OF CODIFIED AGENCY COMPENSATION METHODOLOGY AND CONTRACT

Obstacle Defined:
Usually, agency remuneration definitions and performance measurement processes are not clearly stated and codified by marketers and agencies, leaving them to be resolved ad hoc, creating misunderstandings, and negatively impacting client/agency relationships.

Solution:
While there may never be “universal,” industry-wide accepted definitions for agency remuneration, there are codification “best practices” related to the processes of selecting, calculating and negotiating agency remuneration:

- Focus on the details. Drop “it goes without saying” when it comes to defining the remuneration.
- Involve and invest the time of an experienced marketing finance person in the type, design, and definition of every component of agency remuneration. Agency remuneration is a strategic imperative.
- Devise consistent reporting formats, timing, audit, and disclosure requirements
- Codify the above in the agency’s contract using examples and attachments

Case Example:
Situation: The large, global and highly diversified/integrated advertising budget (including traditional media, direct marketing, and digital) of a global consumer products company is managed by a global agency that is part of one of the largest communication networks. Client and agency have successfully partnered for over a decade.

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Their agency agreement was drafted 10+ years ago and the remuneration model chosen was labor based with calculation of direct hours/staff costs and of a multiplier per country inclusive of overhead and profit.

No specific definition was provided in the agreement for the calculation of the direct client hours vs. indirect and no breakdown was specified in the contract for overhead and profit. Moreover, the by-country multipliers had not been revised for more than a decade.

The marketer assumed over the years that the agency would calculate the fee components "as per industry standards." Given that there are no universal "standards" for definition of labor-based fee components, the agency applied the methodology they were most familiar with and accepted.

Action: The external consultant was brought in to help resolve the confusion, clarify definition misunderstandings, and to benchmark multipliers. An opinion was issued that focused on the full re-writing of the contract (in order to also include the several amendments issued over the years) with specific and detailed provisions on:

- Calculation of direct client hours, non-client agency hours, and total actual hours
- Calculation of salary used as "base"
- Breakdown of overhead and profit components
- Definition of costs reasonably included in overhead
- Design of quarterly reports with detailed information on actual and budgeted fee components

Furthermore, a comprehensive audit clause to ensure the return of all rebates and discounts (including volume discounts) was developed.

Result: The lack of transparency and focus on assumed "common sense" definitions created tension and waste of management resources for both parties.

The ultimate result was:

- An Agency Services Agreement in line with current best practices to ensure full transparency for agency compensation and audit
- Clear, streamlined reporting procedures
- 5% savings on annual agency remuneration
- An open and fruitful dialogue on agency remuneration and related policies and procedures between client and agencies

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Obstacle 3.
AGENCY COMPENSATION ONLY TIED TO INPUTS

Obstacle Defined:
Critics of agency remuneration models tied only to inputs (salaries, hourly rates, costs, etc.) argue they foster low productivity rather than efficiency; fees go up as staff is added regardless of the actual value produced or the “quality” of the work. On the other hand, models based only on outputs are complex and encompass metrics that are difficult to calculate, track, and manage; these make it challenging to arrive at a fair fee that is value based and economically viable for both parties.

The “golden mean” is a methodology that takes into account and balances both inputs and outputs. Most marketers and agencies are comfortable with input-based models that cover agency costs and a profit and where an output/performance compensation model provides a balancing element and ties profit to “value”. Some marketers, who have tried to shift to output (only) models, have discovered they require lengthy and elaborate processes and extensive fact databases for design and implementation. With open dialogue, transparency and goal setting, balanced, multi-faceted compensation systems work well for both marketer and agency.

Solution:

- Tie base agency remuneration in part to performance and “value-add” indicia (e.g., increase in market share and sales, agency performance evaluations, etc.) as these are perceived and acknowledged by marketing and financial stakeholders, employees, customers, and others as appropriate.
- Incorporate qualitative and quantitative evaluative elements identified through diagnostics and testing.
- Involve the agency in all phases of the process: design, negotiation, and data gathering; the agency needs to embrace and commit to everything and you will learn a lot about your agency in this regard.
- We have seen successful examples where an agency proposes a series of SOWs (each dimensioned with a fixed fee and staffing plan) that specifically spells out outcomes, deliverables, accountability, base fees, and rewards, particularly for execution-intensive projects (vs. strategic projects which can be handled differently based on specific agency resources required).
- The client counterpoint to this is independent benchmarking of inputs and outputs so a “golden mean” is achieved.

Case Example:
Situation: A Global Consumer Products company has an AOR global agency aligned with a large agency holding company. Annual ad spending is on the order of $1 billion. The marketer had previously implemented a comprehensive makeover of its compensation model from

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commission on media to fees linked to inputs and outputs (performance). Remuneration is calculated by country and brand at headquarters.

Action: Consultant is asked to assist, particularly with benchmarks, given client needs to avoid an “agency review” of the agency due to its outstanding work. Consultant helped determine agency costs, FTE levels and other inputs that could be compared to benchmarks, as well as develop benchmarks for performance outputs. Consultant ultimately asked to provide a “fairness” opinion on agency compensation arrangement that would address internal auditor’s question: “Is this agency’s scope, staffing and fee ‘good value-for-money’ and ‘fair’ for us?”

Result: The approach needed to ensure a disciplined remuneration system that worked for both parties and was understood by both parties in the same way. Definitions and methodology were key. Since the agency’s work was considered “outstanding” by the client, through use of a “fairness opinion” rendered by an independent third party, this approach was intended to avoid an “agency review” that would otherwise be required by terms of the agency contract.

It was essential that outputs and inputs be holistically considered in evaluating compensation so a “value approach to compensation was in place. The approach taken was several-fold by assessing and benchmarking a) agency inputs (scope, staffing, salaries. overhead, and profit, and multiplier) and b) value outputs. It was formally determined by the third party that compensation was indeed “fair” and in the context of these findings: 1) the cost of average agency FTE was +39% above benchmark due to staffing senior skew, 2) overhead rate was below benchmark, 3) profit was much higher than benchmark, 4) multiplier was within benchmark range, and 5) a sample of cost/deliverable showed none had a variance above + or – 10% of benchmark. In conclusion, the agency compensation methodology was also revised to have more based on performance/value (outputs) than had been assigned to inputs (labor/overhead).

Obstacle 4.
AGENCY AND MARKETER ALIGNMENT

Obstacle Defined:
In difficult economic times, all can feel stressed and taken advantage of when things do not work out as planned and when blamed for outcomes beyond their control. Advertising and other marketing communications professionals are especially sensitive to this, as neither marketers nor agencies have good measurement tools in place yet, though some progress is being made. When agencies suffer from this, it often leads to a “victim” mentality. Marketers often go to the other extreme and adopt an attitude of “we know what we’re doing, so do what we SAY and not what we DO”. There not only is lack of alignment, but in our experience, partnerships that are outright adversarial.

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Within the marketer organization itself, the disciplines of marketing, finance, audit, and procurement are often not aligned. None of this is beneficial to marketers or agencies. Lack of alignment negatively impacts an agency's work product effectiveness and efficiency and can be particularly detrimental to Brands and their relationships with customers.

Solution:

Resolution of this obstacle takes different forms. Here are some:

- Reduced to its essence, it is about honest communication between client and agency. Each needs to be candid with the other, not worrying about temporary hurt feelings. Candor only occurs in a minority of cases.
- Agencies need to be willing to negotiate larger risk-and-reward ranges to remuneration. Agencies (except, typically, for smaller ones) are by nature risk-averse and avoid putting "skin in the game" in legally binding ways.
- Agencies need to evolve their models, structures and strategic investments so they can generate economic results for their clients (and, of course, do well for themselves and their owners). This is something the agency needs to do. Clients can guide and provide input but cannot do it for the agency.
- Many advertising agencies are still structured to create broadcast TV commercials, and for this type of agency:
- Many large agencies still have senior-management intensive structures that are no longer realistic: they're too expensive to maintain, not responsive to client needs, not good for morale, and hinder the agency's creative talent pool. Senior account managers, in particular, need to demonstrate their worth to clients and to colleagues to avoid elimination.
- The good news is that many digital/interactive agencies have figured out how to deliver measurable value, are highly profitable, are fun places to work, and are able to walk away from clients' lowball offers and work elsewhere.
- Other professional services firms such as management consultants, lawyers, and architects, as well as a handful of agencies, have gone on the offense and are pro-active. Those that deliver economic value and thought leadership thrive.

Case Example:

<u>Situation</u>: The client was Automotive, and its global creative agency is part of a major holding company. Procurement is very unhappy with the agency's annual fee (even more than one would expect). Client marketing is very satisfied with the agency's work, as are consumers measured in terms of sales. All agree something is "off" with agency staffing and fee although opinions differ dramatically. The agency thinks "everything is OK."

<u>Action</u>: Agency requests, and client totally supports, a third party expert's staffing and agency compensation benchmarking and assessment (i.e., "fairness" opinion).

<u>Result</u>: The independent experts' fairness opinion concluded that:

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1. The agency's economics were within a reasonable industry benchmark range for salaries and multiplier although agency profit margin was at the lower end of range and overhead at the higher end;
2. Fee cost per deliverable was way above high end of range, and, importantly;
3. The client's Scope of Work for the agency was insufficiently detailed ("poor") creating slippage in timelines and deliverables where inefficiencies and ineffectiveness materialized; and,
4. The client's approval process was burdened with hierarchy driving agency's costs upward to meet client's processes.

However, once these were identified, with everyone on the same page in concurrence, changes were made with quarterly monitoring becoming essential to keep matters on track. Adjustments were also made to provisions of the client's contract in the areas of transparency and reporting. There was cost containment too — 21% of agency annual fee would result in client fee savings and re-investment but agency's projected profit margin was substantially increased.

Obstacle 5.
MEDIA "GROUP THINK"

Obstacle Defined:
Many advertisers sub-optimize their TV investments by advertising on over-priced programs. They often choose high reach, high profile, high cost programming that are justified by arguments of "environment," and "audience engagement."

Solution:
The problem with these arguments is that there is very little empirical data to support that high CPM (cost per thousand) ads are worth the premium price paid and intuitive arguments that suggest that they're not. For example, if asked what program you were watching the last time you saw a GEICO caveman ad, would you remember? Chances are that you'd remember the ad but not the program you were watching. If one remembers the ad but doesn't remember the program, then placing the spot on a few carefully assembled "efficient" CPM TV programs might be able to deliver the same number of impressions for significantly less.

This Obstacle was overcome by:

- Testing the effectiveness of high-reach, premium priced programming vs. high efficiency programming to see if the premium is truly justified (e.g., was there better re-call, higher consideration, higher likelihood to recommend, etc.).

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- Testing the effectiveness of high efficiency programming to see if there is any degradation to awareness, consideration, likelihood to recommend, etc. (e.g., did the baseline measures of any of these drop or was there no change).
- Asking one's self if a single exposure during the Academy Awards, NFL Football, or NCAA Finals is really worth 2 or 3 times more than reaching the exact same viewer thirty minutes prior, after, or on another day of the week while watching another program.

Case Example:
Situation: This Financial Services Company favored high-profile, high-reach, high-cost sports programming.

Action: A portfolio of efficient TV programs was carefully re-constructed that satisfied the planning parameters (e.g., target demographic, TRPs, day-part mix, etc.,) that the client had given to the agency.

Result: The efficiency program, when compared to the one recommended by the agency, cost 25% less and delivered the same number of impressions to the same target demographic. The client chose to divert a portion of its high-profile TV budget to more efficient TV programs to test its effectiveness. A year later, it concluded that there was no detrimental impact to the brand, awareness, etc., dropping $8M of efficiencies to its bottom line, and altered its go-forward TV media program strategy.

Obstacle 6.
COST CONTAINMENT VS. VALUE ADDED

Obstacle Defined:
Procurement brings value to the Brand through economics and cost assessment and process management. Striking the right balance between efficiency and effectiveness is learned over time. Those that do not create this equilibrium can wreak havoc on Brands, marketing communications, and agency relationships. Everyone on the client side, including supply chain, needs to know what motivates or de-motivates talent and what the Brand's needs are. Marketer *internal alignment* whose goal supports Brand betterment and wealth is a critical element towards obtaining the best client-side talent and external agency talent.

Solution:
Great talent ("superstar") is expensive at any senior level, particularly when done by an external agency or outsourced … although there is nothing wrong in doing it this way if it returns measurable "value-for-money".

There are different ways to approach this Obstacle:

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- Determine which internal resources would not survive without perennial external support and then replace them or wholly outsource their roles to eliminate redundant cost.
- Employing internal "superstars" vs. paying 3X for the same talent on the outside. Marketers can use a few flexible "superstars" at entry and mid-levels vs. solely at executive levels. This can save not only 75% per person (vs. hiring as external) but also produce the same or better value.
- The case can be made for outsourced superstars for solving a specialty issue or to add value that cannot otherwise be obtained.
- External agencies can and must add value, and be aware the risk inherent in internal brand management. A marketer brand director sometimes assumes he/she knows how to manage an ad agency better than the agency itself.

Case Example:
Situation: Client is a Major National Retailer. Its large digital/interactive agency is part of an agency holding company.

Action: Metrics were recently developed for comparing a digital agency's staffing, fee economics, and deliverables to industry benchmarks for like agencies. Procurement's task was to determine whether the agency's annual retainer fee is fair agency compensation, i.e.,

1) Within a range of "reasonableness" so the company does not have to engage in an otherwise mandated agency review, and

2) Given the level and type of agency talent provided to the client account whether "value" was being delivered for services rendered for the client's brands.

Result: Independent experts determined a) client's Scope of Work was viewed inconsistently by the parties and hence at variance, b) client and agency did not use the same definitions when developing the agency's staffing plan, and c) although the client thought the agency's fee costs were "high", in fact when benchmarked independently they were within a reasonable range. Marketing agency benchmarking required agency positions to be aligned to industry definitions and agency economics compared to like agencies in like manner so there was comparability.

The agency's fee did not change as the consultant gave the client its opinion that the agency's fee was "fair and a good value".

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In Conclusion

Six Obstacles stand in the way of improved Marketing Supply Chain efficiency and effectiveness:

1. Marketer Accountability
2. Absence of a Codified Agency Compensation Methodology and Contract
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4. Agency and Marketer Alignment
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Should you wish specifics of the study or to learn more, please email Lee Anne Morgan at lamorgan@morgananderson.com or Arthur Anderson at aanderson@morgananderson.com.

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