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“More Thoughtful Approach to Agency Relationships in Order”

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As republished from ChiefMarketer.com
January 26, 2010

The relationship between marketers and their marketing communications agencies has come a long way, particularly in the area of agency compensation. Unfortunately, there is still too much conflict, resulting in too many agency “reviews” that often result in a marketer switching shops without making a serious attempt to align the financial interests of both parties.

Changing agencies usually is a disruptive process for the brands involved. With the recession making everyone’s business decisions ever more critical, a more thoughtful approach to the marketer/agency relationship is in order. Although the bottom line is still of paramount importance, more attention needs to be paid to the day-to-day communications and expectations that define the relationship and drive the compensation model.

The nice thing about the 15% media commission model that marketers used to use for compensating agencies was that it was simple. Take the 15% commission and apply it to the media spend. But as client spending shifted increasingly to other types of marketing communications from media advertising—whether it was promotion, direct marketing, digital, events, or PR—the commission model fell out bed.

Of course, it didn’t help when media inflation came along and clients began to understand that agency profits for large accounts escalated beyond normal and, more important, that there was little if no link between agency compensation and agency staffing on the account. In the late 1980s, there was a shift toward new “labor-based” fixed fee models. These were based on a description of services required, staffing plans and FTE’s (Full Time Equivalent employees) but they generally fell short of best practices for both advertiser and agency.

Along the way in the continuum of compensation models, one thing has changed very little: agency non-transparency. As clients have become more sophisticated about agency economics, their requests for transparency have increased. Adding corporate procurement people to the mix has served to increase these requests. However, masters of consumer psychology that agencies are, they have proven to be adept at masking their cost structures—from overhead to staffing to profit. Whereas at one time it was standard for an agency to apply the same cost criteria to all of its clients, it has become standard for some agencies to customize their cost model to each client. What used to be an apples-to-apples comparison is now fruit salad. Adding to the marketer's dilemma, now the agency holding companies are negotiating their operating agency's compensation and contracts, and some holding companies have implemented "rules" forbidding transparency. How long this will last is uncertain, but it adds to a marketer's suspicion that it is not being treated fairly. An unfortunate side effect of this is that the focus of the discussion between client and agency is "money" (agency economics), rather than the quality and performance of the agency's work.

What are marketers to do? Barring a sudden end to agency non-transparency, the alternative consists of new methodologies, compensation processes and performance metrics. Someone armed with the right arsenal of quantitative and qualitative measures of the marketer/agency relationship can, in virtually all cases, independently benchmark them against industry standards. Such an approach also serves to help shift the focus of the discussion from "money" to quality and performance of the agency's work and its impact on the client's business.

One of the newest tools is the "best practice" Scope Of Work (SOW), a structured document linking deliverables, media spending and agency resources to the brand(s), process and results. Although the concept of a SOW document has been around since the demise of media commissions, only recently has it been given a full context of definitions and metrics to make it a key performance indicator for agency efficiency and effectiveness. For advanced marketers, a best practice SOW is also a key component for constructing the new coin of the realm, Value Based Compensation.

It is not uncommon for an agency to propose assigning, say, 132 full-time employees (FTEs) on a $250 million account that, based on similar accounts, could do just fine with 100 FTEs. Such disparity can easily represent a difference of $5 million in fee costs over a year's time, as well as increasing senior agency's management needs. Moreover, each agency has its own opinion as to not only total account staffing levels, but the seniority of each individual staffer involved. Without benchmarking to industry norms, who's to say what level of staffing is appropriate? A best-practice SOW document results in an optimal staffing resources plan that can be benchmarked while, at the same time, encouraging constructive dialogue between client and agency rather than "money" talk. It also embraces client marketing for a critical role rather than leaving it solely in the hands of client procurement.

In this difficult economic environment, agencies are well advised to be proactive and collaborative in their clients' efforts to bring greater transparency to the table. Yes, a "bad" client can use it against the agency, but a "good" client will appreciate the candor, and it will enhance the client/agency relationship. If an agency is reluctant to talk about underlying economics, the path open to marketers will be to talk about SOW, staffing resources and work processes. Done correctly, a best-practice SOW document is win- win for agency and client.

Above all, a best-practice SOW is a "living" document and a communications tool that can help to forge dialogue and transparent negotiation from its inception and throughout the year. It is a touchstone document for the effective management of the agency as well as discipline tool for the marketer.

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