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"Using the Right Metrics for Measuring the Agency Relationship"

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Although every advertising dollar spent should count, particularly in these difficult times, the agency relationship[1]—and agency compensation—have, to some, seemed either a) too "qualitative," and hence immeasurable, or b) not material enough in the overall marketing budget. However, today, nothing could be farther from the truth. In fact: Agency fees still represent from 5% to 20% of marketing communications expenditures. The adage, "a better agency relationship leads to better work, which leads to better business results", still holds. The agency relationship is one of the most important drivers of ROI for marketing communications investments. In fact, more and more, agencies are being called upon to participate in strategic planning decision-making.

Historically, traditional agency metrics consisted of a 15% fixed commission calculated on media-spending volume and nothing more. This situation has dramatically changed in recent years, and the situation today is very different from what it used to be. Methodologies, definitions, and performance metrics have been developed and codified, producing quantitative and qualitative measurement of the agency relationship that, in virtually all cases, can be independently benchmarked. This means more highly calibrated incentive arrangements are possible using the new metrics developed.

Marketers' management of the agency relationship has become performance-based, paralleling some aspects of Human Resource management, although it is more complicated and sensitive. These incentive arrangements are also being incorporated within marketing dashboards, balanced scorecards, and other marketing processes and tools.

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FIGURE 1. The Agency Relationship: Then & Now

Figure 1. The Agency Relationship: Then & Now

	1910	1980	1990	2000	2010
Spending Level/Type	Critical	Very Important	Important	Relevant	Relevant
Compensation Methodology	15% fixed commission	Variable negotiated commission	Labor-based fee	Deliverables-based fee	"Value-based" fee
Incentive	None	Sometimes bonus	Usually bonus	Performance incentive	Risk/reward
Transparency (Cost Metrics)	None	None	Some	Much	Total
Performance (Value Metrics)	None	Anecdotal	Sales, market share, agency performance -standardized	Business metrics, subject-matter metrics, agency performance evaluation	Robust 360 two-way - customized

The transparency of today's agency compensation methodologies, including hourly rates, is beginning to impact the opaque hourly rates generally used by other professional services. The range of compensation methodologies used by major marketers is diverse, and today incentive arrangements are used by 90 percent-plus of U.S.-based mega advertisers. There is, however, much work to be done to raise these to higher standards.

FIGURE 2. The Agency Relationship: 2008 Compensation Methodologies Metrics Framework

Figure 2. The Agency Relationship: 2008 Compensation Methodologies

BASE COMPENSATION	MAJOR U.S. MARKETERS
Variable Commission (volume-based)	14%
Annual Fee (scope/labor-based)	26%
Variable Fee (deliverables-based)	4%
Hourly Rate (annual & project-based)	37%
Risk/Reward ("value"-based)	2%
Hybrid	12%
Other	5%
INCENTIVE COMPENSATION	
Use by Large Advertisers ($100M-$500M expenditures)	48%
Use by Mega Advertisers ($500M+ expenditures)	91%

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METRICS FRAMEWORK

As agency fees evolved from fixed commission to more transparent labor-based, hourly rate, and other arrangements, the efficiency of the relationship, as well as effectiveness, came into play. Since benchmarking the agency relationship has become the norm, the metrics needed to do that continue to evolve. The result is a negotiated and customized agency fee and performance arrangement between each client and each agency. Benchmarking enables the marketer to compare and see each separate agency relationship in an overall context. It also enables development of “risk” and “reward” metrics for the economics of the relationship, and performance-based scenarios for facilitating this are on the rise.

The right metrics for measuring agency relationships are made possible by a framework that identifies issues and needs and fosters apples-to-apples comparisons. These are used by a CMO/CFO cross-functional team to:

- Define and motivate an agency’s best work for the year;
- Obtain the very best talent resources the agency has for the marketer’s account;
- Foster agency transparency, leading to accountability; and
- Link agencies’ fees to marketers’ needs and business results.

There are five core areas for measurement of the agency relationship. Each has a methodology, subsets, definitions, metrics, and benchmarks. The five areas can be communicated between client and agency through a facilitated “onboarding” process that assures both marketer and agency are on the same page, resulting in mutually embraced goals being communicated, measured, and monitored.

The five core areas are:

1. **Scope Of Work (SOW).** SOW “drives” the agency relationship using codified methodology and definitions, and is benchmarked.
2. **Staffing Resources Plan.** This represents the agency talent that “fires” and impacts efficiency, effectiveness, and quality of work product and, importantly, is benchmarked to SOW.
3. **Base Compensation.** This represents the marketer’s “investment” in the agency for the SOW and Staffing Plan. Its methodology and definitions are grounded in talent and economics: FTEs, salaries, overhead, profit, multiplier, and others, all of which can be benchmarked. A “risk” element is constructed in the Base Fee and is balanced with a “reward” element in the Incentive Fee.

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4. **Incentive Compensation.** This reward element motivates the agency to contribute a high performance level and is driven by three metrics, each having sub-metrics:

   a) client business metrics;
   b) subject-matter (e.g. advertising) metrics; and
   c) agency relationship performance metrics.

The Incentive Fee tops off the Base Fee and offers substantial upside to the base compensation.

Primary examples are:

- **"Business Metrics"** can be measures derived from brand tracking studies linked to brand goals, client "success" criteria, client revenues, and client market share. These are weighted and rated, usually through a marketer/agency brokering process, and then agreed upon.

- **"Subject-matter (Advertising) Metrics"** for a general advertising creative agency can be derived from TV advertising testing, website/digital results, email response rates, and ROI from addressable direct marketing programs. These are weighted and rated using the same brokering process as for Business Metrics.

- **"Relationship Performance",** the third element of the incentive fee, provides important feedback on what is working and what is not in the agency relationship. Its specifics are defined and brokered by both marketer and agency, with the focus usually on what needs to happen in the agency relationship to achieve successful business results for the marketer.

These can be determined by paper-based survey or—a better practice—by web-enabled survey, so many stakeholders can readily be included in the evaluation. Rather than a laundry list of tasks and "thing making", measures can include a combination of the agency's vital contributions such as thought leadership, innovation, collaboration, key services (disciplines), process management, and "stewardship". (Stewardship addresses such metrics as the agency's stewarding of the marketer's fee and expenditures, staffing the right resources on the account, and trending costs for the account downward.)

In a recent Association of National Advertisers survey, 82 percent of major marketers said agency performance evaluation was the single most important metric in an incentive arrangement. However, aside from a few best-practice exceptions, current approaches to relationship evaluation are old and tired. Also, there is little agreement between marketers and agencies on how to prioritize an agency's contributions to the marketer (see Figure 3).

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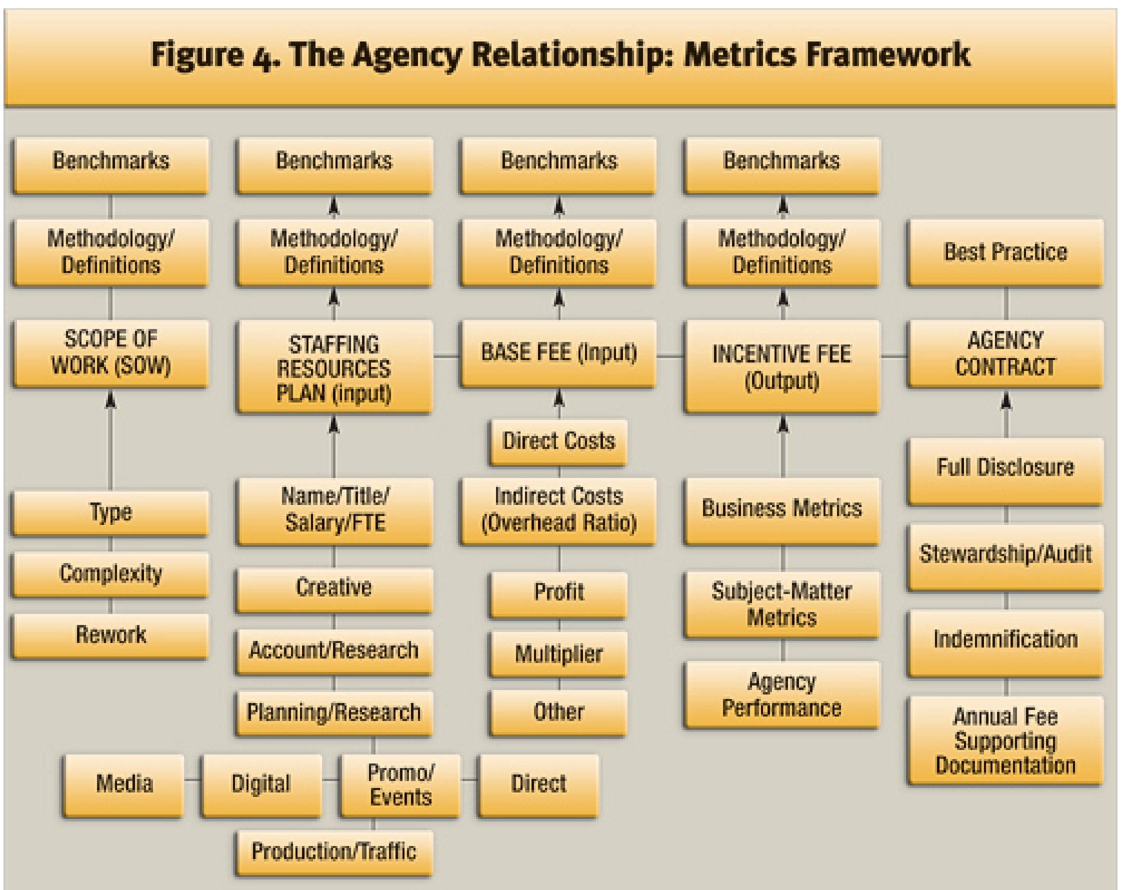
FIGURE 3: The Agency Relationship: Client/Agency Gaps in Communication

Marketers' Rank	Agency Contribution	Agencies' Rank
1	Develop and produce creative idea for marketer	4
2	Agency disciplines well integrated	6
3	Agency works collaboratively with marketer	19
4	Agency ideas are suitable for multiple channels	7
5	Best agency people are on marketer's account	14

Source: 2007 ANA/AAAA joint study

5. **Agency Best-Practices Agreement.** This is the legal platform for articulating the agency's stewardship, transparency, audit, and other fiduciary responsibilities, and the economics of the relationship, which can serve as guidelines for a periodic contract compliance audit. The agreement includes an appendix, which documents the specific agency business terms and requirements for the year, and legal counsel's provisions, which reside in the main body of the contract. A schematic for the metrics framework appears in Figure 4.

FIGURE 4. The Agency Relationship: Metrics Framework



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There are as many examples of the use of the right metrics for measuring the agency relationship as there are agency relationships. The “right” metrics result from the “right” due diligence, analytics, strategic thinking, execution, and measurement/monitoring. If John Wanamaker[2] were here today, he would say, “I know there is waste in the agency relationship; but now I know how to measure it.”

CASE STUDY: USING METRICS TO ASSESS AGENCY RELATIONSHIPS

The case example below involved a large consumer services/products marketer that wished to assign a brand to one of two advertising creative agencies, with media handled separately. Both Agency A and Agency B are highly regarded, award-winning agencies. Each has worked with the marketer previously.

A best-practice Scope of Work was constructed that was highly specific in terms of channels, deliverables, and agency resources required and budgeted by channel/brand. Driven by this, a Staffing Resource Plan was presented by each agency, including name, title and time allocated for each full-time employee (FTE) on the account. These were benchmarked to the SOW and recommendations were made by a third-party advisor. Once staffing was in agreement, each agency provided its costs and fee for the SOW. This enabled benchmarking to industry standards. Separately, legal counsel proceeded to draft the new agency contract, with an appendix of business terms and numbers documented by the marketer and its advisor.

The marketer and its advisor developed alternative fee and performance negotiating scenarios. For example, agency performance evaluation included features such as:

- Two-way 360-degree agency evaluation;
- Metrics developed from client and agency inputs with a development and vetting process facilitated by the advisor; and
- Web-based distribution of the evaluation survey so the agency relationship could be readily monitored and cost-destructive behaviors could be identified and changed.

At first blush, it would appear, based on the financials, that Agency A, which was proposing a materially lesser fee for the identical SOW, would get the nod for the assignment, given comparable creative talent. However, respective Staffing Plans and agency economics varied dramatically, and given other considerations such as agency culture, staffing and strategic thinking, Agency B received the assignment at a lesser negotiated Base Fee plus an Incentive Fee providing high reward opportunities.

The compensation requested by the agencies was $10.5 million and $13.8 million respectively, for the identical SOW. The final fee agreed to was a $9.5 million Base Fee, plus an Incentive Fee

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driven by business, advertising, and relationship performance metrics. This outcome reflected a re-defined Scope of Work, a rigorous Staffing Plan, qualitative and quantitative measurement

metrics, a heavily discussed and negotiated relationship evaluation program, and an "on-boarding" process to start the new year on a fast track to success. Given that client-agency communications and expectations were also on track, in addition to the right metrics for measuring the agency relationship, it was a win/win.

FIGURE 5. The Agency Relationship: Case Example Dashboard
(Per MorganAnderson Methodology/Definitions).

Figure 5. The Agency Relationship: Case Example Dashboard (Per MorganAnderson Methodology/Definitions).

	Facts	Agency A	Agency B	Benchmarks	Decision
Media Investment	$150M				
Non-media Investment	$45M				
Markets	USA + Canada				
Channels	4				
Scope of Work	28 pages				
Staffing FTEs		30.0	59.5		
Senior/Junior Ratio		Senior skew	Junior skew		
Overhead Ratio		130%	110%	100%-120%	
Average Annual Salary		$130K	$95K		
Fee Cost/FTE		$350K	$230K		
Reputation/ Evaluation		9 out of 10	9 out of 10		Quarterly evaluation
Hours/FTE		1800	1900		
Multiplier		2.72		2.40	2.25-2.45
Performance Evaluation					3 Elements - 360 two-way
Proposed Fee		$10.5M	$13.9M		
Final Fee					$9.5M Base Fee + Incentive Fee

[1] In the context of this article, "the agency relationship" means one or more external advertising or marketing services firms used for marketing communications by a marketer, and the term includes the marketer's client role in the relationship. In all fairness, 80 percent of the inefficiencies and process impediments embedded in a client/agency relationship are client driven.

[2] John Wanamaker was a retail mogul (1838-1922) credited with the famous saying, "I know half my advertising is wasted. I just don't know which half." (Wikipedia.com).

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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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