WINNING AT AGENCY REMUNERATION

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Agency remuneration is one of the most important factors affecting the client-agency relationship, yet for many executives it is one of the least understood. Today's remuneration options are much more varied and complicated than in the previous century when media commissions prevailed.

Having a fundamental understanding of agency cost drivers and the impact that fee agreements can have on agency motivation, capacity and capability is crucial to being able to effectively negotiate and manage agency relationships, regardless of the method of remuneration selected, or the type of agency.

While there is no one size fits all solution, the best agency remuneration agreements serve both the client and agency. Because any remuneration agreement that works to the disadvantage of either party will eventually work to the disadvantage of both parties. An inequitable remuneration agreement will usually result in an unproductive, and potentially contentious, relationship between the client and agency.

Our hope is that this white paper can provide some support and guidance to help you arrive at a remuneration approach that creates mutual advantage for you and your agencies.

TYPES OF REMUNERATION MODELS

A first step in understanding agency remuneration is to define the basic methods in use today.

The three most common methods are “commissions,” “fees,” and “performance incentives.” Increasingly, marketers are moving to more progressive methodologies such as “value based” to focus agencies on the outcomes of marketing communications to be delivered, rather than paying agencies based on the level of effort taken to get there.

HISTORIC AND CURRENT METHODS

COMMISSION

A base fee tied to clients media spend

LABOR-BASED FEE

Fee based on actual time spent

Includes hourly rate cards or multiplier pricing

OUTPUT-BASED FEE (PROJECT FEES)

Fees based on individual project costs

PROGRESSIVE METHODS

PERFORMANCE-BASED FEE

Base retainer fee with an incentive for achieving mutually agreed KPI’s/results

VALUE-BASED FEE

Tied to perceived value of outcome

COMMISSION

Under this approach, the agency's remuneration is based on obtaining a percentage (commission or markup) of the cost of media, production, or third-party services executed by the agency on behalf of the client (i.e., the agency's billings). For advertising agencies, this was the most common compensation method throughout most of the past century. However, today a minority of marketers employs them.

"Fixed Commission" is one set percentage that is negotiated by the client and agency. 15% was long accepted as the "standard" commission rate, although over time this standard has been replaced by varying and, often, lower rates.

"Sliding Scale Commission" varies the commission rate by the level of client spending – the client and agency negotiate a starting rate for "x" level of spending and then a lower rate (or rates) when spending reaches a specified higher level (or levels) of spending. This is almost exclusively employed in relation to media spending. Although a sliding scale commission could theoretically be established with agency production spending, it is rarely done given the relatively smaller scale of production vs. media spending.

LABOR-BASED FEES

As the name implies, these are fees that are based on the cost of the agency labor employed to service the client's business. Typically, the client and agency will agree to a scope of work and an agency staffing plan to deliver against that scope of work. The staffing plan will usually entail a designation of specific agency positions and time (expressed either in hours and/or "FTE's" – full-time equivalent employees). The client and agency negotiate a fee that will cover the agency's staff costs plus allowable overhead/expenses and profit.

OUTPUT-BASED FEES

Output based fees are negotiated rates for specific agency work/services without client regard to agency staffing or labor costs. In these agreements, the client and agency negotiate a set fee in exchange for specific agency deliverables or "outputs." The client is not concerned with what it actually costs the agency to deliver the outputs as long as they are satisfactorily delivered for a fee that the client determines is reasonable.

VALUE-BASED FEES

These compensation agreements are based on a negotiated "value" of the agency's services, without regard to agency costs. These agreements require both client and agency to agree on a "value" tied to the work or services performed by the agency. From a client standpoint, the "value" will generally need to be tied to accomplishing some specific business or marketing goals, although it could be defined in other ways. This might sound similar to a performance incentive arrangement. However, in a true value-based compensation agreement, all of the agency's compensation is tied to the negotiated "value," whereas performance incentives are structured as a component of another method of compensation (fees or commissions).

PERFORMANCE-BASED

Technically, this is not a distinct, stand-alone compensation method, as performance incentives can be structured as an element of a fee or commission-based agreement. In performance incentive agreements, a portion of the agency fee (or of the commission rate) is tied to the attainment of agreed-upon performance goals. Performance incentives are often structured in a "risk-reward" fashion where the agency agrees to put a portion of its fee (or commission rate) at risk in exchange for the potential to receive a higher fee (or commission rate) than they would have under the "base" compensation agreement.

While offering many potential benefits, performance incentives are not going to be appropriate for every client-agency relationship. Indeed, performance incentives should probably be avoided in situations where the appropriate evaluative measurement tools are not in place, or where the administrative time/cost is judged to be too much relative to their potential benefits.

SETTING MARKETING BUDGETS

As with successful marketing programs, the best agency remuneration arrangements start with thoughtful planning. This is true whether determining the best remuneration method to employ or negotiating the specifics of a tried and true remuneration method for the twentieth time.

TOP DOWN BUDGETING

This is when marketing is given a budget based on factors such as prior year spends and the forecasted overall revenue of the business in a given year. This usually means that marketers have to rationalise and prioritise their activities based on cost as they are unlikely to be able to do everything that they desire. In this situation, it is useful to provide the agency with a budget upfront and let them work with you to determine what activities and services are most required.

PLANNING AGENCY FEES

Having a clear process for how agency fees will be arrived at will help to ensure that all parties are clear on the steps that will be taken to get to an agreement efficiently. Discussions on remuneration can become an emotional and a drawn out process if either party feels like they are in a weakened position which is an unnecessary drain on both marketing and agency resources. Best practice in negotiations sees open dialogue and transparency so that the positions of each party are understood and questions can be clarified and addressed in a timely manner.

1) Set business goals/marketing goals and the agency's expected role in achieving those goals. The goals for most organizations will ultimately tie back to sales and/or market share. But, goals might also cover non-sales related issues or opportunities; e.g., improving the corporate image or promoting a charitable cause.

2) Define a specific scope of work and budget that is tied to the agreed goals. Beyond tying back to the marketing goals, the best scopes of work are precise and specific in terms of agency communications and service deliverables, as well as any specific tasks and execution that the client expects to be accomplished.

3) Depending on the agency remuneration type chosen, there may be a review of the agency resources required to deliver the goals and the scope. Once the goals, scope and budget are determined, the agency should then be asked to prepare a proposal detailing the resources they will provide and the proposed "price" (whether it be a fee or commission) for providing those services. In a value based model, this step is omitted, as the marketer uses a framework or methodology to arrive at the investment levels behind each marketing activity. The agency responds with a proposal on the services to be delivered against those investment levels.

4) Determine/negotiate method and amount of remuneration. Determining the method of remuneration might actually be accomplished when setting the marketing goals and the agency expectations for helping achieve those goals. And, some clients ask the agency to propose not only the amount, but also the method of remuneration. But, if the client and agency have not already agreed on the method early on, it must be established once the scope, budget and required agency resources are approved.

5) Codify the approved remuneration plan contractually. Whether part of a one-time project agreement or as an annual exhibit to an established retainer contract, the remuneration method and terms should be formalized and signed by both parties.

6) Establish a plan for managing the remuneration. The degree of management and oversight required depends on the method and complexity of the remuneration plan. Regardless of the method, the client and agency will ideally each designate a person or small team to handle remuneration issues.

VARYING REMUNERATION MODELS BY AGENCY TYPE

Since the best practice for arriving at the right remuneration model is based on the qualities of fairness, adaptability, simplicity, reward and predictability, by extension the remuneration model does not necessarily require customisation to each of the different agency partners that a marketer engages. In fact, having one consistently applied remuneration model across all partners, in today's world of fragmentation and hyper specialisation, serves to build further efficiency and expertise into the process.

That said, certain remuneration methods lend themselves better to certain agencies and services than others. The following summarizes some nuances and alternatives for each of these agency disciplines.

<table>
<tr><th></th><th>CREATIVE AGENCY</th><th>DIGITAL AGENCY</th><th>MEDIA AGENCY</th><th>PR AGENCY</th></tr>
<tr><td>COMMISSION</td><td colspan="2">Limited application in modern day for creative and digital agencies since paid / owned / earned media models overtake pure play advertising media spends.</td><td>Most likely agency type to be paid on commission. Marketers are increasingly moving to fee based arrangements, however.</td><td>Not typically used.</td></tr>
<tr><td>LABOR-BASED</td><td colspan="3">Most common when agency services revolve around strategic partnering whether its consumer insights, customer journeys, media planning services.</td><td>Most common method for PR, as agency services at different times carry high value, such as for crisis communications</td></tr>
<tr><td>OUTPUT-BASED</td><td colspan="2">Works well for project fees and deliverables where consistent and well known processes are followed, and output speed and quality can be anticipated and replicated such as retail/BTL deliverables.</td><td>Not typically used.</td><td>Less typical as the 'output' is less quantifiable and efficiencies are not driven by volume of deliverables.</td></tr>
<tr><td>VALUE-BASED</td><td colspan="4">Can be applied to any type of agency, as the methodology for arriving at value is independent of agency input costs and instead arrived at based on business value drivers as determined by the marketer.</td></tr>
<tr><td>PERFORMANCE -BASED</td><td colspan="3">Can be applied across creative, digital & media agencies with a balanced score card approach that measures agencies on brand, business and marketing metrics as well as qualitative agency performance results.</td><td>Until such time as PR influence can be more closely tied to business results, performance based model opportunities are limited, or tied wholly to agency performance.</td></tr>
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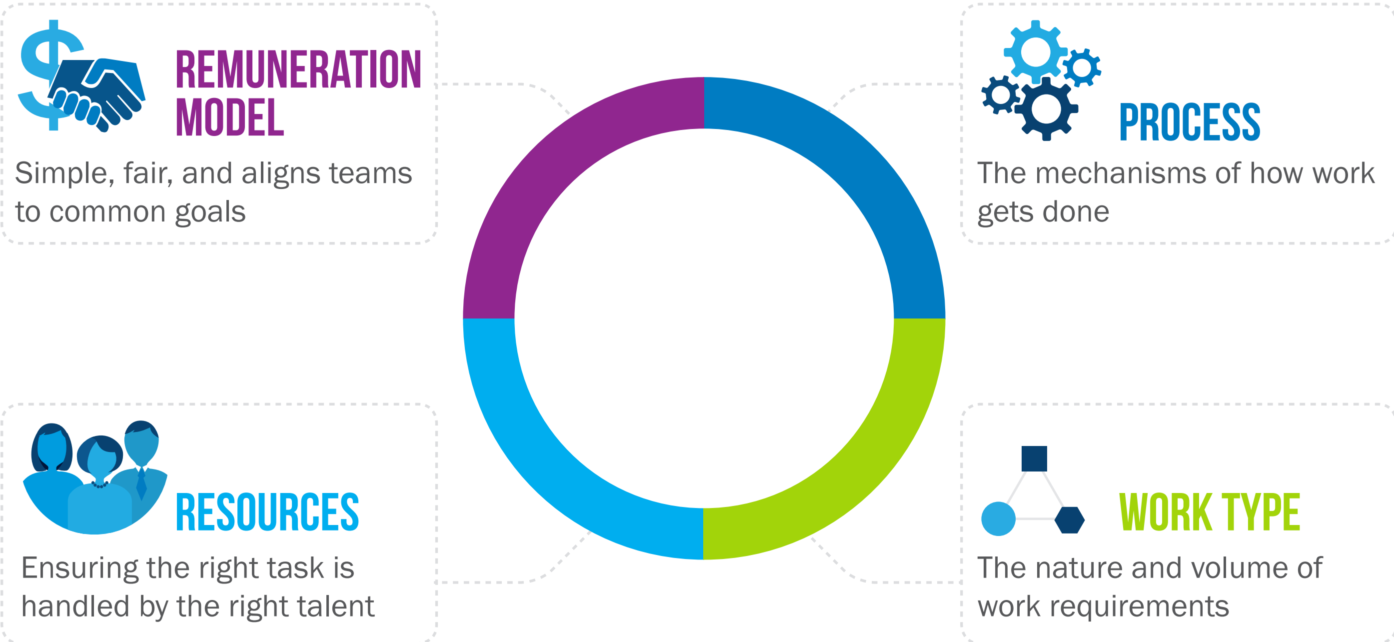
DRIVING EFFICIENCIES IN MARKETING SPEND

While determining the type of remuneration model to implement with your agency partners is an important consideration, there are other factors that become important in getting to the right investment level for the services you require from your agency partners.

It's all well and good to strive for top quality services at the lowest possible price, but how do you strike the right balance to ensure that spend is sustainable over time and building towards year on year value creation over time? The answer to this question lies in looking deeper than surface level, and also considering the type of services that you require, who will deliver them, and how the work gets done.

Having a clear understanding of the baseline in each of these areas will set you up for future negotiations because you will have a clear understanding of where you can focus to either drive the efficiencies you need in process or volume of work or grown value and service quality by looking at the talent and performance structure in place.



Some questions you can ask yourself to determine whether the efficiency of your agency engagement is optimal include:

REMUNERATION:

- Is our remuneration model driving desired agency behaviors?
- Do we have a clear idea of what we value in an agency partner? Is it quick delivery? Is it network capability? Is it creative quality?

PROCESS:

- Are we issuing clear briefs to the agency and supporting them with clear expectations on ways of working?
- Do we know how the creative process works and the main pain points of the agency in delivering great work?

RESOURCES:

- Am I using strategic resources on the most high impact initiatives?
- Is my agency able to attract and retain resources that deliver peak creativity?

WORK TYPE:

- Have we evaluated what work should be done by the agency vs what should be done in house?
- Are we maximising our efficiency gains by consolidating requirements across business units to promote reuse of existing assets?

Often, discussions around fees and money can sometimes be a very ‘emotional’ topic for agencies, especially in an economic climate where budgets are tight. Whether you are starting off a new relationship or renegotiating with an existing agency partner, approaching the process with with philosophy of fairness, openness and transparency will make future fee discussions less tense and lead to the best mutual outcomes.

CASE STUDY: REMUNERATION MODEL FOR GLOBAL FMCG

The client’s question was “How do we revolutionize our agency remuneration model to inspire and motivate agencies to deliver brilliant communication?”

The FMCG Company discovered that over time, inconsistent fee management across brands working with multiple agencies had emerged, leading to high tension and high time commitment in negotiating fees.

R3 assisted by developing an industry leading perspective on outcome based remuneration, which moves away from traditional cost plus methodologies and anchors agency fees to the critical value indicators that drive the client’s business.

In order to do this, strong engagement with all stakeholders across departments, brands, and functions was necessary, to drive alignment. A robust methodology for data collection and analysis and a roadmap approach to implementation resulted in a clear framework for brands to negotiate fees in a consistent way across the organization, while still motivating and rewarding top performing agencies.

For this global FMCG Company, the R3 answer provided a remuneration model that moves away from pricing inputs, toward rewarding agencies for outcomes achieved.

ABOUT R3

OUR REASON FOR BEING

In a word, we are about performance. R3 (www.rthree.com) was established in 2002 in response to the increasing need of marketers to enhance their return on marketing, media and agency investments, and to improve transparency and accountability.

We act as coaches to marketers wanting to play better.

OUR BACKGROUND

We've worked with more than one hundred companies on global, regional and local assignments to drive efficiency and effectiveness.

We have talent based in the US, Asia Pacific and Europe and partners in LATAM and Africa. Through global work for Samsung, Coca-Cola, JNJ, Visa, Unilever and others, we have developed robust benchmarks and process targets for more than 70 countries.

WHAT WE DO

Our core service offerings include proprietary processes and tools in the areas of marketing investment and agency relations.

HOW WE DO IT

We invest in the best talent, bringing in senior leaders from marketing, agency and analytic backgrounds.

Since 2002, we've interviewed more than 2,000 marketers about their agency relations.

Since 2006, we've spoken to more than 100,000 consumers in China's top twenty cities and continue to do so every three months.

Each month, we exclusively track over 1,000 agency new business wins around the world.

We authored the book “China CMO” about marketers in the world's most dynamic country. We maintain an ongoing database of media costs for key markets.

We have co-developed software to measure agency and media performance.

RETURN ON AGENCIES

We help marketers find, pay and keep the best possible agency relationships – covering Creative, Media, PR, Digital, Social, Performance, Event, Promotions and CRM.

We take the lead in improving the Integration process through proprietary software and consulting.

RETURN ON MEDIA

We offer professional analysis of the media process, planning and buying with proprietary benchmarks and tools to set and measure performance.

We conduct financial audits to validate and benchmark transparency.

RETURN ON INVESTMENT

We review marketing data, structure and processes to help benchmark and drive improvement.

We track Digital Engagement in China through a proprietary study in China called EnSpire.

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