SECOND EDITION, 2012

The Guide to Agency Remuneration

by Tom Denford & David Indo

Preface

Welcome to the ID Comms Guide to Agency Remuneration.

This book addresses some common questions and helps marketers understand how to properly incentivize their marketing service agencies.

Do you pay your media agency a fixed commission for the work they do?

Do you know where the agency adds the most value to your business?

Are you unsure if you are getting value for money from your agency?

Do you work in procurement and need to find productivity improvements in media spend?

Do you want to make the agency more accountable for their results?

Are you nervous about the lack of transparency from your agency?

Do you think that commission is so low that your agency must be losing money?

Have you wondered what alternative models might exist?

Are you an agency trying to innovate your terms of business?

If you answered 'yes' to any of the questions opposite then this book is for you.

In recent years more and more clients have been finding that the traditional commission based model of paying an agency is rather outdated because it may sometimes reward the agency to give a less effective solution. Instead many clients are now seeking new ways to reward and incentivize their agencies, aligning them closer with their own goals and keeping them more accountable for success.

This book is important in the current economic climate as marketing budgets are under greater scrutiny than ever and there are pressures on agencies to show greater accountability. Agency remuneration is a great place to start to address some of these tensions.

This guide is primarily written about media agency remuneration, but the models and principles can equally be applied to other agency disciplines such as creative, digital, PR and direct marketing for example.

Tom Denford & David Indo

Founders, ID Comms Ltd. 2012

*“Price is what you pay,
value is what you get”*

Warren Buffett

“A majority of marketers around the world do not believe that their agencies are sufficiently results driven"

WARC

CHAPTER 1

Executive Summary

Having the right agency remuneration model in place will make your investments in media more effective. It is that simple.

Most clients still work with out-dated legacy models of remuneration, mostly using media commission, which we believe risks as much as 30% of the value of that budget. We strongly encourage clients to consider moving away from commission to an alternative model which gives greater transparency and aligns the agency more directly with the company's own business and marketing goals.

These are the main headlines from this book, however we recommend you read deeper into the detail in the rest of the book to fully understand your opportunities.

The 3 remuneration models:

<u>The Commission Based</u> - this is the most common amongst media agencies and is where the agency earns an agreed percentage of the client's media billings spent.

<u>The Fee Based</u> - this has traditionally been more common amongst creative agencies, where the agency earns an hourly rate based on the resource supplied.

<u>The Value Based</u> - this model is slowly growing in popularity and involves the agency earning their profit based on the value they create for the client.

There is a growing trend of clients moving away from Commission towards modern Fee and Value based models. Some combine these to form a hybrid of fee plus a performance related bonus payment.

ID Comms' Five Rules of Modern Remuneration:

1. Suppliers will need to become more accountable for the value they create
2. Suppliers will need to work to clearly set "higher goals"
3. Clients will need to be able to offer a share in success to suppliers
4. The supplier's profit must be in areas where most value can be created
5. There should be no profit from areas where no value can be created for client

The STAR model

ID Comms has developed the STAR model (Shared Targets And Rewards) which is a modern, value based remuneration model for the 21st century. STAR has two components:

1. A base fee, which allows the agency to cover its costs and break-even
2. A separate profit component calculated upon the agency's performance and delivery of results

"If agencies are to avoid longer-term decline, experimentation in new models of remuneration and agency structure is only going to increase"

Tim Bradshaw, Financial Times

Why consider remuneration?

Agency remuneration is currently one of the hottest topics of industry debate.

We estimate that for some large brands, as much as 30% of the value of their communications investment can be missed in the media value chain.

So, having the right agency working to the right remuneration terms can have a huge positive impact on the productivity of your media investment.

Losing value

What this means is that the client's marketing service suppliers are not creating enough value from their involvement relative to the fees that they are charging. This guide is not about cutting agency fees, instead we are focusing on how to make every unit of marketing investment work harder by incentivising agencies to account for the net value they create.

LOSS OF VALUE IS USUALLY THE RESULT OF:

- Incorrect objective setting
- Poor briefing
- Poor strategic planning
- Working with the wrong suppliers
- Un-transparent trading practices
- Weak remuneration models
- Incorrect media choice and execution
- Lack of proper data, analysis and reporting

These are all areas that can be addressed by having the right payment model in place. The right model will prioritize (by rewarding) the right areas of agency focus, which create the most value.

The issue of agency payment models has earned a lot of press coverage, comment and debate in recent years, prompted by a severe recession which caused many clients to re-evaluate their supplier contracts and terms of business. We believe this was long overdue and we now encourage the increased interest in finding new, more effective ways for agencies and clients to work together.

"Painful as it is, this recession is highly disruptive and a powerful force for change. It demands the development of new ideas and facilitates long-needed action"

Colin Gottleib, Chief Executive, OMG EMEA

Current market context

Good media performance is no longer just about media discounts.

Media pricing is now so low from competition that is has created a commoditized market. Today, what will differentiate one media agency from another is not pricing but how much value they can create from a fixed media budget.

The skill of a modern media agency needs to be less about access to media discounts and more about choice - making decisions in media, which have the greatest positive effect to grow a client's business. And so, as the media market has rapidly evolved in the last 15 years, so too must the model for how agencies are measured and rewarded to make the right decisions.

With increasing business pressure on marketing departments, there has been an increasing focus on marketing to deliver more with less; more sales, more traffic, more share or more awareness with less budget, less people, less suppliers and less overall resources.

At the same time there have been huge economic, social, technological and behavioral shifts at play which have had significant effects (many positive) on the media and marketing industry. The primary change has been the continued fragmentation of media audiences away from mass channels into more niche media consumption. Fragmentation has also diluted the general quality of media environments, making it important for the media agency to be able to identify the best quality media spaces and not just the best audiences.

Why remuneration is so important

A positive of media fragmentation is that it has created far more opportunities than ever for brands to connect efficiently with their most valuable audiences, because once you have found them, you can target your audience very directly and engage with them very efficiently.

However, the ongoing fragmentation of media means that your media agency is having to make many more, important choices on your behalf than ever before:

- Choosing the most effective channels
- Choosing the best way to activate in those channels
- Choosing the best complementary mix of channels
- Maximizing ‘free’ media distribution (e.g. social media)

It is how and why those choices in media are made that is the key issue. Clients need to ensure that their agency payment model is incentivizing the right choices to be made which create the most value for the client.

Why? Because media agencies are seen as sometimes working to their own business agenda, rather than concentrating on the client’s marketing requirements.

Different choices the agency takes in selecting media channels can affect the media agency’s income and therefore the way the media agency is incentivized from the outset will naturally have an influence on how they make choices in media.

Having a remuneration model which aligns the media agency closer to the client’s business goals is fundamentally important to generate the most value for the client, in the choice of media.

Put simply, the agency’s opportunity to make a profit should lie in making choices which generate the greatest value for the client.

Accountable media neutrality

With so many media choices available to clients, they need to know that they are getting unbiased advice on which channels to use.

An agency with a cross-media offering (such as a creative agency or media agency) should in theory offer clients a completely objective point of view about which media channels will be most effective and relevant to answer the client's brief.

In practice however, there is often a bias towards certain media choices, meaning that the choice of media is not always made 100% in the client's best interests. Usually this is a symptom of a remuneration model that influences an agency's choices, for example if a creative agency is making a large proportion of their income from the production process then they may be more likely to recommend media, such as TV or print, which are more production intensive than say PR which involves minimal production. In the same way, a media agency paid by media commission may be more likely to recommend media which takes less time (and headcount resources) to implement. A TV plan can spend large chunks of the client's money very quickly compared to say, organizing an event or planning an intricate digital campaign.

In many agency contracts, the additional labour involved in planning and buying digital media will be charged at a higher rate of commission than offline media. It is clear to see how this situation could rightly or wrongly bring into question an agency's media neutral advice.

We believe that it should be the ambition of all clients to work with agencies that are media neutral to ensure that the advice they receive is entirely in the best interests of the client not the agency's bottom line. Agencies themselves feel a growing sense of frustration at having their media objectivity questioned, simply because of a payment model often mandated to them by the very client who is questioning their media choices.

The only way to guarantee neutrality in advice on media channel is to ensure that the agency has no direct income advantage in recommending one medium over another or one media vendor over another. This can be achieved by adopting a remuneration model which fairly rewards the agency for making choices fully in the client's interest.

Chapter 3

Why you should think about re-evaluating your agency's terms of business

In recessionary times, improving the productivity of existing investments by generating new value from them is as important as cutting costs. Re-evaluating your relationships with agencies has therefore never been more important.

To deliver that productivity, all marketing service suppliers need to be making greater commitments to their clients. What does this mean for agencies?

The new rules of the client agency relationship

We believe that there are some new rules required for the client-agency relationship which will ensure that the agency is working in the full interests of their clients.

The key to these rules is identifying which business and marketing objectives of the company that the agency should share in delivering. We have called these “higher goals” because they extend beyond the traditional media objectives and metrics.

The new rules should also restrict how an agency can make a profit on the client’s business, to ensure that focus on delivering these higher goals is maintained.

“Existing terms of business need to be reshaped. The agency model of the future then must rest on some kind of pay-for-performance model, balanced by a share of both risk and reward”

Pip Brooking, ex-Editor, Media&Marketing Global

1. Agencies will need to become more accountable for the value they create
2. Agencies will need to work to clearly set “higher goals” that align with a client’s business goals
3. In exchange the client will need to be able to offer a share in success to the agency
4. The agency’s “opportunity for profit” must be in areas where most value can be created for the client
5. There should be no “opportunity for profit” for an agency from areas where there is no opportunity for value to be created for the client

When to act? You don’t need to wait until the contract expires to change your remuneration model. It won’t require a complicated pitch process. It can be a mutually beneficial solution for both client and agency.

Next we will look at the three main remuneration models currently in common use.

The problem with commission

Consider an estate agent (or real estate broker):

Most estate agents work on commission, averaging around 2%

When selling your house, as a vendor your goals will be to maximize the sale price and minimize the headaches.

The estate agent's goal may be very different, for example, to make the biggest operating margin on any house sale.

Using a scenario: you have a house, priced at £320,000 to sell.

Working with a commission based model, the estate agent would prefer to sell your house quickly by pricing it below the market at £300,000 (earning them £6,000 commission), even though it is £20,000 less than you wanted.

For the estate agent, this is better than working an extra month finding the right buyer for you at £320,000.

Putting in the extra time and effort to sell your house for the higher price would only earn them an additional £400, whilst their extra effort would be worth an extra £20,000 to you.

So, for the estate agent, earning the first £6,000 of their income is relatively easy, but the final £400 is what requires the most time and effort.

In this scenario, you can see that the commission model doesn't actually incentivize the estate agent to work 100% in your interests because there will be a point at which delivering exactly what you want (as the client) becomes financially difficult for them (the agent) to do.

In most cases, commission based remuneration models for agencies provide similar conflicts of interest.

You can see here how a commission payment model doesn't always provide the most value because it doesn't incentivize behaviour, which is in the best interests of the client.

The remuneration models

On the following pages we have detailed the three most common forms of agency remuneration, especially in media.

This list is clearly not exhaustive and other variant and blended models do exist. We have represented here the ‘primary colours’ which are the basis for most agency remuneration models.

It is likely that your current agency contracts use one or more of these.

The three main remuneration model types

The 3 remuneration models we have considered:

The Commission Based - this is the most common amongst media agencies and is where the agency earns an agreed percentage of the client's variable media billings.

The Fee Based - this has traditionally been more common amongst creative agencies, where the agency earns an hourly rate based on the resource supplied.

The Value Based - this model is slowly growing in popularity and involves the agency earning their profit based on the value they create for the client.

These are the three main models for agency remuneration, each has its benefits and drawbacks. There is no hard and fast rule to which remuneration model you should use because it depends on your priorities as a client but the general trend in recent years is for clients to move away from commission based models to more accountable models of fee or value based payment.

The commission based model, which dates back to the early part of the 20th century, is surprisingly still the most common model of paying an agency.

The commission level may be negotiated as part of a long term contract and is charged on a fixed percentage of media billings. Over the years the average percentage commission that agencies charge has been eroded by competition and now sits between 1-3% for most large agencies, although accounts do change hands for less than 1%.

Some agencies and clients have moved to a fee based model, where the agency bills by the hour for work. This has the advantage of making the agency more accountable for the resource they supply because the hours spent on the client's work can be agreed upfront. The agency's profit margin and overheads are also more transparent in the fee.

Finally, some clients are moving beyond fee and adopting a value based model, which holds the agency to even greater account for the work they do by incentivizing them on the value they add to the client's business. This is the most robust of the three models.

On the following pages we will explore the three models in more detail.

Commission Based

The commission based model allows media agencies to retain a percentage of the client's media budget as payment for the services they offer in managing and investing that budget. Agency commission was originally charged at 15% but lately commission levels of 2% or less for offline media are not uncommon due to increased competition amongst agencies to win large billing clients. It is very hard for an agency to break even on a media commission less than 2.5%.

Commission based models are arguably out-dated today. They were designed for and made sense in a world of limited mass media buying, where an advertiser wanted access to the best TV programs or sites in a newspaper. The advertiser would pay the agency for negotiating cheaper rates and better placement for their brand.

	POSITIVES	NEGATIVES
CLIENT	Predictable expenditure Needs relatively little management Easy to negotiate downwards	Makes the agency a 'selling supplier' Impossible to get media neutral advice Promotes culture of rebate retention
AGENCY	Predictable income based on budget Easy to look competitive Easy to under resource accounts	Income is slave to client budget changes Agency offering becomes commoditized Doesn't recognize value of good agency work

Today, commission is a flawed way to pay for media planning and buying because it actually incentivizes neither. Commission does not incentivize an agency to buy cheaper, if anything earning a fixed commission on a cheaper media deal would actually result in less agency income. In a recession, agencies on commission will have seen their income drop, in some cases by 30% or more over the last two years, affecting service and talent quality available to clients.

Regarding media planning, with so many more choices in media, the skill of media planning has become more important, to ensure that the client's budget is invested in the most effective places. A commission based model doesn't incentivize the agency to necessarily provide the best media planning, because working on commissions can make it difficult for the agency to offer media-neutral advice. In fact, commission can reward the agency for prioritizing mass media choices because those are the simplest (and less labour-intensive) ways to spend large budgets and therefore quickly earn the commission.

"Some say [the volume media deal] system, kills planning: money has to go where group deals need topping up to earn rebates for the agency, not the best place for the client."

Tom De Castella, MediaWeek

Fee Based

This form of agency payment is currently the preferred method for a growing number of clients that are evolving away from a commission-based model. It is calculated based on the anticipated labour (salary) costs required to service the account, then added on top of this are agency overheads of between 50%-120% and for good measure topped up with a profit margin of around 15%. It is guaranteed agency income irrespective of fluctuating marketing budgets and the client's business performance.

	POSITIVES	NEGATIVES
CLIENT	Greater transparency Ensures agency neutrality in media choice Gives access to agency overhead and profit	Makes time the currency Can reward slowness and inefficiency Guarantees agency profit without results
AGENCY	Guarantees agency income Predictable profit margin Ability to plan (and stretch) resource	Transparency Limits some access to rebate incomes Exposes operational costs and overheads

Whilst commission still makes up the majority of agency contracts, some clients have been moving to a fee-based model. They see this as a better alternative to commission based payment because it makes the agency account for the resource dedicated to that client and the time they spend working on the client's business. It empowers the client to strip away any resource they feel is unwarranted and makes every member of the team accountable for their time, if not the quality of their work.

It has the advantage of creating a more transparent working relationship, because the client can see how much the agency charges for overhead and what profit margin they expect. The limitations of a fee based model however are that the agency isn't rewarded for efficiency and if budgets are cut then the agency can arguably earn a greater profit margin because fees will usually remain fixed. It also doesn't hold the agency to account for results or the value they add to the client's business.

As a result, many fee-based deals contain a performance bonus (PRIP) as an incentive to deliver high quality service. However in our experience the benchmarks for these are often too few and too soft and can usually be regarded by agencies as guaranteed income.

"One finance director confided to me that his agency had little incentive to streamline the creative development process because they would earn less as a result. That cannot be a satisfactory state of affairs."

Paul Feldwick, AdMap

Value Based

The value-based system is where the agency earns a profit based upon the value they add to the client's business. It allows the agency to share in the risks and rewards of media investment and so makes them more accountable for the value they create. It brings a greater sense of business partnership into the client / agency relationship by allowing the agency to guarantee a break even point and then earning all of their profit based on their performance.

	POSITIVES	NEGATIVES
CLIENT	Aligns the agency to client goals Total transparency from agency Agency accountable for the value they add Less financial risk than fee based model	Hard work to roll out initially Requires management of a detailed scope of work Requires some ongoing agency performance evaluation
AGENCY	Opportunity to make a better profit margin Projectable, reliable income Elevates agency to partner status	Loss of profit for year one Requires resource to be somewhat re-organised No room for any un-transparent income

The value based remuneration model is arguably the future of agency contracts because it entirely aligns the work of the agency with the client's business goals, meaning all agency resource can be focused and accountable for the value it creates. In this model, the agency's profit can only be maximized if they deliver against the metrics put in place, ensuring the agency applies the most appropriate resources to the client's business and manages the work in an efficient way.

The upside for the agency can be a greater profit margin, but because this is only earned when the value delivered to the client is maximized, the additional cost to client can be justified as an accountable investment. This also has the benefit of encouraging the agency to ignore the contractual loop-holes which may have allowed the agency to profit from media rebates in the past and keeps them focused more on delivering greater value to earn greater profit, in a transparent way.

The value based model requires some work to set up because a detailed scope of work and set of agency evaluation metrics needs to be agreed, however this is a one-off task and one which begins paying back immediately.

"From a client point of view, you don't only want to pay for effort, you want to pay for results"

Carol Kruse, VP Marketing, The Coca-Cola Company

Chapter 5

Changing to a new model

It is understandable that commission based remuneration has survived for so long as the thought of changing models can seem like a daunting and risky undertaking, plus commission often appears to be convenient, accountable and manageable. However, you can be reassured that changing your company's model is simple with the right planning, good communication and a clear timeline.

Many clients have already begun to evolve their agency remuneration models, many managing a hybrid of commission and fee where the agency earns a small percentage commission for media buying which covers basic overheads, a central team charges a management fee and then a performance bonus element allows for the agency's profit.

This is a positive step but it is not enough. We believe that clients should now be looking to move away from commission entirely and look to work with a fee or value based model. Sometimes a hybrid (fee+value) model will be most appropriate.

The process of changing the agency remuneration model should take around two months to complete and involves a commitment from all stakeholders to make a positive change. The rewards are many, from short term benefits of creating a closer more aligned relationship with your agency, through to long term financial benefits from far more effective communications, with your marketing investments working to their full potential.

Moving to a value-based model, clients will discover that costs can be saved immediately in year one, as the profit payment to the agency is deferred until the close of the client's financial year. More on this later...

Who's success is it anyway?

One challenge to value-based remuneration models is that in order to fairly reward the best work, they require complicated econometric modeling to determine precisely the proportion of success that an individual agency delivered to the clients business.

Trying to apply layers of complex analysis to remuneration models is a mistake in our view. We believe that identifying an agency's exact contribution to a company's success is a hugely subjective and therefore impossible task to calculate fairly. Trying to isolate an individual agency's work also risks creating conflict between agencies unnecessarily and therefore inhibits positive collaborations.

A modern, value based model need to take a broader view of client's business success. The model must be a system of shared targets and shared rewards, so that agencies are encouraged to collaborate in the best interests of the client.

You will see on the following pages that we have devised a remuneration model which doesn't require complex data modeling or detailed attribution in order to provide the right incentive for agencies to work in full alignment to their client's own business goals.

The STAR model: Shared Targets and Rewards

Due to the increasing interest from our clients, we developed a value-based remuneration framework called STAR: Shared Targets and Rewards

Our ambition was to create a simple model; easy to implement and easy to maintain. STAR simply aligns agency suppliers closer to your own business goals and then improves the productivity of media management.

We believe that having shared targets and rewards is the key to a successful and profitable client / agency partnership.

STAR is a remuneration framework we developed at ID Comms and we use it to help our clients implement change in their agency remuneration. We rolled out the first STAR project across Europe for a top 10 consumer brand in 2009.

STAR is a modern agency remuneration model in which the entire agency profit is determined by the value the agency generates for the client's business on specific performance indicators.

STAR is designed to be used by agencies and clients seeking a fairer, more transparent and effective method of agency payment. The core focus of STAR is to ensure that the full value of a client's media investment is being realised and no value is being lost from poor media choice and agency inefficiency.

STAR is a framework which can easily be tailored to a client's specific situation meaning our clients get a STAR model built upon a set of consistent principles but unique to their business.

The Star Philosophy

- Shifting the responsibility for agency profitability back onto the agency, requiring them to manage their costs and demonstrate the value delivered to client
- Investing in the best agency resource to deliver the most value
- Motivating the agency to deliver world class work whilst managing costs in order to maximize their own profits
- Encouraging the client to be more disciplined in managing budgets, briefs and scope of work
- Focus everyone on driving tangible value to the business from investments in media

STAR: how it works

STAR calculates the agency's income in two parts, separating a base fee from the agency's potential profit margin.

Firstly, we always allow the agency to break-even on their costs of servicing the client's business. We don't believe that agencies should normally be expected to risk losing money on people's base salaries, thus the calculation of the base fee needs to be set at the agency's break even point on salary costs. Our operational expertise and knowledge of industry best practice allows us to accurately advise this benchmark.

Therefore once we have a defined agency scope of work, we then review the agency's FTE resource proposal against delivering that scope of work. We then cross-check their costs against agency salary benchmarks and finally apply a conservative agency overhead.

This overall calculation defines the agency's base fee, the minimum they could earn from working with this client. Once this is agreed it becomes incumbent upon the agency to manage their own costs efficiently, encouraging them to organize their resources more effectively to best service their clients.

The agency's ability to earn a profit is calculated completely separately, based on their actual performance, as detailed on the following pages.

We will consider how the agency's base fee is calculated and then how we calculate their profit margin based on performance.

Base Fee

The Base Fee is determined from a scope of work, the agency's headcount costs to deliver it and a small agency overhead.

For example, elements of a scope of work may include:

- Insight Tasks

- Planning Tasks

- Execution Tasks

- Contingency & Support Tasks

The agency may have resources to deliver all of these elements. They will identify the right individuals and allocate a proportion of their time to deliver what is required, applying real salary costs to create an overall cost for delivering that scope of work.

STAR: Calculating the profit

The old adage “what gets measured gets done” is very relevant when considering your agency’s profit. We believe that calculating the agency’s profit entirely upon their performance keeps them focused to deliver the most value for clients.

In the STAR model, the agency’s profit is calculated based on their performance score from 0 to 100, where a score of 100 unlocks the maximum profit margin, perhaps 30%.

We recommend assessing the agency across four areas, each with a weighted contribution to the overall score, this weighting will vary client by client depending on the objectives for their business and their marketing priorities.

ID Comms works with the marketing team and procurement specialists to define the focus of these assessments and will advise the correct weightings based on our experience of what will provide the correct incentive for the agency.

Within each of the four areas of assessment, a STAR assessment matrix is created bespoke for each client which aggregates the weighted scoring for each element and generates the overall score out of 100. The profit payment is based entirely upon this score.

Profit

The Profit calculation is a simple schedule of agency assessments which scores their performance across the year. The profit payment is made in arrears at the close of the client’s financial year, meaning the client can defer this payment into the next financial year, saving costs from the first year of a STAR programme.

For example an agency performance evaluation may include:

- Delivery of the Scope of Work

- Agency service evaluation

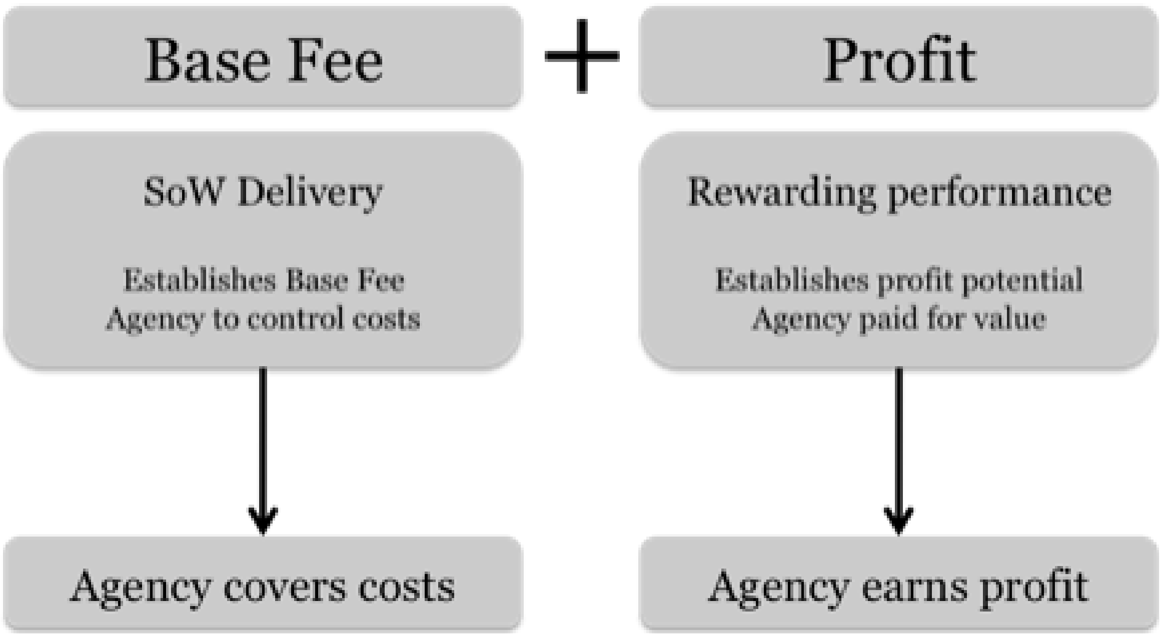
- Buying performance

- Client’s business performance

Client Business Performance - the KPI used here will naturally vary by client depending on how they measure their own success. We will strongly advise that the agency be rewarded upon very similar metrics of success that the client uses internally.

STAR: Summary

So, the agency's income consists of two parts, a Base Fee which allows them to break even and cover their costs of doing business added together with a Profit element which is earned only from their good performance. The agency's opportunity to make a profit is therefore directly linked to creating the most value for the client.



The STAR value based remuneration model offers a new, more rewarding way for clients to work productively with their agencies.

The model is designed to protect the value in the media value chain and ensure that client's budgets are working as hard as they can at all times.

We believe it is fair to the agency and gives them the freedom to focus all their energy into delivering world-class work rather than worrying about their bottom-line, in the knowledge that by doing the best work they can, they will share in the client's success, be well rewarded and be more valued as a partner.

Transforming the client-agency relationship

FROM	TO
Paying agencies for media buying	Rewarding agencies for results
Receiving cost proposals	Focusing on solutions to challenges
Agency as a supplier	Agency as a marketing partner
Individual targets	Collaborative goals
Hoping for media neutrality	Ensuring media neutrality
Doubting transparency	Guaranteeing transparency

STAR: Benefits

- STAR makes the client and the agency jointly responsible for delivering value
- STAR generates immediate cost saving for year one
- STAR establishes a true partnership between client and agency
- STAR guarantees transparency, media objectivity and accountability
- STAR is unquestionably the remuneration model of the future

We believe STAR is the most user-friendly, transparent and productive remuneration model. It offers companies a clear working process, setting reasonable benchmarks for the agency based on up to date industry standards.

Agency evaluation can very easily become a subjective exercise and it is very important, whichever model you use, to have a clear framework which allows a structured, objective approach to be maintained. ID Comms' independence guarantees that objectivity prevails across the process.

The value-based model transforms the client-agency relationship, turning it into a value based partnership where both sides share the same goals and can work together more collaboratively and productively than ever before.

"By switching to a value-based system, we're going to be focusing on [agency] outputs and outcomes."

Sarah Armstrong, Director Worldwide Media Operations, The Coca-Cola Company.

Implications for the industry

At ID Comms, we believe that the knock on effects of clients embracing new forms of agency remuneration are significant and far reaching.
A value based model (related to agency performance) effects more than just that individual client / agency relationship. In this chapter we look at some other parties affected.

Implications for Procurement

Greater definition of value

Procurement leaders often get accused of being in the business of cost savings and thus commission based models would seem to be popular amongst procurement because of the ease with which they can be negotiated downwards. However, we could equally accuse the agency of commoditizing media (and losing sight of the value of their offerings) which has caused procurement to view media as a cost to be managed rather than an investment.

We believe procurement has a crucial role to play in ensuring that the relationship between client and agency is as productive and creates as much value as possible. This requires the marketing procurement leader to have a good understanding of the marketing process and where value is created, lost and hidden.

Media as an investment

We encourage all marketing procurement professionals to be helping their companies by re-evaluating their agency remuneration. They should be driven by the desire to unlock value rather than further commoditize media service by searching for lower costs. Agencies often complain that they are seen by clients as suppliers of commodity and that they get no traction at the top table with their clients. We believe that procurement will play a vital role in translating marketing success back into the language of success that the CEO and CFO can appreciate, who are in the business of managing investment rather than just controlling costs. That should be good news for anyone running a marketing services business.

New insights for Procurement

For procurement, moving to a value-based model provides three interesting learnings:

1. Identifies agencies that are over-delivering - STAR rewards them by ensuring they are paid fairly for the extra value they are creating

2. Identifies agencies that are hitting expectations and earning a profit in line with their value delivery

3. Identifies agencies that are under-performing or currently overcharging for the value they are creating

This is an incredibly valuable insight, it allows the client to be able to prioritize the agencies they use, based upon their value delivery to the business.

"In a recession, improving the effectiveness of existing investments and generating new value is as important as cutting costs"

Howard Stringer, ex-CEO, Sony

Implications for Media Agencies

Agencies are willing to be more accountable

It could be presumed that being forced to be more accountable should be a headache for agencies. However, in our experience most agencies are happy to be more accountable because they want to be able to prove the value they can add and therefore be paid more fairly for the work they do. Very few agencies would fight against getting greater credit for their hard work. A value based system will cause the agency to reorganize their resources around a new scope of work but this is a job that only has to be done once and leaves the agency with a far more efficient structure. They also have to face this challenge whilst being unsure of their profit margin for the first year (because it is paid in arrears), which perhaps makes any new investment in resource a small risk for them.

Isolating an agency's contribution

A common criticism levied at value based remuneration models is that it requires an agency to account for their individual contribution of success. How do you isolate the contribution of a single agency to the marketing success? Many have attempted heavyweight econometric modeling to identify which parts of the marketing mix achieved what result. These usually have tracked variables in the marketing mix and created a 'statistical likelihood' at best. We believe this holy grail of infinitely accountable marketing is both unachievable and ultimately counterproductive. Imagine the scenario where every agency could isolate their contribution to the client's success, this would end up being more divisive than helpful because it would pit agencies against one another in competition rather than collaboration.

Unlocks media neutrality

Another implication for the agency is that it allows them unquestionable legitimacy in claiming media neutrality and provides the media agency with the complete freedom to develop strategies in the client's best interests.

A more creative agency culture

Internally within agencies, having the freedom of media neutrality will arguably raise the importance of high-quality planning skills. This will present a significant cultural shift within media agencies where good ideas become the valued currency not media discounts. We would expect that an agency working in a value based remuneration model would generally be a far better place to work for anyone with a creative drive than one working on a commission model.

A seat at the top table

Moving to a STAR model will fundamentally change the client / agency dynamics, with the shared target and reward principle resulting in a partnership relationship and therefore opening the door, perhaps for the first time, to a seat for the agency at the marketing top table.

"Payment by commission works badly in an age when many of the best solution don't pay any commission. It means there is virtually no connection between the agency activities that add value and those that make them money"

Rory Sutherland, President, IPA

Implications for Media Vendors

Greater transparency in trading

As agencies become more transparent and accountable, this will inevitably have a (generally positive) knock-on effect to the media and content owner, who themselves will have to demonstrate more transparency and accountability in the deals they do with agencies and clients. Media owners universally recognise that if the media agency can be neutral and make choices in media which are less income dependent then they will make fairer, more considered recommendations to their clients. In practice this may benefit smaller media owners who may have a very effective platform but until now haven't been able to compete with the commercial terms of the big media networks.

Media owner acting like an agency

We expect that many more deals will be done directly between client and media owner which has been a growing trend in recent years as media owners invest in their own planning and creative development capabilities. Of course media owners are naturally media biased, but for some of the big groups like Time Warner, IPC, MSNBC they have a broad enough portfolio that strong full-service deals are being done with brands that see them as a good brand fit (Rolex and CNN for example). Some clients may actually consider their key media owners more trusted than their agency, so there may be more cases of client brands and media owner brands forging powerful long-term brand partnerships directly.

The end of rebates as incentives

For those media owners who have pegged much of their success on offering rebates and financial incentives to agencies, they will have to rethink how they market their media product to clients and agencies to attract media budgets. Others meanwhile, who have been able to already offer a transparent deal, will be able to better merchandise this position to clients. The industry will champion those media vendors who offer full transparency and support the end of rebate income for agencies.

Media pricing

We may see media pricing go down as media owners cease subsidising agency income through rebates and could therefore invest more into the actual deals they offer. Also as agencies act in more media neutral ways, the bigger media owners will have to get more competitive on price because there will be more valid competition for every dollar of the client's media budget.

"Agencies have reduced their fees to a level where they just are not viable, so you have to ask the question where else are they getting the money from?"

Francis Marsh, Media auditor

Implications for the agency pitch

A quick word on the agency pitch process.

In recent years, media pitches have become more and more competitive on price. As that competition has driven down media pricing, focus turned to the agency's income. Again, aggressive competition (and an inability of agencies to often justify and defend what they are paid) has eroded agency income.

The modern pitch process finds a commission based payment model very convenient because it provides an easily comparable standard when looking at different agency structures, it can easily be negotiated downwards and is very procurement friendly because it appears to be discounted.

However, we believe that because agency offerings are becoming more standardised and comparable, there are too many media agency pitches now being won on the continued discounting of media prices and especially agency fees. This is not the client's fault, arguably it stems from agencies being unable to differentiate themselves from their competition, forcing pricing discounts, rather than value or creativity to be the determining influence on agency choice.

The modern media pitch must evaluate agencies based upon the value that their ideas and effort can generate. This requires a re-calibration of how agencies themselves are valued. Having the right remuneration model as part of that pitch focuses the agency to present a business case which doesn't put discount above all else, but instead offers the greatest value to the client from the same resources and budget. We believe that many agencies have lost sight of their own value to clients and struggle to differentiate themselves at a pitch whilst also proposing remuneration terms that demonstrate the real value they are offering.

If you are contemplating pitching your media agency, we highly recommend you should also be re-evaluating how you will incentivise them and take the opportunity to introduce the right remuneration model for your business.

"If billings and market share are the objectives, agencies might take on business at a loss or a low commission. They hope to negotiate improved terms later on, but that's wishful thinking."

Jed Glanvill, CEO, MindShare UK

About the authors

Tom Denford and David Indo are the Founding Partners of ID Comms, a leading communications consulting business headquartered in London, England.

ID Comms is a trusted solutions provider to companies requiring high quality media skills and resources. We work with ambitious international brands looking to improve the productivity of their marketing investments.

ID Comms provides best practice and leadership in four key areas; Ideas, People, Processes and Tools.

Tom Denford - Founding Partner, ID Comms Ltd

A multi-award winning communications strategist, Tom has 15 years of valuable experience in the communications business having worked for a number of the world's largest global media and creative agency networks and some of the world's biggest brands such as adidas, HP, Diageo, Nokia, Novartis and Sony in recent years.

Most recently Tom was Global Head of Communications Planning at Carat and before that worked as Director of Comms Planning at JWT in New York.

Tom is very driven to innovate the productivity of the client / agency relationship, most notably how media resource is organised, how agencies can work better together and how resources should be paid for.

Tom is an Associate Lecturer for the Marketing Communications MA at the University of Greenwich and a regular on media panels, award juries and trade press.

David Indo - Founding Partner, ID Comms Ltd

David has spent the last 20 years helping brands solve their marketing challenges, both from an agency and client perspective.

Before launching ID Comms, David was President of Global Clients at Carat with leadership responsibility for some of Carat's flagship accounts; adidas, Coca-Cola and Diageo.

Prior to that he spent 8 years on the client side, first with The Coca-Cola Company responsible for the media function across the Middle East and North African division, and most recently as Nike European Media Director, based in the Netherlands.

During his time at Nike, David managed an annual media budget of $160m, an agency network spanning 27 countries and led the brand communications process for key global initiatives including 2 Football World Cups, an Olympic Games and the ground breaking launch of Nike+, in addition to 40 European product launches.

Thank yous and credits

We would like to thank the many friends and colleagues who gave their valuable advice and insights in helping us write this book and their time in proof reading, with particular thanks to:

Kester Fielding at Diageo

Andrew Lowdon at C-Words

Steve Middleton at SMSolutions

Max Raven at CNN

Credits:

Cover: 'The Agency Bid' by Tom Fishburne, reproduced with permission. See more of Tom's great work at www.tomfishburne.com

Tom Denford, David Indo, London, 2010

Thank you for reading, please share with others and feel free to get in touch with us if you would like to learn more about managing your agency relationships and innovating your remuneration.

Contact ID Comms:

Telephone: +44 (0) 20 7377 9073

Website: www.idcomms.com