World Federation of Advertisers

Observatory International

Global Agency Remuneration 2018

Peer research

Introduction from the Observatory International

The last global remuneration survey conducted by the WFA was undertaken in 2014, and is regularly used by members to help formulate their thinking on remuneration constructs.

Whilst many of the detailed findings from that piece are replicated and updated in this study along with associated trend shifts, we have tried to get more ‘under the skin’ of the status quo in recognition of some of the day to day issues and frustrations we see confronting the marketing procurement profession in their dealings with agencies.

As you will see as you read through the following report, over the last four years there have been a number of developments in the fundamental way remuneration is approached - but also some deep – rooted issues which have not been rectified at the same pace.

Whilst the headline news is that a very high percentage of our respondents feel they are getting good value from their agencies, there are fundamental levels of concern over transparency.

We all know a sense of feeling ‘robbed’ or constant wrangling over monies is de-motivating for all parties concerned, and hardly conducive to providing a great environment for producing business-changing work.

And yet these problems persist – and they remain grounded in the same issues that were present well before the last survey was undertaken, these being;

- Working from ill-defined scopes of work, often as a result of time pressured marketers ‘short-handing’ requirements which invariably have consequences when the true expectations are revealed and not costed for.
- Issues around time/labour-based activities (which remain the de-fault for many) that can reward poor performers in the same way as those that truly deliver.
- Continual pressure to reduce agency costs, and increase scope resulting in a downward spiral in faith, relationships and quality of work produced.

There is light on the horizon however.

Whilst labour-based activities account for the highest percentage of remuneration arrangements, we are seeing an up-turn in payment by results (PBR) related activities - though the light on the horizon is often dimmed by the haze of how these are constructed with many being far from beneficial, and thus motivational, to agencies.

We have plenty of casebook evidence to show that a well-constructed PBR scheme can re-double agency efforts and quality of work – but these are built around well-developed foundations that provide the basis for truly fair payment for agencies and not geared purely towards the benefit of the client’s budget bottom line.

We also know that better procurement comes from ‘managing’ the financial aspects of the relationship. By that we mean monitoring it and discussing it with the stakeholders on a regular basis rather than simply agreeing a budget and disappearing for the next year until it’s time to re-negotiate.

That way you can keep a constant look-out on issues of scope creep/change and head off situations before they become major problems.

The reality is that buying agency services is not rocket science. It simply needs a common-sense approach based on an understanding of the needs and desires of all stakeholders.

And the foresight to recognise that the best approach is a genuinely fair one that fulfils the realistic needs of all concerned.

Stuart Pocock,
Joint Owner & Managing Partner
Observatory International

Executive Summary

- **Perceptions of value delivered from agencies is very positive**, with 87% of respondents feeling that they are getting genuine value for money from their agencies (v around 67% in 2011). In addition, virtually 70% agree that their agencies are now accountable for the value that they create.

- **52% think they focus too much on remuneration** and this has a detrimental impact on agency relationships.

- **Transparency concerns remain**, with more than half of the respondents not feeling that they are getting full transparency on their agencies' costing models.

- **The majority believe new models could improve client-agency partnerships.** 71% of the respondents feel that changing their current agency remuneration models would improve the relationships that they have with their agencies, 19% of them strongly agree.

- **Getting sufficient detail on scope of work is a significant issue** with only 31% of respondents believing they get a highly detailed scope from their marketing counterparts.

- **Labour-based fees the most commonly used** across all agency types but increasingly in decline (35% 2018 v 54% 2011). Many recognise this is not the best methodology to frame agency costs – largely because it can reward a poorly performing agency in precisely the same way as one which is truly delivering.

- Undoubtedly, as a result of the above, we are seeing other models being increasingly used by respondents: **fixed/output based, and value/performance-based remunerations are on the rise**.

- **Whilst the majority of respondents are happy with their remuneration approach, a substantial number (almost 40%) are not.** This may explain the wide number of methodologies in use and the lack of a more single-minded 'best practice' approach.

About this document

This document contains the results of an online survey conducted in Q3 2018, which explored the evolution of global agency remuneration models. All respondents were **senior marketing procurement experts, half of them have a global strategic role,** with the remainder having regional responsibilities with a weighting towards APAC and Europe. **42 different advertisers took part into this study, representing over 14 different sectors**. Some comparisons have been made to similar studies in 2011 and 2014 (the questions are consistent, but the samples differ, so should be used for indicative purposes only).

Please bear in mind that this document is not a definitive guide. Rather, it provides general, high-level information to assist WFA members when unilaterally taking decisions concerning their negotiations with agencies on appropriate agency remuneration models.

The actions outlined in this report will be discussed and further developed at WFA member events www.wfanet.org/events.

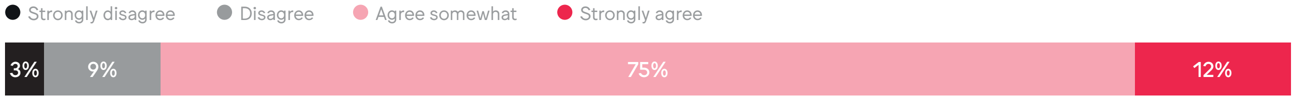
Contents

Detailed answers

Part 1 ⁄ Current perceptions

Perceptions of value for money from agencies is very positive.
87% of respondents feel that they are getting value for money from their agencies (v around 67% in 2011) and 69% agree that their agencies are now accountable for the value that they create. The climb in value for money rating from 2011 is almost certainly as a result of greater confidence in the relationships that have been built between procurement and their agency counterparts. However, there is still a gap on a trust level as can be seen from Fig.2.

Fig 1. I feel that I am getting value for money from my agencies

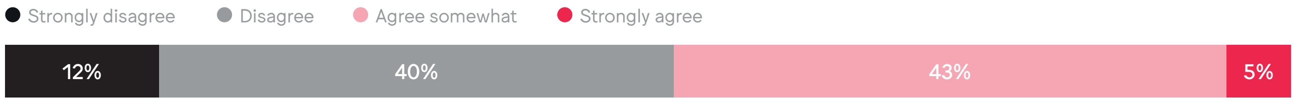


Though transparency concerns remain.
Despite the perceptions on value, over half of the respondents felt they weren't getting true transparency on their agencies' costing models. The fact that these two findings are somewhat contradictory makes this worthy of further investigation. One can hypothesise, based on industry experience, that whilst procurement professionals can get good detail on charge out rates, understanding how totals are actually calculated by agencies is rather more difficult.

Certainly, most agencies will be transparent on margin and overhead (the actual overhead breakdown may be more difficult to get to) – but understanding the amount of time allocated to specific tasks by differing levels of personnel is far more complex and may require specialist external support for clients or procurement to get an answer. Perhaps this lack of clarity, combined with all the issues on rebates and media transparency of late, leaves an element of lingering doubt for many.

It is worth noting that if procurement have some concerns about transparency – agencies do too. Concerns over negotiation on a less than robust scope of work can often lead to agencies trying to ensure they have some protection on scope creep post-appointment which can add tensions in negotiation. They may have some justification for that approach as can be seen later in this report.

Fig 2. I feel that I am getting full transparency on my agencies' costing models



'Transparency: it's a 2-way street'

Agencies:
- Overheads
- Margins
- Rebates
- Discounts
- Audience delivery
- Viewability
- Brand safety
- Actual billable hours

Marketers ⁄ Procurement:
- Big picture
- Marketing objectives
- Personal objectives
- Budgets
- Timeframes – milestones⁄deadlines
- Results
- Mandatories⁄no-go areas
- Evaluation frameworks

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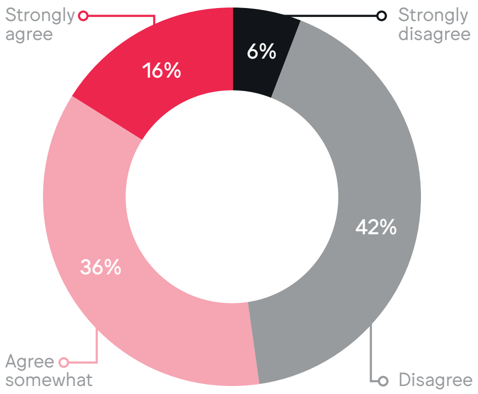
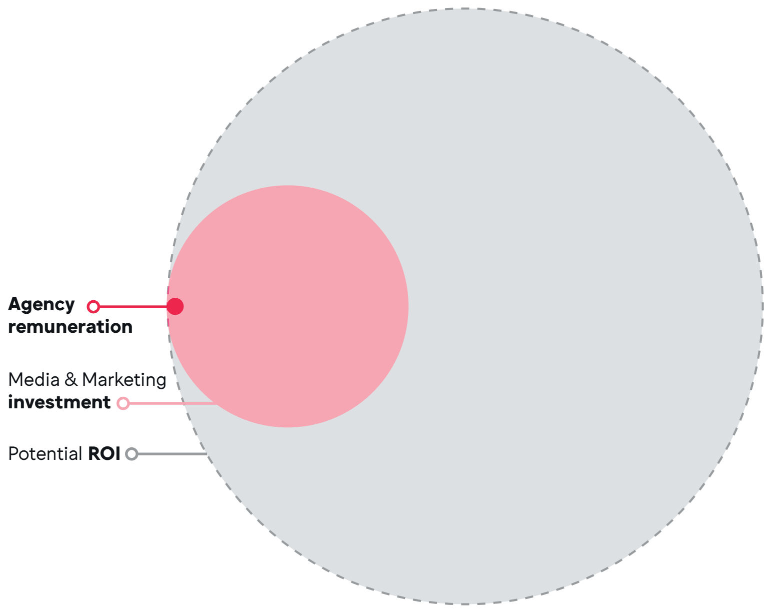
52% think they focus too much on remuneration and it has a detrimental impact on relationships.
Given the somewhat contradictory responses to the previous two questions, it is perhaps surprising that over more than half of respondents think that they place too much focus on agency remuneration and have concerns over the impact of this on the relationship. Agencies would agree.

Most creatively orientated agencies have concerns over time-based activities which they argue ignores the added value that the agency can contribute to their client's business. Certainly, they prefer the main focus to be on return on investment. Whilst this can be delivered by great channel planning and use of media, they rightly argue that the media spend will be wasted unless it's used to deliver truly engaging creative work. In reality, creativity sits at the absolute core of campaign performance, and under-investing on that is rarely productive overall.

Another important point to remember is that all agencies have variable degrees of talent within the building. All clients want their best possible – but the great talent goes to clients who are prepared to pay for it. Those who don't, get a second rate team - and often second rate work.

Fig 3. As client, we focus too much on remuneration and this has a detrimental impact on agency relationships





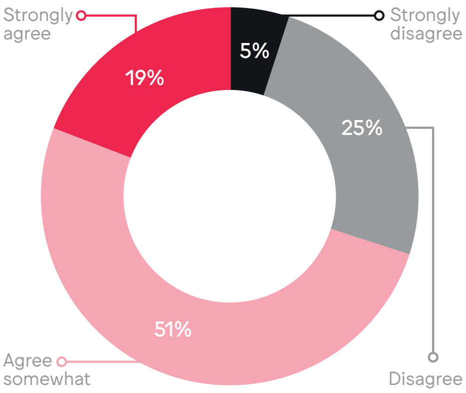
Where the value opportunity sits, or the 'Bubble' illustration
David Little, Senior Marketing Procurement Expert.

> "Our procurement strategy is a value-based strategy, and so it has to be with our partners. We need to look beyond just remuneration."
>
> HERSHEY'S The Hershey Company
>
> **Sherry Ulsh,**
> Indirect Procurement Senior Manager

The majority believe new models could improve client-agency partnerships.
81% expect that to be a continued shift towards performance-based remuneration models (a focus on outcomes), to the ongoing decline of labour based (FTE) and commission-based models. In one respondents' case they have moved to '100% based on incremental sales generated'.

Performance-based remuneration will be welcomed by most agencies as it potentially recognises the contribution they are making to their clients' businesses. But within the framework that's used, it's critical to ensure that both parties interests are considered and balanced. This means that businesses must ensure they set realistic and achievable KPI's and there are robust methodologies in place to ensure appropriate measurement. And whilst perhaps a detail, when budgeting, businesses should always ensure that they have sufficient monies set aside when they need to cover maximum possible performance payment by their agencies.

Fig 4. I feel that changing my current agency remuneration models would improve the relationships that I have with my agencies



> "Our business partners must have an opportunity to make a fair profit."
>
> Johnson & Johnson — **Constance Pincus,** Associate Director, Global Agency Relations

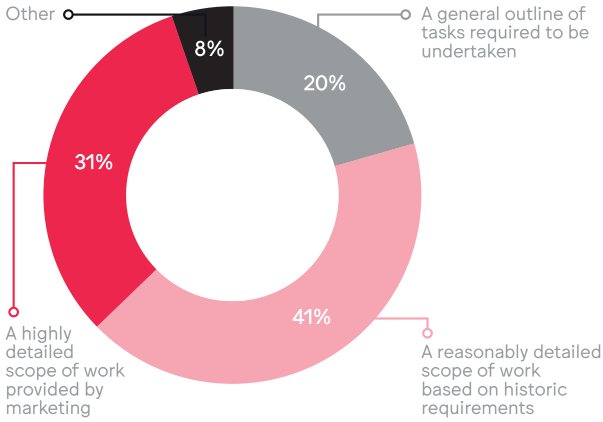
> "It's essential to cover all the agency costs even in case of a PBR model."
>
> SWAROVSKI — **Alexander Kellner,** Associate Director Category Management Marketing & Communication

SOW from stakeholders is often not sufficiently detailed.
Scope of work (SOW) provision is *the* essential component in fee negotiation, however it is often not sufficiently detailed and simply passed off to procurement by marketing as a basis to negotiate. This can lead to conflict on costs from the agency when the actual needs are briefed to the agency by marketing. By this time fees are agreed and there is no more flexibility.

On the record, comments included:

- As much as available from marketing team.
- 50% a general outline, 50% reasonably detailed.
- Depends on brands, all 3 situations may occur.
- Only basic briefings, no real scope-of work description possible to be used for RFQ existing.
- For some categories e.g., media and creative scopes of work are highly details versus in categories e.g. Experiential and PR which is much looser and unquantified.

Fig 5. When asking your agencies to provide cost estimates... Do marketing provide you with:



Insufficient detail in scope sits at the heart of the vast majority of problems with fee negotiations.
The verbatims provide a lens to one of the key issues that causes significant problems with fee negotiation. And the problem tends to lie with hard pressed marketers who either simply don't have the time to dedicate to completing detailed scopes or who simply can't because know they will need flexibility to react to market pressures which can change scope at short notice.

In the first instance, it is incumbent on procurement to set a process in place to ensure they have real clarity on scope from the outset. It is invariably a tough and time-consuming task – but if completed properly will ensure that there is absolute clarity between all the parties involved.

Crucially, that level of clarity also makes the setting of any PBR mechanism considerably easier. Where significant need for flexibility is envisaged, procurement need to ensure they have a model in place which is designed to cope with that need. 'Menu price-based' may well be the best approach for many of these type of agency assignments. This approach can also provide real clarity from the outset for all concerned parties.

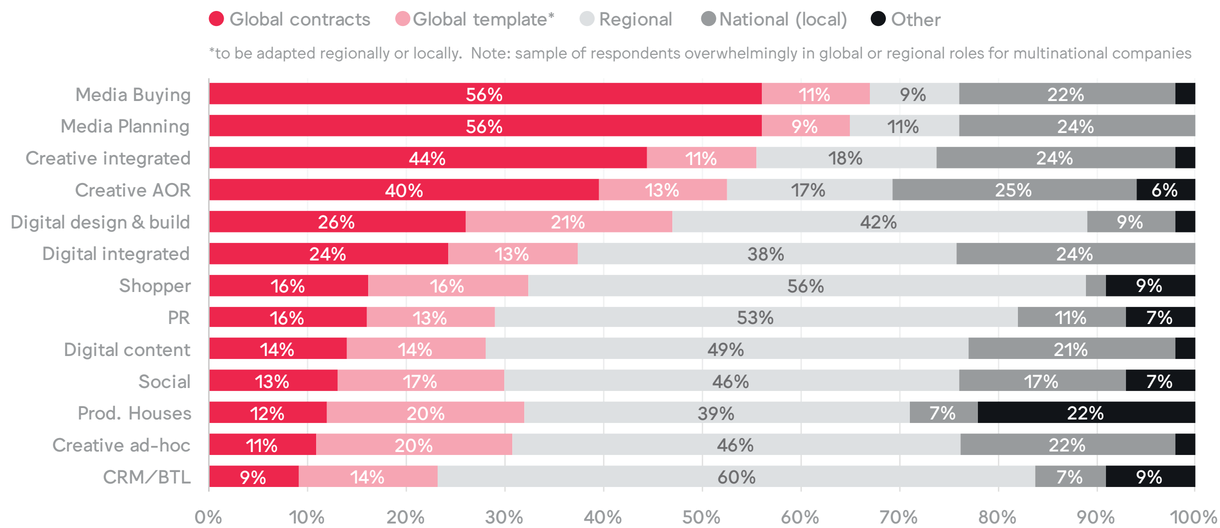
8 steps to improve your SOW:

1. Work closely with your marketing counterparts to define scope in as much detail as possible.
2. Allow adequate time.
3. Offer agencies as much clarity over your budget as you can:
   a. outline fee budget
   b. production budget
   c. potential media budget
4. Take a project by project, campaign by campaign approach to deliverables if necessary.
5. In a long-term relationship don't forget the ongoing everyday strategic, supervisory or roster interaction requirements that will need to be costed for too.
6. You might want to consider 'menu pricing' i.e. deliverables based.
7. Be flexible over refining the SOW as time progresses.
8. Be flexible when reviewing the associated fee too!

Part 2 / Primary remuneration models in use

Need for flexibility based on structures.
Findings underpin the need for flexibility in approach dependent upon how communications operations are structured – globally/regionally/nationally. Global contracts dominate across mature/ 'legacy' agency types i.e. media and creative, whilst regional approaches, dominate for other styles of agency – not unsurprisingly as there will be the need for more tailored communications activity. Adapted global' framework contracts are in use across all disciplines.

Fig 6. How do you approach your agency remuneration?



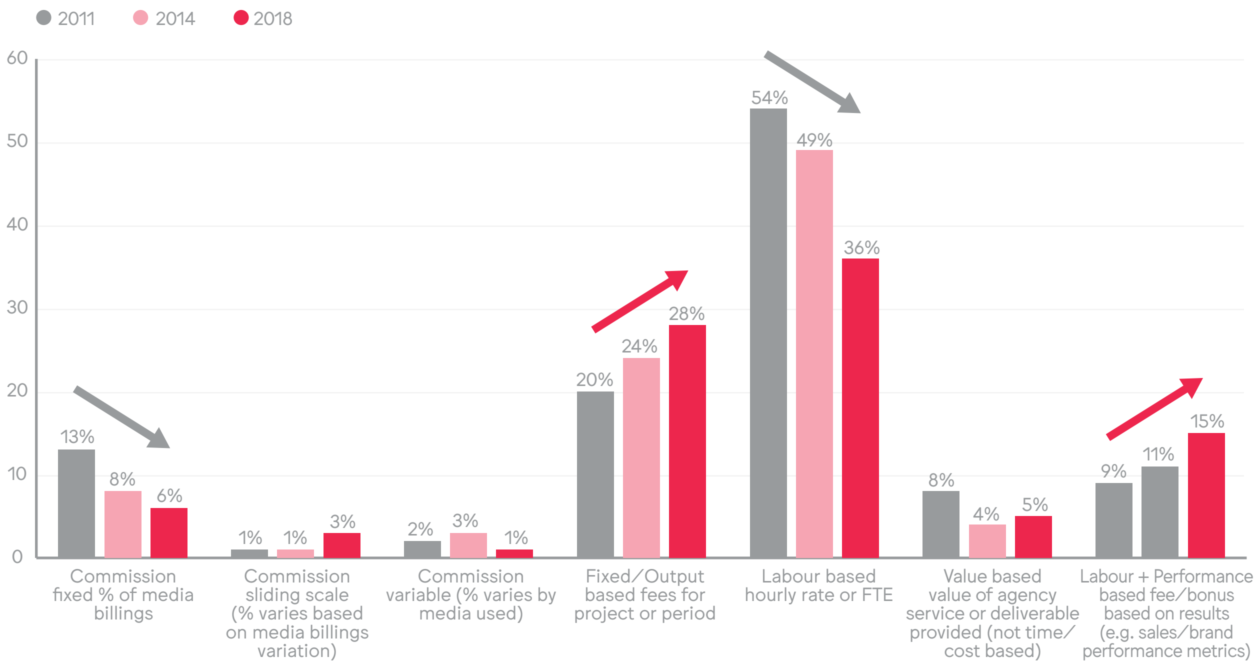
Labour-based fees the most commonly used but increasingly in decline (35% 2018 v 54% 2011).
We continue to see a steady decline in fixed % of media billings, largely because this is becoming less appropriate with the media mixes that are in use today. Sliding scale media commissions appear to be on the increase – though relatively few members seem to be using this approach. Variable commission appears to be rarely used.

Whilst labour-based is in decline, we have seen a steady increase in project-based activities. Whilst this approach (especially if linked to menu pricing) gives businesses increased flexibility there is a potential downside in that brand understanding can disappear due to 'available' people being brought in to work on the task rather than those who work normally work on it day-to-day and have real brand knowledge and understanding. And because agencies will have their best people on retainer business, quality of work can also suffer.

Pure value-based activity remains low – largely because most businesses don't have the methodologies or historic information in place to define appropriate baselines.

And as pure labour-based activity falls, labour-based plus performance element is on the increase. However, there are many variants of this approach – and not all of them particularly motivating for agencies.

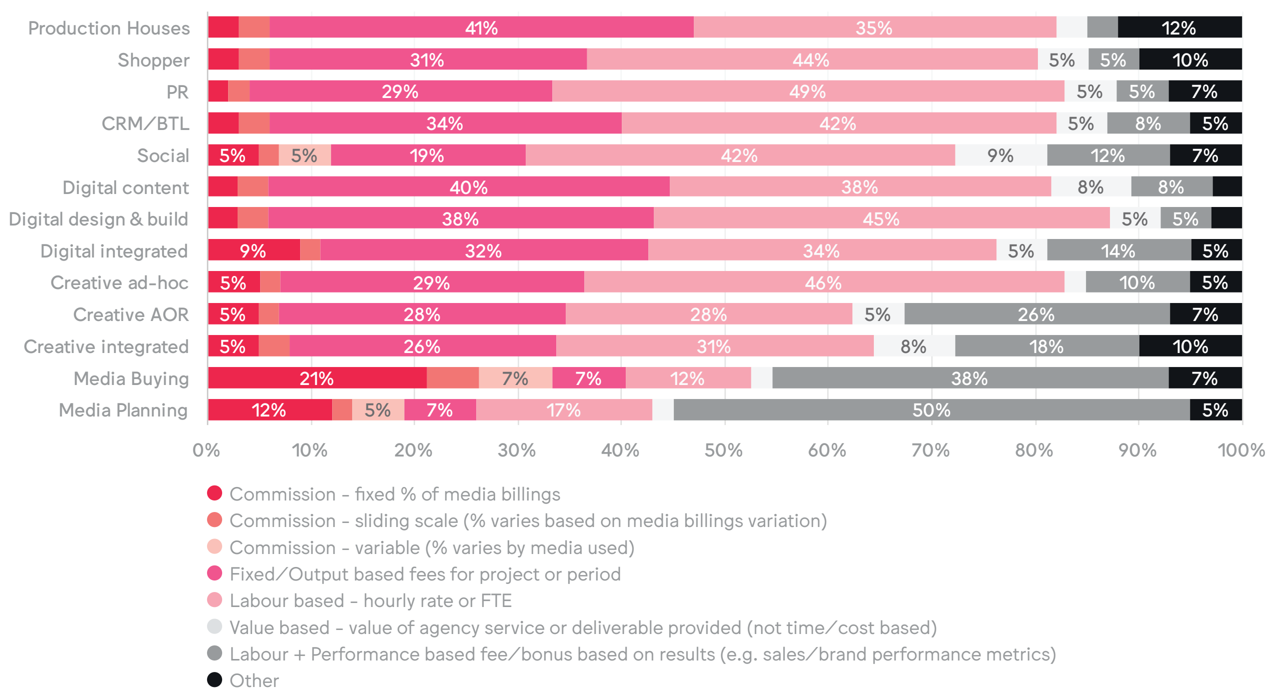
Fig 7. What type of compensation methodology do you mainly use?



No clear 'best practice' by agency type.
This chart evidences the **very different approaches taken by various organisations**, with their differing agency types. It also indicates that, regardless of type of agency, **no clear 'best practice'** methodology appears to be in use. There may be a number of factors lying behind this:

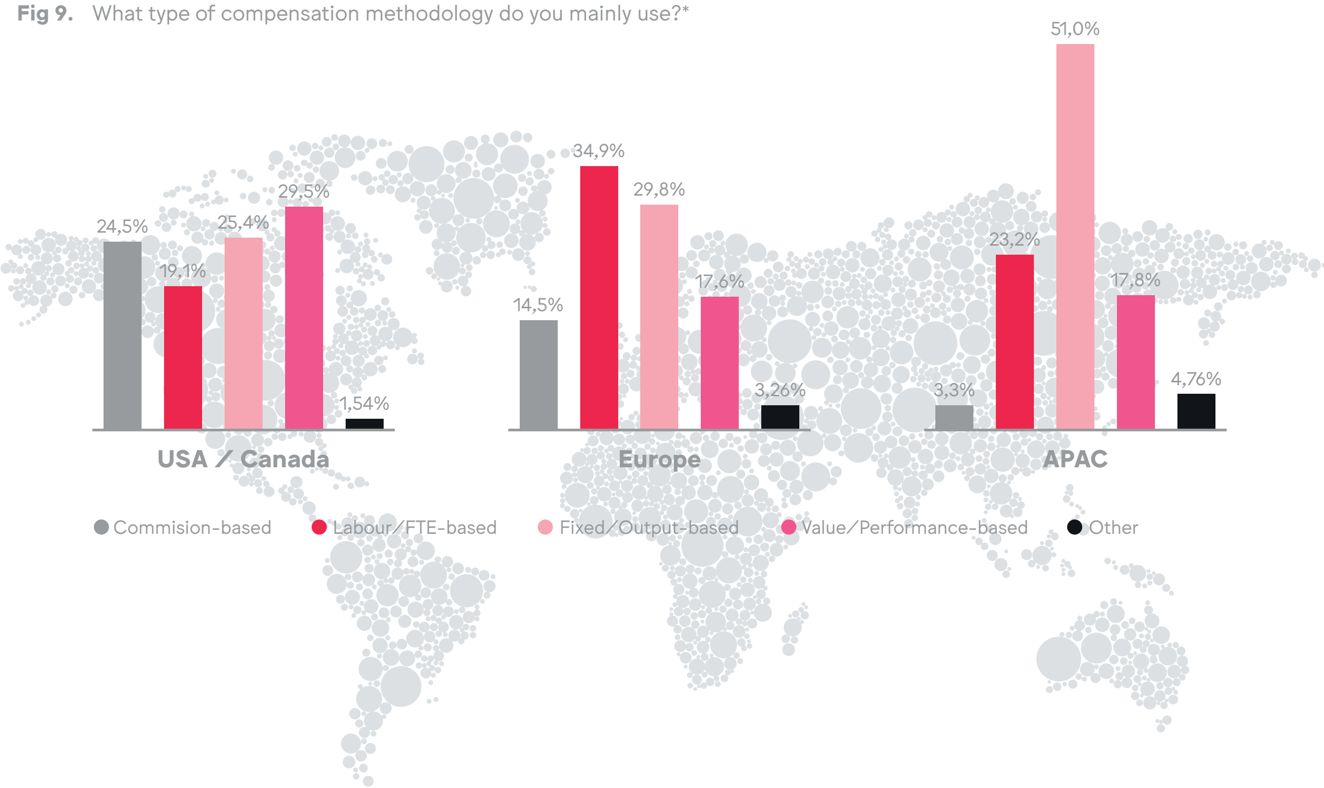
- de-centralised organisations operating different methodologies across markets;
- dissatisfaction with payment structures leading businesses to experiment with alternatives;
- length of agency business tenure directing the remuneration direction etc.

Fig 8. What type of compensation methodology do you mainly use?



Regional models differ significantly.
When we looked at this in 2014, we saw a rather different picture – albeit based on a small sample size. But the most consistent change across all markets has been the increase in value/performance-based remuneration which has climbed significantly across all regions.

Fig 9. What type of compensation methodology do you mainly use?*



*Note: **Results are indicative only**. Samples not statistically relevant. 50% respondents were global (not regional) in scope and so excluded from this. Excluded LATAM and MEA as sample too low

What is perhaps surprising are the levels of commission-based activities – especially in the USA/Canada. We suspect this is a facet of the sample rather than an overall robust picture.

Our findings do not fully reflect other national studies undertaken in the US market as they report a decline in performance related fees. Whilst we don't see that with larger businesses, there is evidence that an increase in project work v longer term relationships has had an effect in this area. In addition, there is evidence that some clients don't want to take time to administer and monitor the PBR and that, combined with a lack of understanding around value of PBR, means that some have moved away from this.

There is no good or bad remuneration model, but there is a right and a wrong way to use each of them. Remuneration models can be grouped into 3 primary overall constructs: time-based, commission-based, outcome/value-based. Various criteria have to be considered in order to define the model that may suit both you and your agency best. Pros & cons of each model can include:

MODEL		FOR	AGAINST
Time based	Retainer	+ Transparent + Accountable + Locks in key talent + Media neutral + Encourages consistency + Provides a good basis for a true business partnership	- Lack of flexibility - Requires clear and detailed scope of work - Can be complex and time consuming to negotiate - Unless tied to a PBR mechanism can reward a good or poorly performing agency in the same way - Does not drive efficiency
	Project	+ Transparent + Accountable + Flexible + Media neutral + Minimise risk	- Requires clear and detailed scope of work - Can be complex and time consuming to negotiate - Real potential for lack of consistency - Unlikely to provide best talent - Caries a higher margin
	Menu-priced	+ Simple + Absolute clarity between parties on cost + Media neutral + Can be used with a 'light touch' core retained team to deliver oversight/talent on business where activities can be turned on/off as required	- Will require significant up-front negotiation and alignment - Potentially lacks incentive - May lack flexibility dependent upon assets negotiated
Commision		+ Simple to calculate + Enables focus on quality of output rather than cost + Basic form of PBR - greater the media spent, the greater the return + % can be 'stepped' on degree of spend	- Relates to amount of media spend - Not actual scope of work - Only applicable to creative with paid for media - Not media neutral - Lacks transparency in relation to actual agency input
Value or outcome		+ Accountable + Potential lower risk + Quality focus + Can potentially drive partnership through shared goals	- Needs deep understanding of previous scopes and costs - Considerable client work to frame basis - Can be very complex to negotiate - Lack of appeal to agency as payment will be end-loaded - May only be appropriate for large/powerful clients

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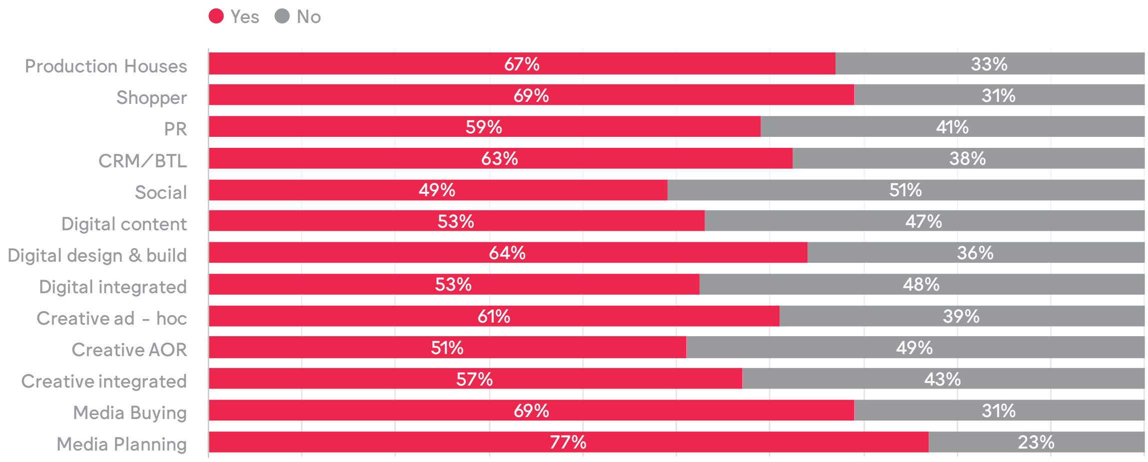
Majority happy with their approaches, but on average 39% not, underlining varied approaches.
On average, and across all agency types, 39% of the respondents are not happy with their current agency remuneration set-ups, perhaps underlined by the varied methodologies shown in Fig. 8. This may be giving rise amongst marketing procurement professionals to question their approach v their peers.

Fig 10. Are you happy with your current model of compensation?



The desire for businesses to simplify and gain greater consistency of outputs through the revision of agency roster models, means there has never been a better opportunity for procurement to use this to develop greater consistency in types of remuneration. We believe that this is something that will be welcomed by both businesses and agencies alike.

Developing a new remuneration model that fits your needs

Creating a new remuneration model takes time and effort – and close working between procurement and their marketing counterparts is key. It's important to understand the key objectives that marketing is looking for in their agency operations and ensure that the remuneration strategy supports those ambitions.

Whilst there is no one size fits all approach due to the differing needs of various businesses, gaining a crystal-clear picture of the requirement and, taking a logical step by step approach to understand:

- Types of agency
- Quality required
- Location
- Agency hierarchy
- Volume of outputs
- Volume of resource
- Budgets/Affordability
- Need for flexibility

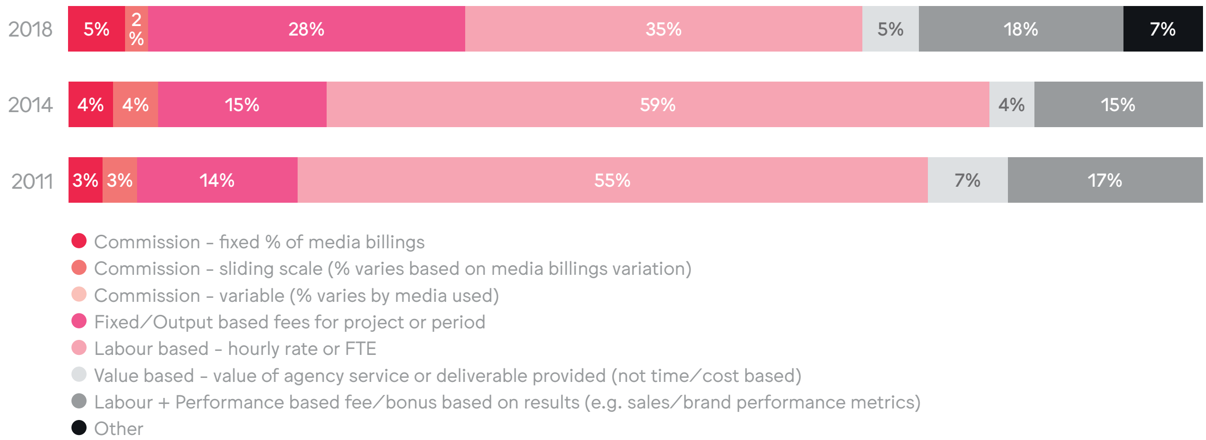
This will provide a solid basis to move forward.

It is worth asking any newly appointed, retained agency to provide costs on a like for like scope of work for two years. The second year should be a lower cost as the agency will not need to dedicate the levels of time required to 'get up the learning curve' in year two. However, don't expect this to be the same if you appoint an agency to work with you on a project basis. They will invariably be using different people across projects, all of whom will need to spend some time getting a knowledge of the business.

Part 3 ⁄ Creative agency remuneration

Creative agency remuneration has shifted away from labour based (FTE) over the past 7 years.
The use of FTE based models in creative remuneration has significantly dropped; respondents seem to be using more fixed/output-based models instead. There is little change in value based and labour/ performance fee usage. Creative agency remuneration has evolved quite significantly over the last 7 years, however 44% of the respondents as per the previous chart remain unhappy with their actual set-up so we can expect more changes to come in the future.

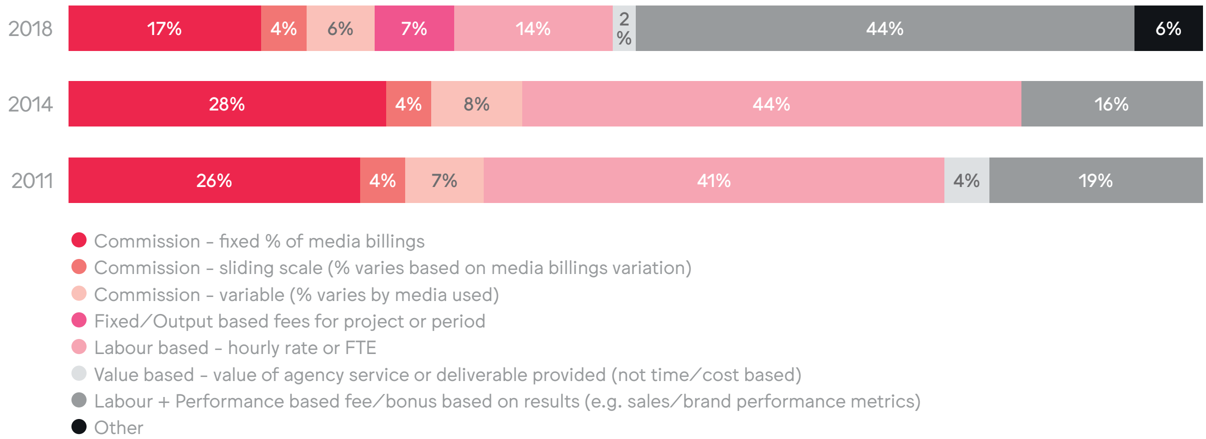
Fig 11. Evolution of creative agency remuneration models since 2011



Part 4 ⁄ Media agency remuneration

Media agency remuneration has also evolved significantly over the last 7 years.
FTE and commission based models have been in decline, probably driven by transparency challenges; 44% of respondents (v 16% in 2014) are now offering a performance based fee/bonus to their agencies on top of labour fee; some (7%) have also started to use fixed/output based remuneration models; more respondents are 'happy' with their media remuneration models than any other agency type.

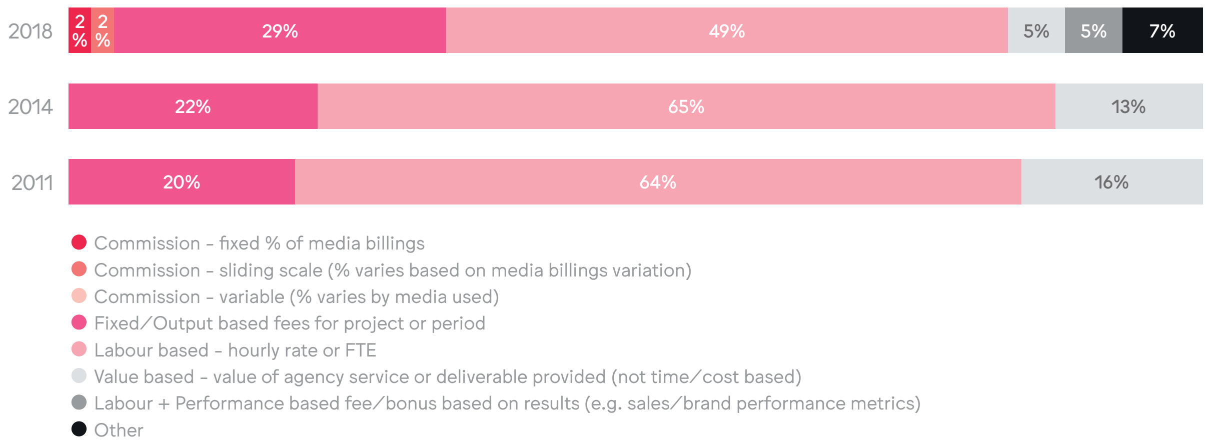
Fig 12. Evolution of media agency remuneration models since 2011



Part 5 / PR agency remuneration

PR agency remuneration also see declining reliance on labour based (FTE) models in past 7 years. Important decrease in the use of labour-based remuneration models. Increasing usage of fixed/output-based models (from 20% to 29% in 7 years) and a small number are using commission-based models (4%). Increasing experimentation in a sector which is notoriously difficult to measure. 41% of the respondents are not happy with their arrangements, and we can expect more changes to come here too in the near future.

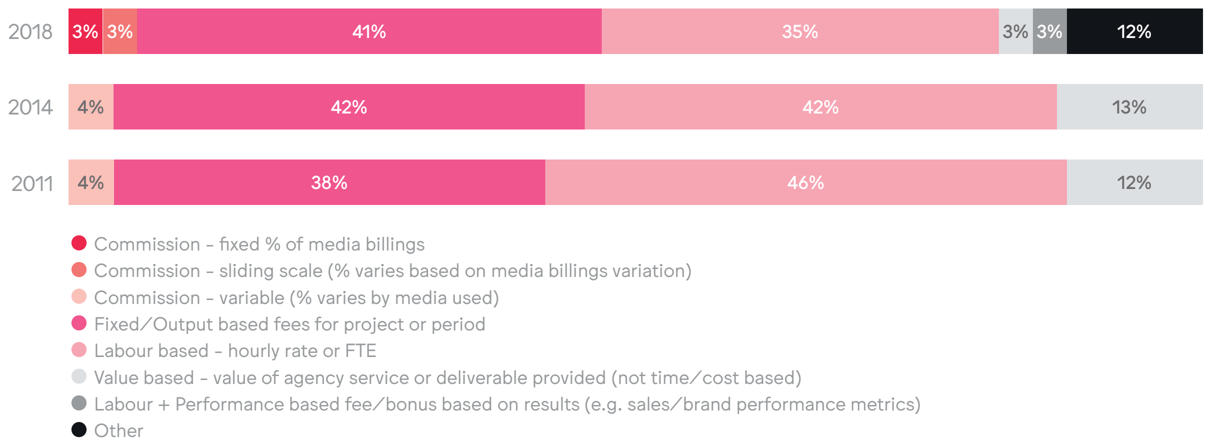
Fig 13. Evolution of creative agency remuneration models since 2011



Part 6 / Production house remuneration

Production house remuneration approaches fairly consistent over the past 7 years. The majority (67%) of respondents are happy with their approaches to remuneration in this area, which may explain the stability; despite much industry focus, value-based remuneration has almost vanished from this area.

Fig 14. Evolution of creative agency remuneration models since 2011



Part 7 / Turning to PBR

82% think it's important or essential to link agency income and performance and 3 in 4 are using PBR models. A PBR dynamic at the heart of the remuneration package is key to driving motivation and effectiveness. An ideal Payment by Results scheme should feature risk & reward for both parties; be easy to manage, and aligned to common objectives between the business and their agencies. Key to this is a strategy where the agency has money 'at risk', and can earn that back by hitting pre-agreed KPI's, and then earn additional bonuses by exceeding those KPI's.

Fig 15. Evolution of creative agency remuneration models since 2011

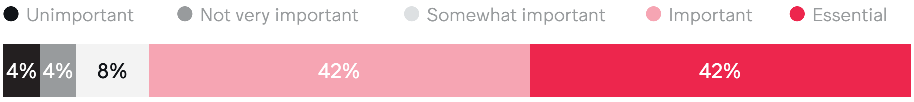
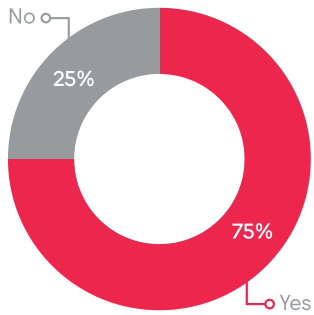


Fig 16. Do you use Performance Based Related (PBR) remuneration models?



PBR mechanisms should:
- → Minimise financial exposure
- → Maximise agency effort
- → Deliver effective ROI

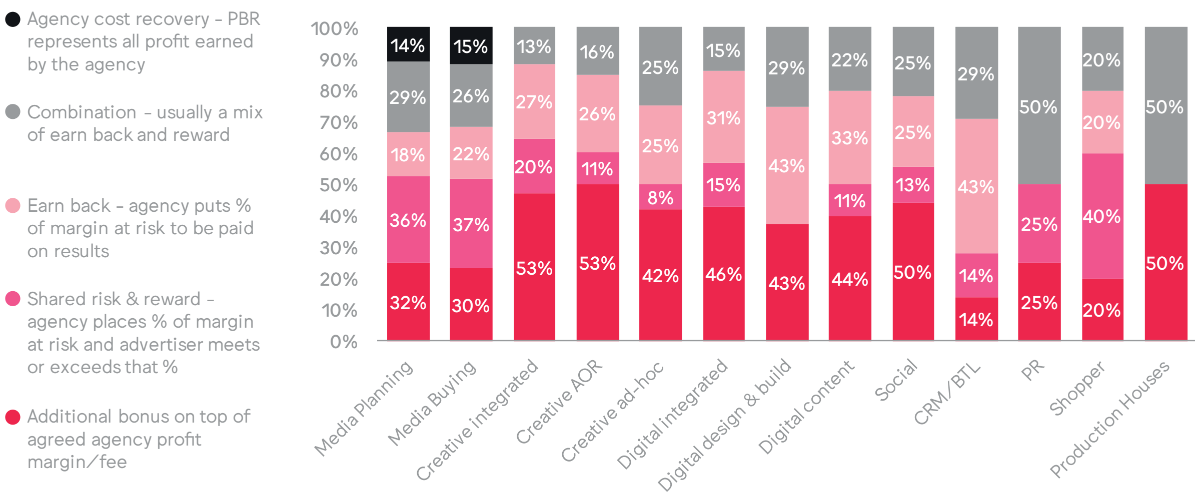
To be genuinely motivating this is best done by:
- → Making the prize juicy
- → Sharing risk both ways
- → Keep construct and reconciliation simple

No clear consensus on 'best practice' PBR methodology.
Additional bonus on top of agreed agency profit margin/fee appears to be the most commonly used model. However, whilst not every available PBR construct is applicable to all types of communications suppliers, there doesn't appear to be consensus on best practice methodology.

For some, this may be due to issues in identifying appropriate KPI's against which to measure value. Certainly, those who do not have or are not aware of available tracking measures are likely to struggle. Again, laying the foundations for the development of KPI's will come by close working between procurement and marketing and the establishment of appropriate common goals which underpin identifiable benefits for the business.

This is particularly important when it comes to different shapes/types of agency. The nature of KPI's for a UX agency are likely to be vastly different from those of a PR Agency. Marketers can help define those measures.

Fig 17. What approach does your PBR model most closely resemble?



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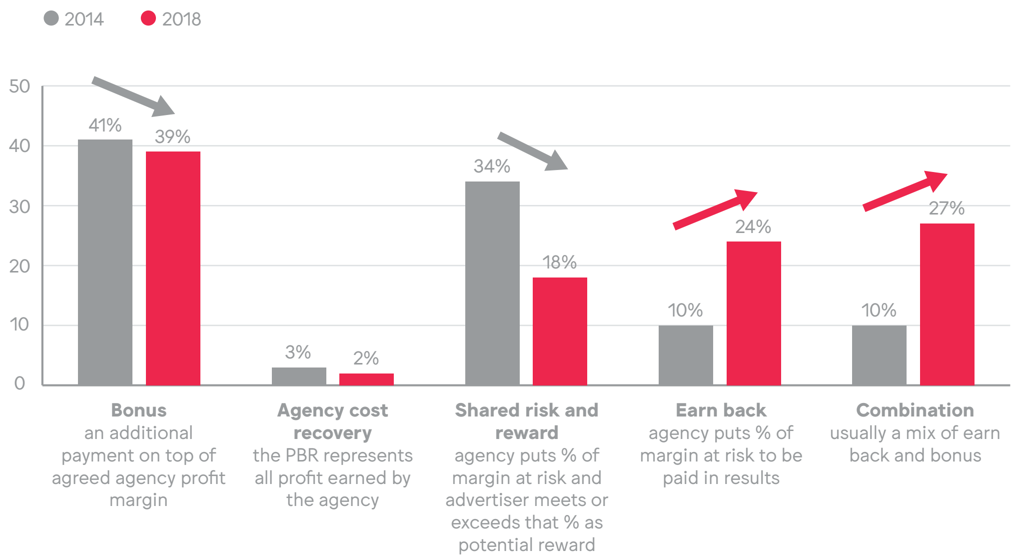
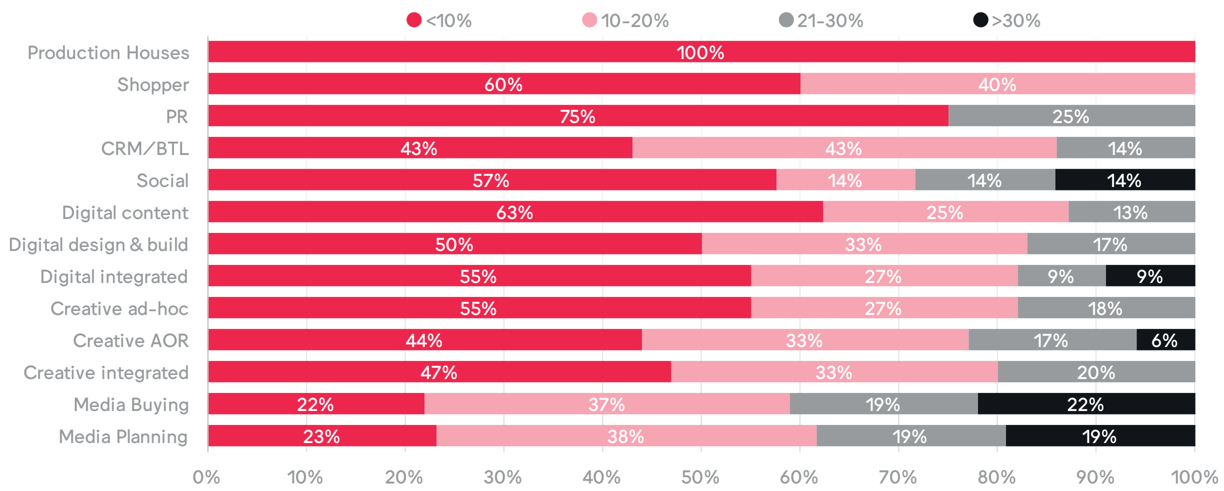
Usage of the 'earn-back' model seems to be increasing. However, unlike true risk and reward, this may have limited motivation for agencies.
Shared risk demonstrates greater commitment between parties and yet seems to be decreasing in use. We were surprised to see only a small drop in 'bonus only' usage given that this approach neither engenders true partnership nor genuine benefit to client. Usage of the 'earn-back' model seems to be increasing, which may possibly be linked to risk mitigation. However, unlike true risk and reward, this isn't really motivating for agencies. Shared risk demonstrates greater commitment between parties and yet seems to be decreasing in use.

Fig 18. PBR methodology evolution since 2014



% of remuneration linked to performance often too low to offer significant incentive.
Across all type of agencies, and on average, less than 20% of the total remuneration is linked to performance for 80% of the respondents. And for more than half of the respondents, less than 10% of remuneration is related to this. The key issue here, however, is what the basis of the performance element is related to. Earn back or true joint risk and reward – both having very different outcomes for the agency. Media continues to be the most 'measurable' dimension – not withstanding recent issues on transparency.

Fig 19. If you remunerate your agency based on performance/value, what % of the remuneration agreement as a whole does that typically constitute?



How to measure agency performance?

Setting KPI's needs close thought but generally operate across three parameters;

- → **hard (sales performance)** e.g. sales/share v plan
- → **robust (brand performance)** e.g. brand tracking measures
- → **soft (agency performance)** e.g. team, strategy, deliverables, operations

How the three dimensions are weighted, and which components are used will vary across type of client and the priorities they are seeking. For example, some clients will consider certain 'hard measures' such as sales as being influenced by a number of factors beyond those of comms. In this instance they will want to allocate a smaller percentage to this element. Measures where the genuine effect of comms can be identified usually fall into the robust areas.

'Soft measure' i.e. the agency's general performance should have close consideration in terms of percentage weighting. They are service businesses and as such a high standard should be the 'norm'.

And, as mentioned earlier, KPI's need to be realistic and achievable.
And monies need to be set aside in the event of maximum scores being realised.

Robust metrics encourage positive behaviour and better agency performance.
In our experience the most effective PBR schemes generally seem to be those that have the greatest level of focus on robust measures – the area where agencies can genuinely demonstrate their potential to change business.

Overweighting hard measures can lead to issues – as there will be elements outside of the agency's control which can affect company performance – or sometimes result in the agency being over-rewarded if the company has an unusually good year.

We mentioned previously the fact that one should be cautious on overweighting 'soft metrics', agency performance measures as service levels are to be naturally expected. However, we have seen high weighting on soft measures used for inter-agency collaboration to significant effect. Agencies rarely play well together – but by placing a reasonable sum of money up for grabs if the agencies work well together has proven to be a significant incentive to change behaviours.

Fig 20. Across the following agencies, what weighting do you give each of the following business metrics within your PBR component?

HARD

	0-10%	11-20%	21-30%	31-40%	41-50%	51-60%	61-70%	71-80%	81-90%	91-100%
MEDIA	13%	15%	23%	10%	10%	5%	5%	10%	3%	5%
CREATIVE	23%	0%	39%	10%	10%	10%	0%	6%	0%	3%
DIGITAL	0%	0%	30%	30%	5%	0%	0%	15%	15%	5%

MEDIUM/ROBUST

	0-10%	11-20%	21-30%	31-40%	41-50%	51-60%	61-70%	71-80%	81-90%	91-100%
MEDIA	22%	11%	27%	8%	5%	5%	5%	5%	5%	5%
CREATIVE	19%	6%	32%	13%	3%	10%	0%	6%	0%	10%
DIGITAL	5%	33%	24%	0%	14%	0%	5%	0%	0%	19%

SOFT

	0-10%	11-20%	21-30%	31-40%	41-50%	51-60%	61-70%	71-80%	81-90%	91-100%
MEDIA	26%	11%	23%	17%	6%	0%	6%	9%	0%	3%
CREATIVE	4%	0%	32%	20%	8%	8%	12%	12%	0%	4%
DIGITAL	0%	0%	40%	7%	27%	0%	7%	20%	0%	0%

How to read these charts: at the top, you have the % ranges for each weighting. Below, you have the % of respondents who selected this range. Red cells indicate the clusters showing the majority of responses.

It is interesting to see that, in the main, businesses appear to be opting for a fairly equal split across the three dimensions. If real consideration is given to KPI's, we would have expected lower hard and soft measures – and much higher robust where, dependent on the businesses' capability to track, the true value of the agencies' outputs can be measured.

On the PBR mechanism, and for agencies providing 'creative' assets, we generally recommend the following as a simple risk/reward mechanic:

Within an agency fee, there will generally be an agreed agency profit margin. We recommend the amount equivalent to 50% of this margin, is put at risk by the agency. However, this amount is matched by the same amount from the client and put into the 'bonus pot'.

- → If the agency misses KPIs, it falls short of its desired profit margin.
- → If the agency hits KPIs, it gets its desired profit margin.
- → If it beats KPIs, it can beat its desired profit margin.

Example:

- Agreed agency fee: $1,000,000
- Agreed agency profit margin: 15% i.e. $150,000
- Agency puts amount at risk (50% of profit): $75,000
- Client matches amount at risk: $75,000
- Total bonus pot: $150,000

Outcome:

- KPIs not achieved: agency forfeits up to $75,000, and does not hit desired profit margin
- KPIs achieved: agency earns back the $75,000, and hits desired profit margin
- KPIs beaten: agency earns up to an additional $75,000, and beats desired profit margin

On the record: what is the one thing you'd like to share to members to watch-out when using PBR models?

- No one size fits all approach - multiple models to fit business, channel, brands etc... that is fit for purpose.
- It takes a long time to negotiate so make sure you allow sufficient time within your sourcing plans.
- Be mindful of some internal behaviours that PBR drive. Internal teams are rapid to claim the downside if the agency doesn't perform but reluctant on paying the upside when the agency over-delivers. PBR needs to be executed the way it was designed even when business pressure calls out for savings.
- Ensure you have quarterly meeting to ensure you keep on track with performance. Align what success looks like.
- Be fair. Bonus should be a true bonus and going truly 'above and beyond'. Increasingly we want to reward individuals for their performance and not just money into the agency P&L.
- Focus on what is truly important and factually measurable, don't overdo on the amount of KPIs.
- The calculation should be clear and univocal and explained in the agency contract. Make sure that all what you agree is transparent and auditable in detail.
- Make sure that criteria/goals have been agreed upfront with the agencies.
- Put hard and soft aspects too into the performance related remuneration part.
- The agency team working on the account must benefit from the extra pay, otherwise it may just increase profit w/o effect on quality. Evaluation should happen based on concrete deliverables and close to the action.

"Effective PBR requires co-created KPIs easily understood, and measured, by all parties."

Carlsberg Group

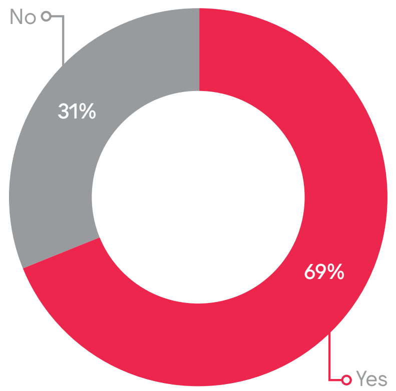
Kate Li,
Asia Procurement Director, Marketing & Sales

"Our new media operating model is based on the collaboration of several media partners working hand-in-hand to deliver value to our business. We've been very clear with our agencies on what we meant by collaboration. This is now a core part of their remuneration, with agencies incentivised on their relationship with other agencies – measured through agency-on-agency evaluations."

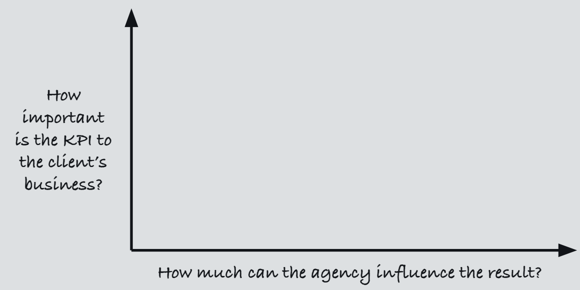
Dr Tamas Szabo,
GCM Marketing

69% of respondents will evolve their performance metrics over the next 12 months.
Setting metrics is not easy – and needs real focus between procurement and marketing. Crucial to a workable performance based arrangement is the need for simplicity – and clarity for both parties. Plus, ideally, having progress reports during the period.

Fig 21. Are you planning to evolve these performance metrics over the next 12 months?



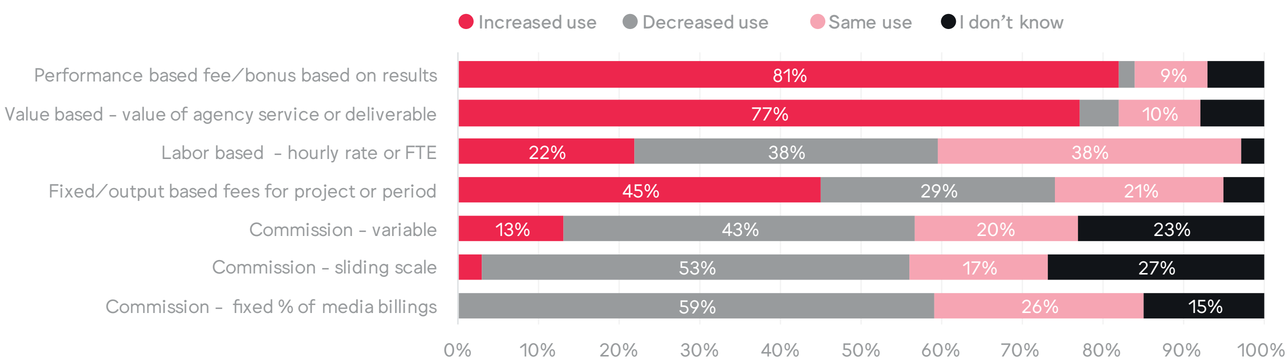
"Following my 'Bubble' illustration, to me this is the second most important graphic in marketing procurement"
David Little, Senior Global Marketing Procurement Expert.



Part 8 / Future needs

More performance and value based models, less commission based in the next 12 months.
Over the next 12 months, respondents plan to decrease commission and labour based models and increase output, performance and value based remuneration models. This would demonstrate a continuing trend since 2011, as per Fig 7. This surely underlines both the realisation of the flaws within pure labour-based constructs and the need for agencies to demonstrate value over sheer cost.

Fig 22. If you plan to refine your agency remuneration models in the next 12 months, what changes are you likely to make?

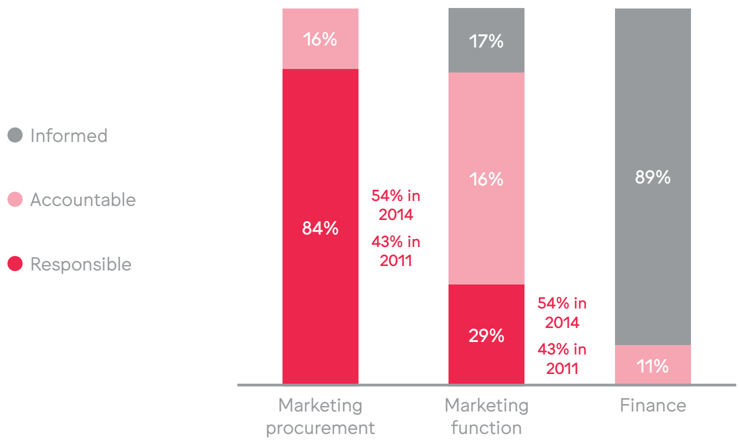


"I'm surprised to still see a lot of companies using labor / hourly-rate based fees as this to me, is the model where you are really not in control. You can't just switch on and off the agency clock. In the end of the day, what you want is to tie your remuneration model to the service output / value delivered by your partners."

Tigran Avakian,
Head of Global Indirect Procurement

Marketing procurement has a growing role in remuneration reviews and implementations.
Procurement undertaking fee negotiation is totally logical – and expected by the agency universe. However, we cannot stress enough the absolute need for close working between procurement and marketing during the negotiation process. In reality, we regularly see a void between the two disciplines (although this is not generally acknowledged) with neither party being fully on the same page. This invariably leads to issues further down the line unless the process is fully aligned between both. It is essential for both parties to understand the ground rules and have absolute clarity on what role each party plays in the process.

Fig 23. Who in your organisation takes the lead in reviewing and implementing changes to agency remuneration models?



"This is our procurement role to work closely with our CFO and make sure that potential performance bonuses are included in the annual marketing budgets. Marketing does not necessarly need take part into this discussion."

COTY **Eniola Akindes,**
Director,
Indirect Procurement,
North America

"Procurement working hand in hand with finance and marketing stakeholders, or the so-called 'golden triangle' was absolutely critical to ensure the successful adoption and implementation of our value based remuneration model. While procurement ensured that agencies were remunerated with market competitive rates and facilitated constructive discussions with all parties, marketing was key in ensuring the right deliverables aligned with business growth strategy and brand health; Finance provided the actual data to back up the assessment."

The Coca-Cola Company **Elaine Chen,**
Global PMO for CEPG
indirect and IT tower,
Coca Cola Far East Ltd.

Models that participants have undertaken

On the record: what is the most innovative example of agency compensation that you have undertaken?

- Share of revenue for successful launch of campaigns.
- Value and project based including PBR linked to the project based on an annual forecast (no commitment).
- 100% fee at risk for Media buy if not achieving cost guarantee.
- 100% based on incremental sales generated.
- Sponsorship contract introduced fee + payment by results.
- Open book calculation in FTE incl. Performance based remuneration by taking full margin at risk incl. potential malus if very bad performance.
- High percentage of risk and earn back through delivery of business metrics.
- Linked 10% of event agency fee to 3 KPIs:
  - → Quality measured by participants of event,
  - → Service measured by brand teams,
  - → Efficiency measured by comparing spent time.
- Variable pricing relationship (mix of retainer + time and material).
- Moving social media team compensation from a fixed commission to an FTE + small % commission.
- Baselining and transparency, to then build up a value-based model.

> The most innovative PBR schemes have always been those which are best balanced and entered into in good faith from both parties, both placing monies at risk – the client from the perspective of being prepared to pay above the going rate for spectacular performance, the agency being prepared to significantly lose-out if they don't deliver.
>
> What we do see increasing levels of, are the implementation of schemes which mitigate risk by clients but place agencies up against the odds when it comes to earning a reasonable income. Whilst these may look good to the business on paper, it's worth remembering that pure business sense will drive the agency to deliver the best work to the clients with the greatest potential for reasonable profit. These one-sided risk approaches rarely deliver a relationship that blossoms into a productive and collaborative arrangement.

10 pieces of advice for greater confidence in agency negotiation

- **Work closely with your marketing counterparts.** We see the best remuneration practices in play when procurement and marketing work closely together (rather than simply claiming to). It is crucial that you work together as a team with clear responsibilities and guardrails to ensure absolute clarity of roles and purpose moving forward.

- **Get a clear, detailed scope of work.** Lack of detail in scope sets agency alarm bells ringing. They will inevitably go into defensive mode on their costs and this can lead into extended and frustrating negotiation and potential perceptions of the agency lacking transparency. Getting detailed scopes from hard pressed marketers is often not easy – but it is the essential start point in any negotiation that isn't going to run in to trouble at a later date.

- **Understanding fee composition.** There is no reason why an agency shouldn't disclose the make up of their fees. The industry norm is direct costs (salaries, employment tax etc) + overhead + profit margin. These may vary significantly by percentage – expect agencies in large metropolitan centres to have significantly higher overheads than those based in the regions where property costs will be much lower.

- **Beware the 'blended' rate.** Some agencies will look to provide 'blended' rates on multinational business. Whilst there is an obvious simplicity and logic to this approach, it can disguise what you are actually paying. Your account director rate for London or Tokyo may look rather lower that normal – but that rate applied to their counterparts in Hungary or Vietnam could be massively inflated. You need to satisfy yourself that the 'blend' is a true reflection of appropriate costs.

- **Appropriate budgeting.** All businesses are looking for more from less. However, on occasions, what is being asked from the agency for the monies available is simply not possible. Be prepared to discuss what the agency can do for the monies after satisfying yourself their rates are realistic, and then push back to marketing to manage expectations.

- **Contracts.** First of all make sure you have one – surprisingly we regularly see clients who don't, especially in developing markets, largely in the naive belief that it gives them greater flexibility. Contracts are there to protect both parties and it's crucial that you have a clear, fair and motivating one in place – not least because without one, the chances are that any rights in creative work will lie with the agency – meaning you can't use it without payment. Consider intellectual property/copyright clauses carefully, review it annually and modify it if circumstances change. Make sure you've got the protection of an appropriate audit clause and don't over-complicate process (and by implication timeburn) with demanding clauses – e.g. multiple estimates triggered by artificially low cost threshold. Always ensure notice terms are adequate – keeping them short can create real issues when running a pitch process that takes time to come to fruition. Finally, make sure it is shared and read by agency users – not simply signed and put in a drawer. They need to understand the ground-rules.

- **Be fair and balanced in your dealings.** Dealing with professional services requires special skills largely because you are buying intangible assets and people. You need an objective mindset, but this needs to be balanced with a recognition of the fact that long after negotiations have ended, your marketing counterparts need a motivated business partner rather than a supplier who is always pushing back over monies. You need to ensure that you are getting good value – but not be overly aggressive to simply push costs down. You and the agencies are looking for the same outcome – win-win.

- **Techniques for the task in hand.** All will experience differing types of negotiation – principally negotiating in a competitive arena (pitch), negotiating a new 'solus' supplier, and negotiating with existing suppliers. There is always a temptation to believe that negotiating in a competitive scenario gives an 'edge'. In some instances, that's true, but in reality, you should be taking the same approach regardless of type of negotiation you're undertaking. That should be a negotiation based on the scope of work and quality of deliverable required.

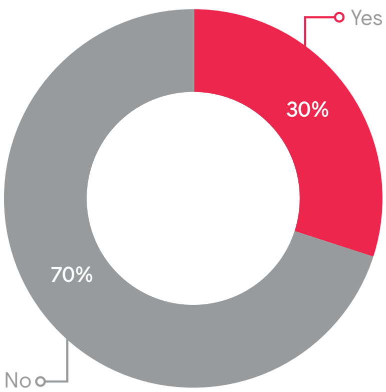
- **Be open minded.** Inevitably you will have devised a remuneration strategy before you engage with agencies. But that doesn't mean you can't be open minded to new approaches that agencies may come up with. As agencies strive to move away from time based fees, we regularly see innovative models devised by them to remove the need for constant haggling and which guarantee the delivery of great work. Some may not give the deep transparency that you are looking for – but providing the end figures are right and tied to a robust MSA, the results can save time and delight all stakeholders.

- **The detail is in the data.** Benchmarking agency rates can be complex and time consuming. Often, it's possible to compare with your own data but from time to time, a new category of agency or new territory arrives and you have no comparisons to work to. In this instance you may look at third party data. That in itself is not an issue – but you do need to interrogate that data to establish its age, the pool from which it's taken (to ensure like for like agency comparison) and whether the rates are 'market price'/un-negotiated or negotiated – and if the latter by what type of client. A big businesses will have the power to negotiate considerably harder than small ones.

Appendix: overhead & profit margin

> **70% of respondents do not have detailed insight into what the agency overhead comprises.**
> Whereas labour-based is still the most popular model in use you do need clarification on:
> → Billable hours
> → Overhead (and ideally what this comprises)
> → Profit margin
>
> Additionally, you need to ensure, when benchmarking rates, that you have like for like information. Beware of using 3rd party data that includes negotiated rates as it can distort.

Fig 24. Do you have detailed insight into what the agency overhead comprises?



What can be included in agency overhead?

This can vary from market to market but typically agency overhead includes:

- Direct property costs
- Equipment
- Non-billable activities
- Non-billable people i.e. admin services
- Rent/rates
- Services (insurances, health schemes, state employment tax, company cars, IT etc.)
- Staff bonuses in some cases

Interrogation of agency overhead is important as what sits in this area can vary significantly. However, agencies are often reticent to provide full details.

China

Profit margin

	0-5%	6-10%	11-15%	16-20%	21-30%	> 30%	Don't know
MEDIA	0%	0%	40%	40%	0%	0%	20%
CREATIVE	0%	0%	0%	0%	0%	0%	100%
DIGITAL	0%	0%	0%	0%	0%	0%	100%

Overhead

	< 50%	51-60%	61-70%	71-80%	81-90%	91-100%	101-110%	111-120%	121-130%	> 130%	N/A
MEDIA	0%	0%	0%	0%	50%	50%	0%	0%	0%	0%	0%
CREATIVE	0%	0%	0%	0%	0%	67%	0%	0%	0%	0%	33%
DIGITAL	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%

How to read these charts: at the top, you have the % ranges for overhead and profit. Below, you have the % of respondents who selected this range. Red cells indicate the clusters showing the majority of responses.

China findings are from a rather small sample (5 respondents only) – which may have distorted findings. Please note by using this data you agree to only use these % indicatively. They should not be considered as recommended ratio and are not intended to replace commercial discussions between clients and agencies. Members should use caution when interpreting these figures.

> What we have observed in recent years in China is an increase in overheads driven by the need to retain staff, more agency competition and higher general running costs. This has led to overheads running generally at the 90-100% mark – but with profits, on average, usually sitting at 10 – 15% level.

France

Profit margin

	0-5%	6-10%	11-15%	16-20%	21-30%	> 30%	Don't know
MEDIA	12%	19%	46%	8%	0%	0%	15%
CREATIVE	0%	16%	31%	6%	12%	0%	34%
DIGITAL	0%	5%	39%	13%	3%	0%	41%

Overhead

	< 50%	51-60%	61-70%	71-80%	81-90%	91-100%	101-110%	111-120%	121-130%	> 130%	N/A
MEDIA	13%	4%	13%	22%	13%	0%	0%	9%	0%	4%	22%
CREATIVE	10%	0%	0%	10%	14%	29%	5%	0%	0%	0%	33%
DIGITAL	18%	0%	0%	5%	0%	14%	18%	5%	0%	0%	41%

How to read these charts: at the top, you have the % ranges for overhead and profit. Below, you have the % of respondents who selected this range. Red cells indicate the clusters showing the majority of responses.

Base for these charts: 24 respondents amongst the 42 companies who took part into this study. Please note by using this data you agree to only use these % indicatively. They should not be considered as recommended ratio and are not intended to replace commercial discussions between clients and agencies. Members should use caution when interpreting these figures.

> Figures here seem seems to be generally in line, although digital agencies have quite a high percentage of respondents indicating profit margins in the 16-20% range, which feels somewhat high.

Germany

Profit margin

	0-5%	6-10%	11-15%	16-20%	21-30%	> 30%	Don't know
MEDIA	11%	25%	54%	4%	0%	0%	7%
CREATIVE	3%	21%	31%	4%	14%	0%	27%
DIGITAL	0%	5%	39%	6%	11%	0%	39%

Overhead

	< 50%	51-60%	61-70%	71-80%	81-90%	91-100%	101-110%	111-120%	121-130%	> 130%	N/A
MEDIA	20%	4%	12%	28%	12%	0%	4%	4%	0%	4%	12%
CREATIVE	9%	4%	0%	0%	20%	31%	7%	0%	0%	0%	29%
DIGITAL	22%	0%	0%	0%	0%	17%	22%	6%	0%	0%	33%

How to read these charts: at the top, you have the % ranges for overhead and profit. Below, you have the % of respondents who selected this range. Red cells indicate the clusters showing the majority of responses.

Base for these charts: 24 respondents amongst the 42 companies who took part into this study. Please note by using this data you agree to only use these % indicatively. They should not be considered as recommended ratio and are not intended to replace commercial discussions between clients and agencies. Members should use caution when interpreting these figures.

> There appear to be one or two findings here which we would contest – especially the fact that 20% of respondents feel that their media agencies have overheads of less than 50% - which seems unlikely. The same applies for digital agencies.

United Kingdom

Profit margin

	0-5%	6-10%	11-15%	16-20%	21-30%	> 30%	Don't know
MEDIA	11%	25%	43%	11%	0%	0%	11%
CREATIVE	0%	17%	33%	6%	18%	0%	27%
DIGITAL	0%	4%	42%	11%	2%	0%	41%

Overhead

	< 50%	51-60%	61-70%	71-80%	81-90%	91-100%	101-110%	111-120%	121-130%	> 130%	N/A
MEDIA	11%	11%	11%	26%	11%	7%	0%	7%	0%	4%	11%
CREATIVE	10%	0%	4%	9%	14%	28%	15%	0%	0%	0%	20%
DIGITAL	18%	0%	0%	4%	4%	13%	32%	5%	0%	0%	23%

How to read these charts: at the top, you have the % ranges for overhead and profit. Below, you have the % of respondents who selected this range. Red cells indicate the clusters showing the majority of responses.

Base for these charts: 24 respondents amongst the 42 companies who took part into this study. Please note by using this data you agree to only use these % indicatively. They should not be considered as recommended ratio and are not intended to replace commercial discussions between clients and agencies. Members should use caution when interpreting these figures.

> The UK figures look generally appropriate – but of course are likely to be biased towards London based agencies (and costs) so will distort the UK average.

USA

Profit margin

	0-5%	6-10%	11-15%	16-20%	21-30%	> 30%	Don't know
MEDIA	0%	38%	25%	0%	0%	0%	38%
CREATIVE	0%	8%	75%	0%	0%	0%	17%
DIGITAL	0%	29%	42%	0%	0%	0%	29%

Overhead

	< 50%	51-60%	61-70%	71-80%	81-90%	91-100%	101-110%	111-120%	121-130%	> 130%	N/A
MEDIA	0%	0%	0%	0%	38%	25%	0%	25%	0%	0%	13%
CREATIVE	0%	0%	0%	0%	28%	28%	0%	28%	0%	0%	17%
DIGITAL	0%	0%	6%	0%	52%	21%	0%	0%	0%	0%	21%

USA findings are from a rather small sample (6 respondents only) – which may have distorted findings. Please note by using this data you agree to only use these % indicatively. They should not be considered as recommended ratio and are not intended to replace commercial discussions between clients and agencies. Members should use caution when interpreting these figures.

> Typically, we would see profit margins in the 17 – 19% area – with media at the lower end of the scale and even some digital and high profile creative achieving 20 – 22%. In terms of overhead, we typically see this in the range of 90 – 110% - dependent on agency type and location.

It is worth bearing in mind that all agencies will strive for sensible profit margins based on the size of the business – so the above averages should be treated precisely as that; averages. Larger businesses may expect their agencies to return lower average profits due to scale of account – smaller can expect to pay higher.

And, as we alluded to in out '10 pieces of advice' it is worth bearing in mind that overheads can vary from region to region, country to country and city to city. But within those parameters, agencies should largely operate on consistent overheads relating to their type.

About the Observatory International:

The Observatory International is the leading global management consultancy dedicated to helping companies maximise their marketing and communications resources. We bring global and local perspectives to marketers along with the knowledge required to overcome the challenges associated with managing communications agencies in these dynamic times. With years of experience working with many of the world's leading brands and agencies, our casebook is full of best practice on how to get the most out of your marketing resources.

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The World Federation of Advertisers (WFA) is the voice of marketers worldwide, representing 90% of global marketing communications spend – roughly US$900 billion per annum – through a unique, global network of the world's biggest markets and biggest marketers. WFA champions responsible and effective marketing communications worldwide.

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Additional information

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