Scope of Work Planning and Activity-Based Pricing

Featuring Michael Farmer, Farmer & Company LLC

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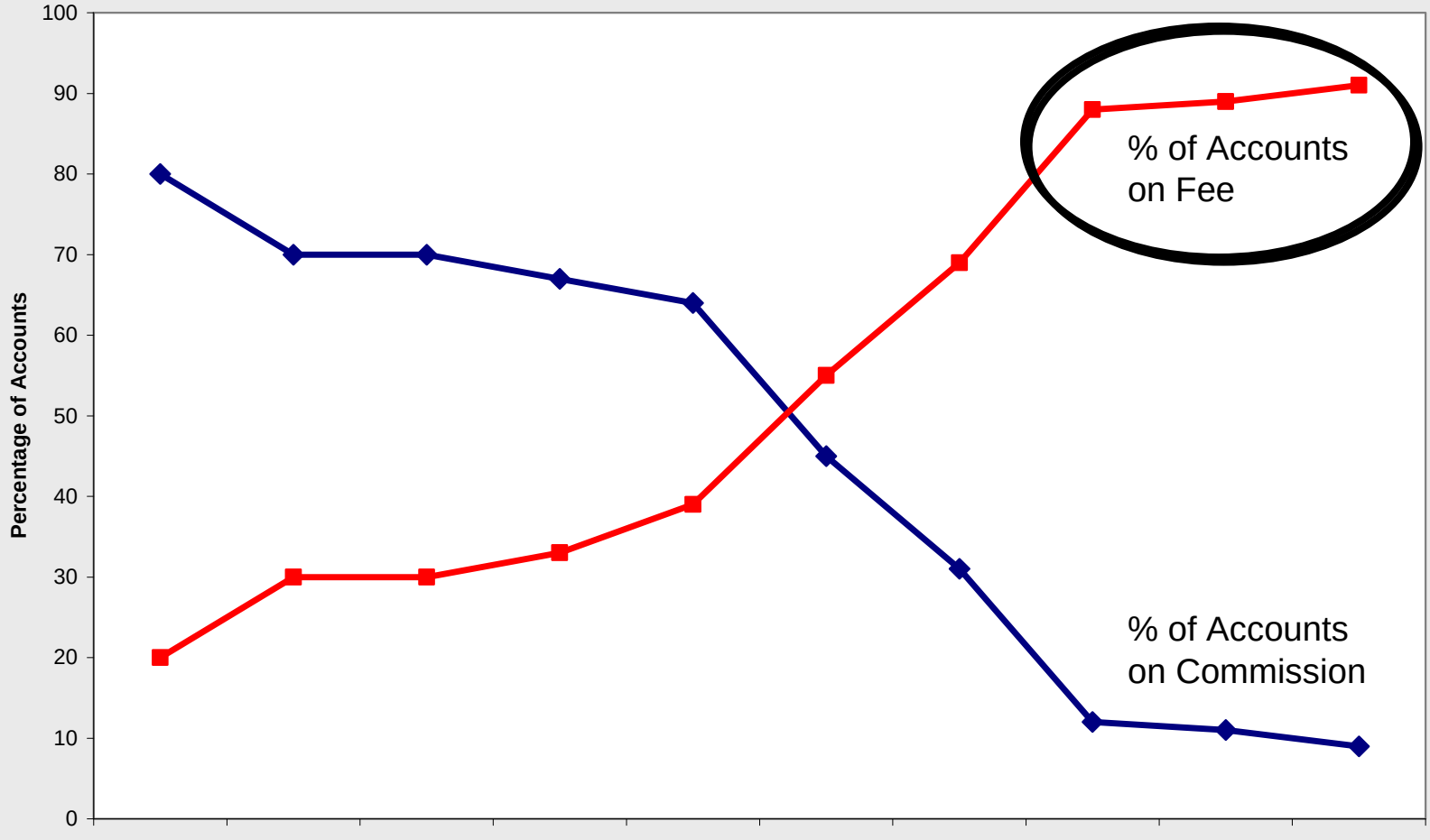
I -- Background & Situation Analysis

The Past 20 Years – Challenges

- Holding Companies – pressure for profits
- Fee-based remuneration
- Procurement
- Reduction in fees
- Client globalization / regionalization
- Growing, complicated workloads
- New media (particularly digital)

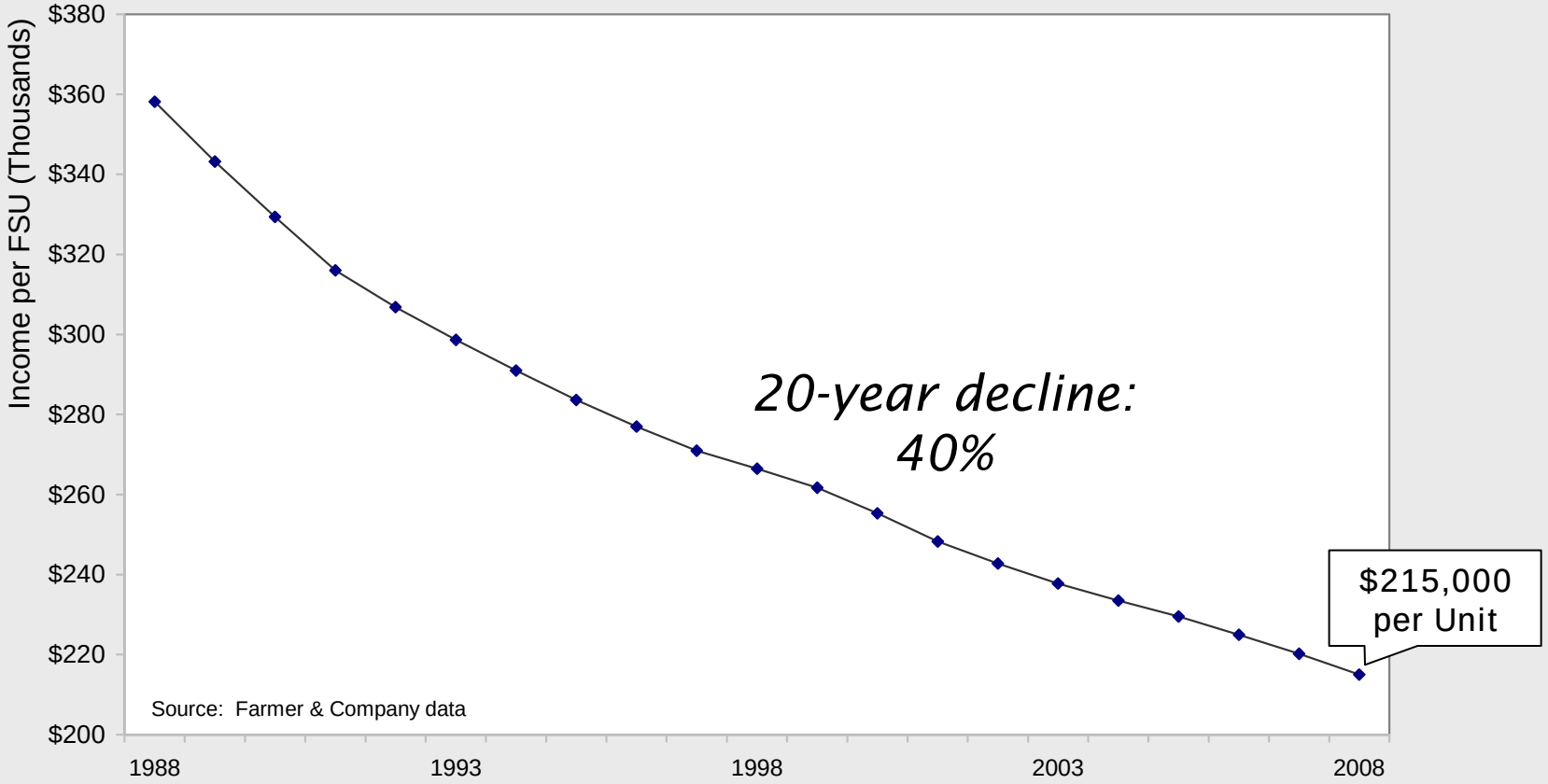
U.S. Fees vs. Commissions 1982-2009
Growing dominance of fee-based pay



Source: ANA

Relentless Decline in Fee Levels

Average Agency Income per Unit of Work $2008



What is a Standard 'Unit of Work?'

- *Farmer Standardized Unit (FSU)* -- a workload metric:
  - *The amount of work carried out by a typical Creative, working 439 man-hours in an efficiently-run and properly staffed relationship ("standard efficiency")*
- *Thus*: one creative working 1,800 hours can complete 4.1 FSU's *at standard efficiency*
  - *Less than 4.1* is due to excessive rework
  - *More than 4.1* is due to understaffing

What is "Standard Efficiency?"

<u>In Traditional Advertising (*example*):</u>

High complexity briefs (*new campaigns or launches*)		2.0 creative teams 2.0 reworks
Average complexity briefs (*ongoing campaigns*)		1.0 creative team 1.0 rework
Low complexity briefs (*very simple continuations*)		1.0 creative team 0.5 reworks
Adaptations (*derived from originations*)		0.5 creative teams 0.0 reworks
Client Service & Planning Costs	**=**	Creative costs (CS&P Ratio = 1.0x)

4.1 FSU's per Creative

Example: NY Agency Office (2008)

- 2,096 projects
  - 631 TV
  - 9 Multimedia
  - 1,273 Print
  - 183 Radio

  } 1,304 originations
  792 adaptations
- Workload = 777 FSU's (*at standard efficiency*)
- 136 Creatives
- 5.7 FSU's per head
- Understaffed

FSU Summary

- FSU's define the amount of work "*at standard efficiency*"
- Each brief has a unique FSU value

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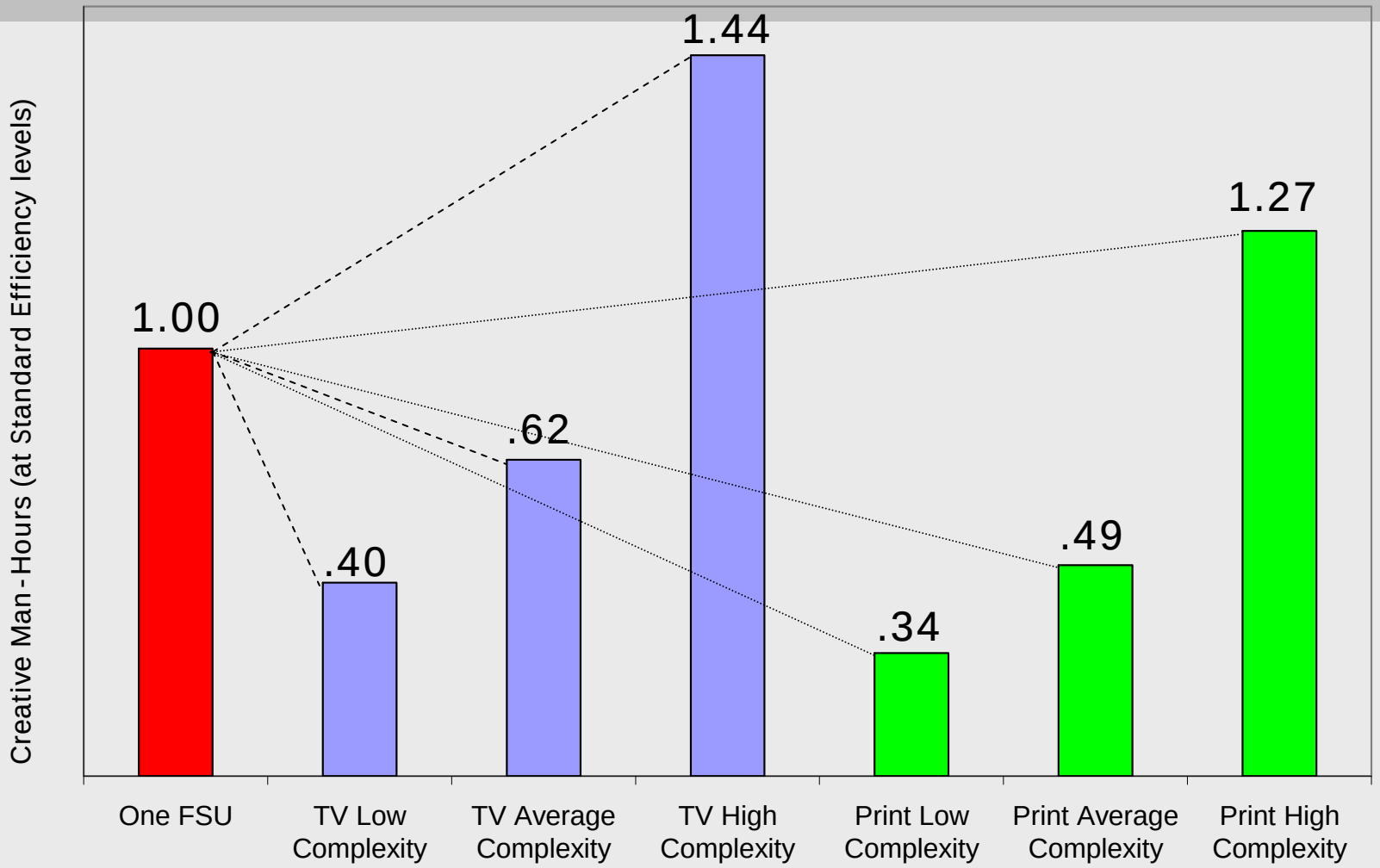
FSU Values: TV & Print Originations. *Example*



Source: Farmer Resource Model

Workload: A Small Scope of Work

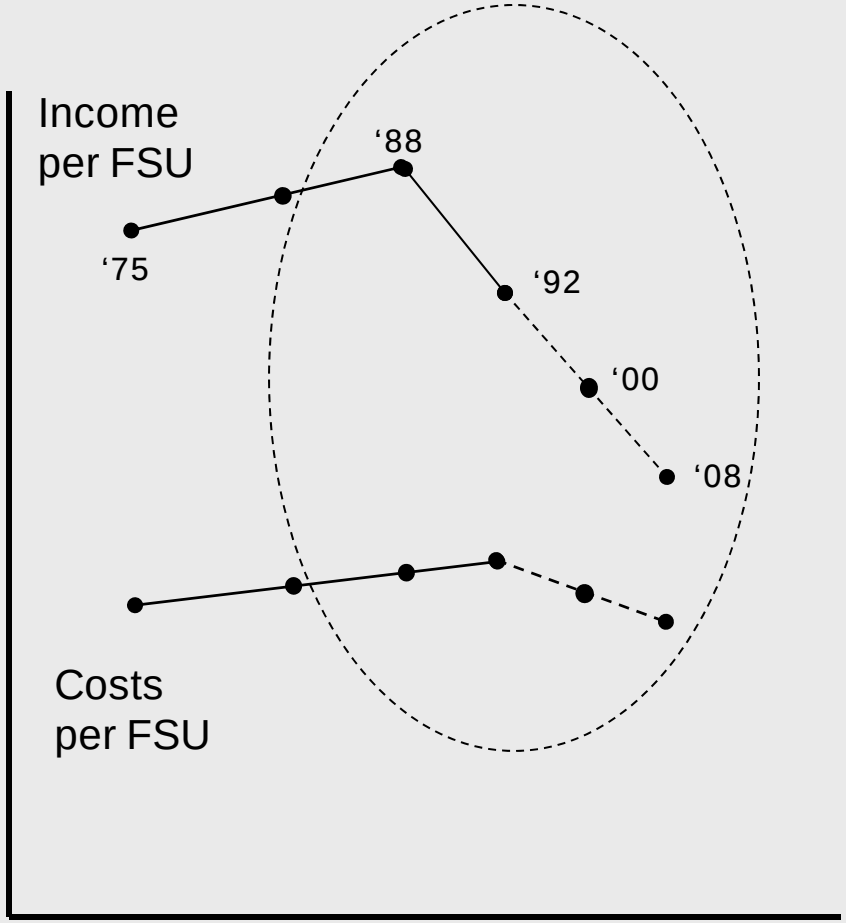
	Brief Type	FSU's
1	TV Origination Low Creative Complexity	0.44
2	TV Origination Average Creative Complexity	0.73
3	TV Origination High Creative Complexity	1,71
4	Print Origination Low Creative Complexity	0.34
5	Print Origination Average Creative Complexity	0.49
6	Print Origination High Creative Complexity	1.27
SOW	**TOTAL WORKLOAD**	**4.98**

Industry: Growth & Decline

From 1988 to 2008 (20 years)

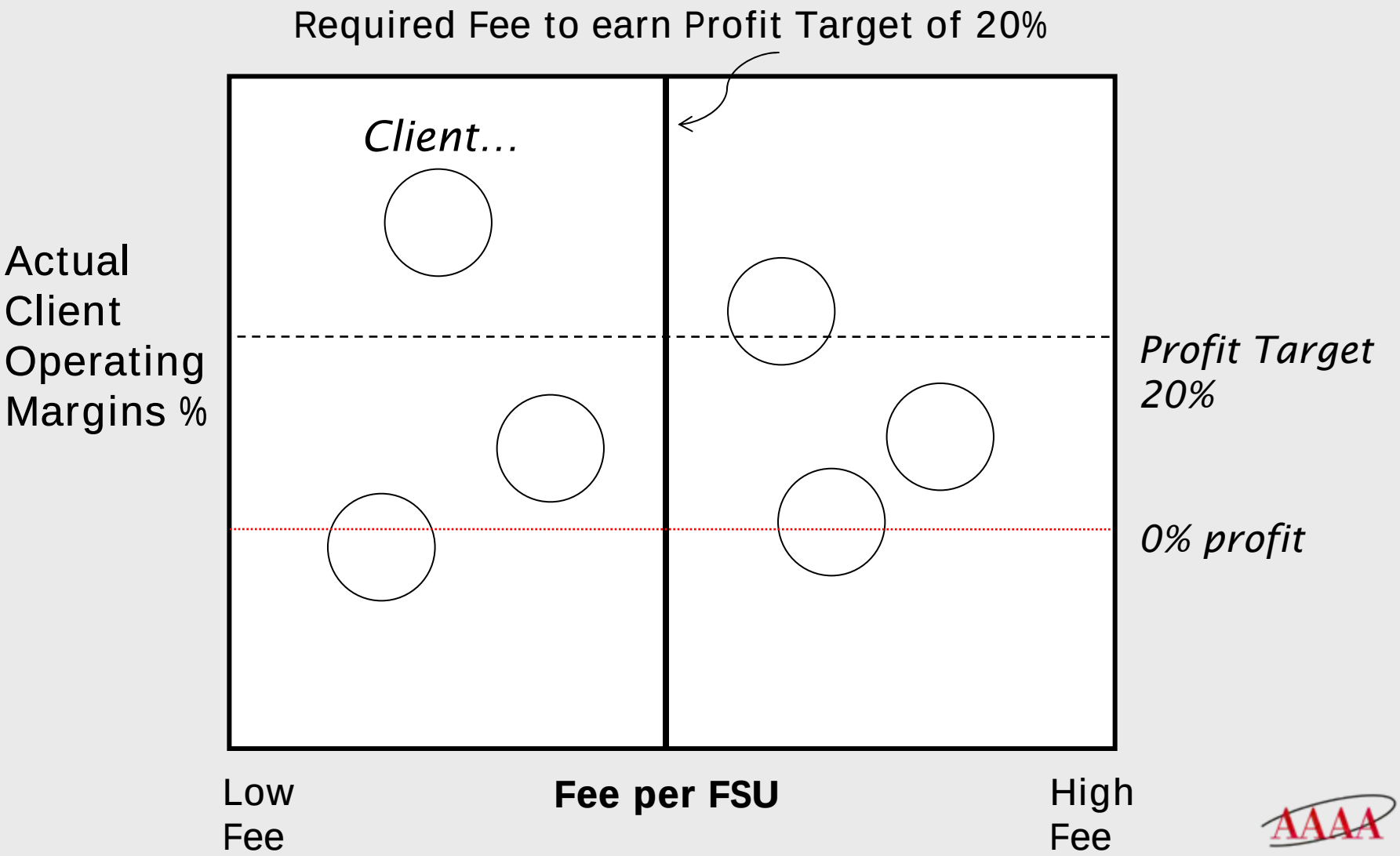
- Growth in creative workloads (FSU's).....60%
- Growth in creative headcounts.....17%
  - Agencies eliminated routine use of multiple creative teams
- Real Growth in agency income.....1%

Executive Summary – Resource Situation

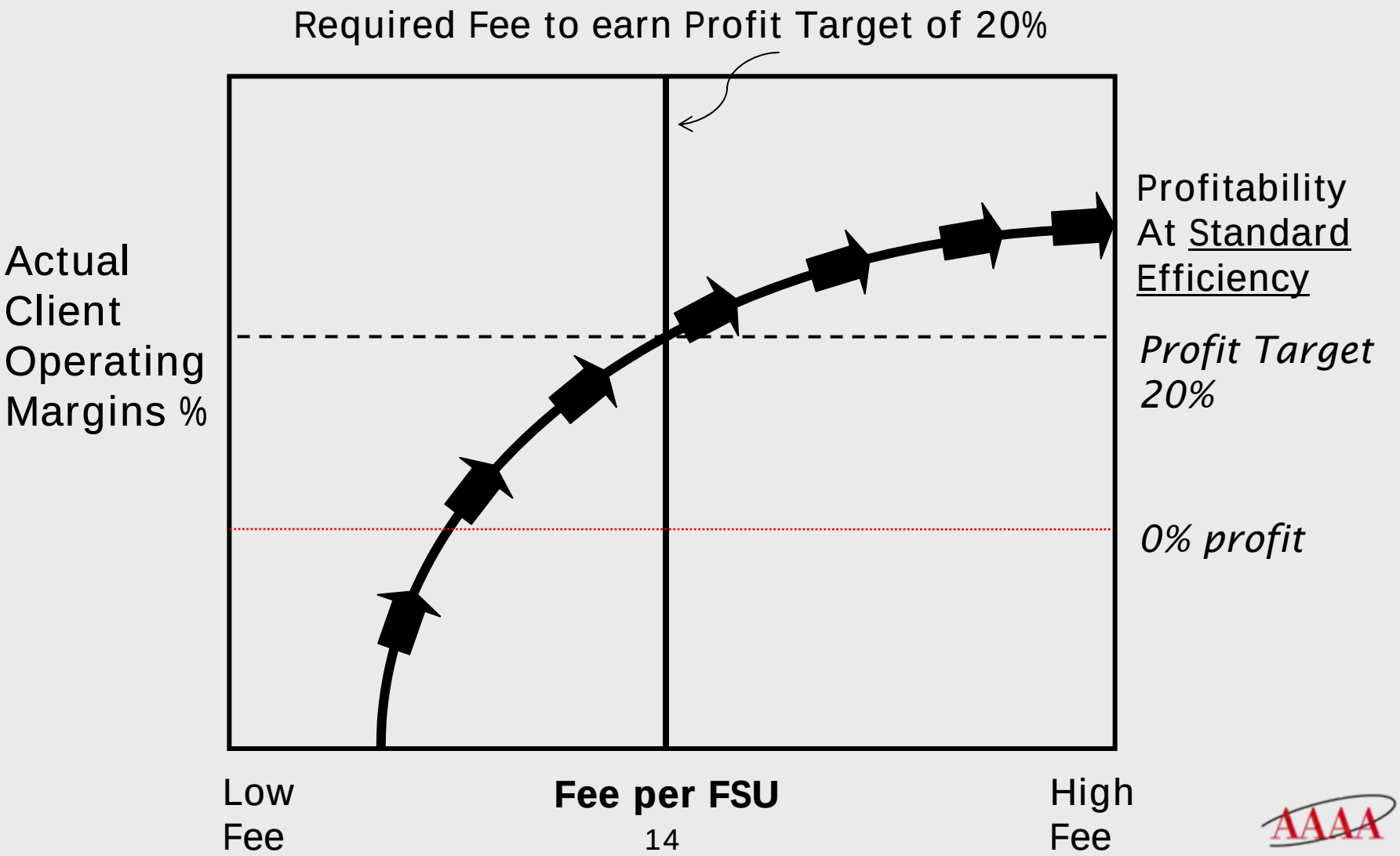


- Fees have declined faster than costs
- Agencies have downsized to meet Holding Company profit goals
- Staff is being squeezed to deliver growing workloads

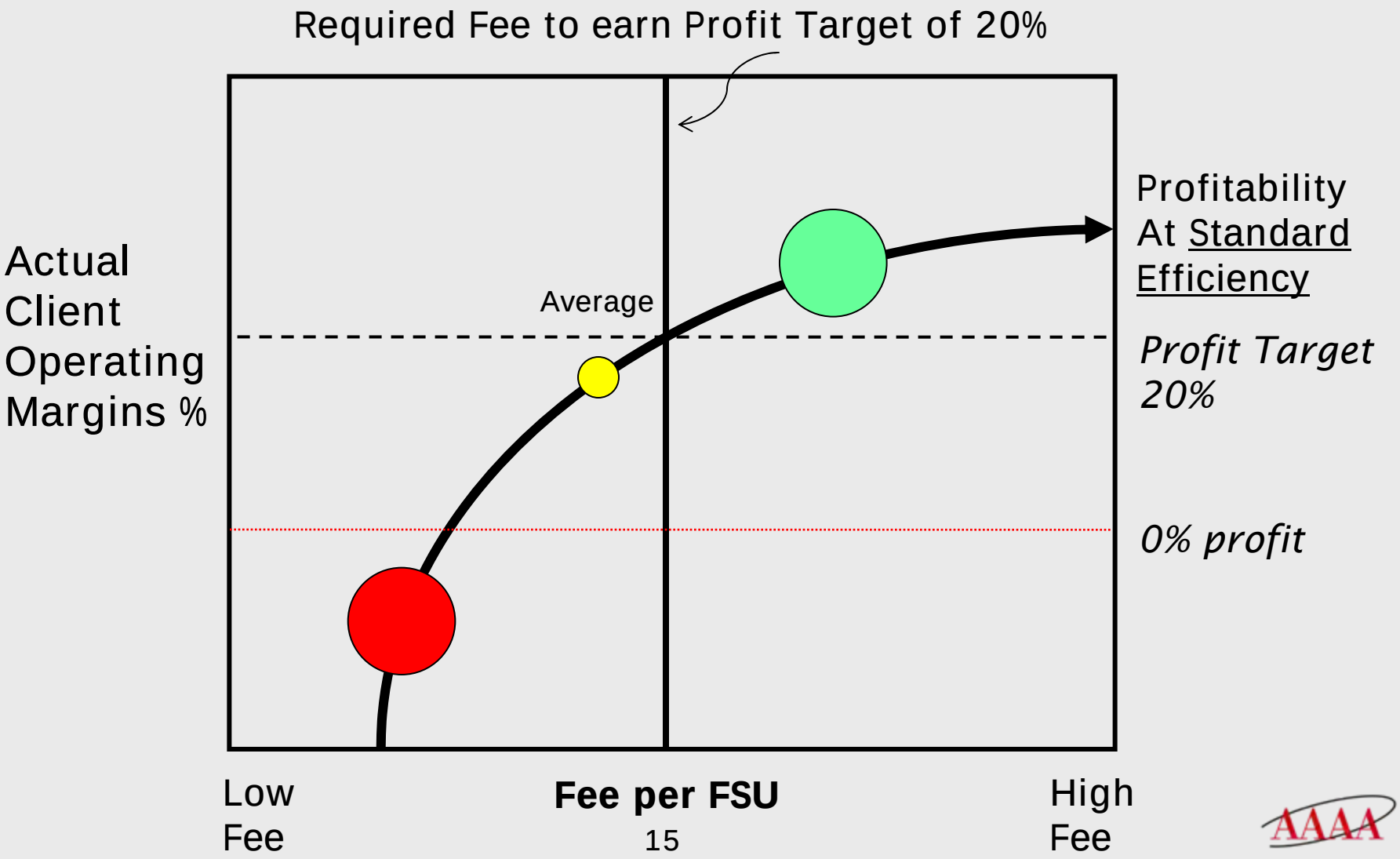
Office Portfolio of Clients



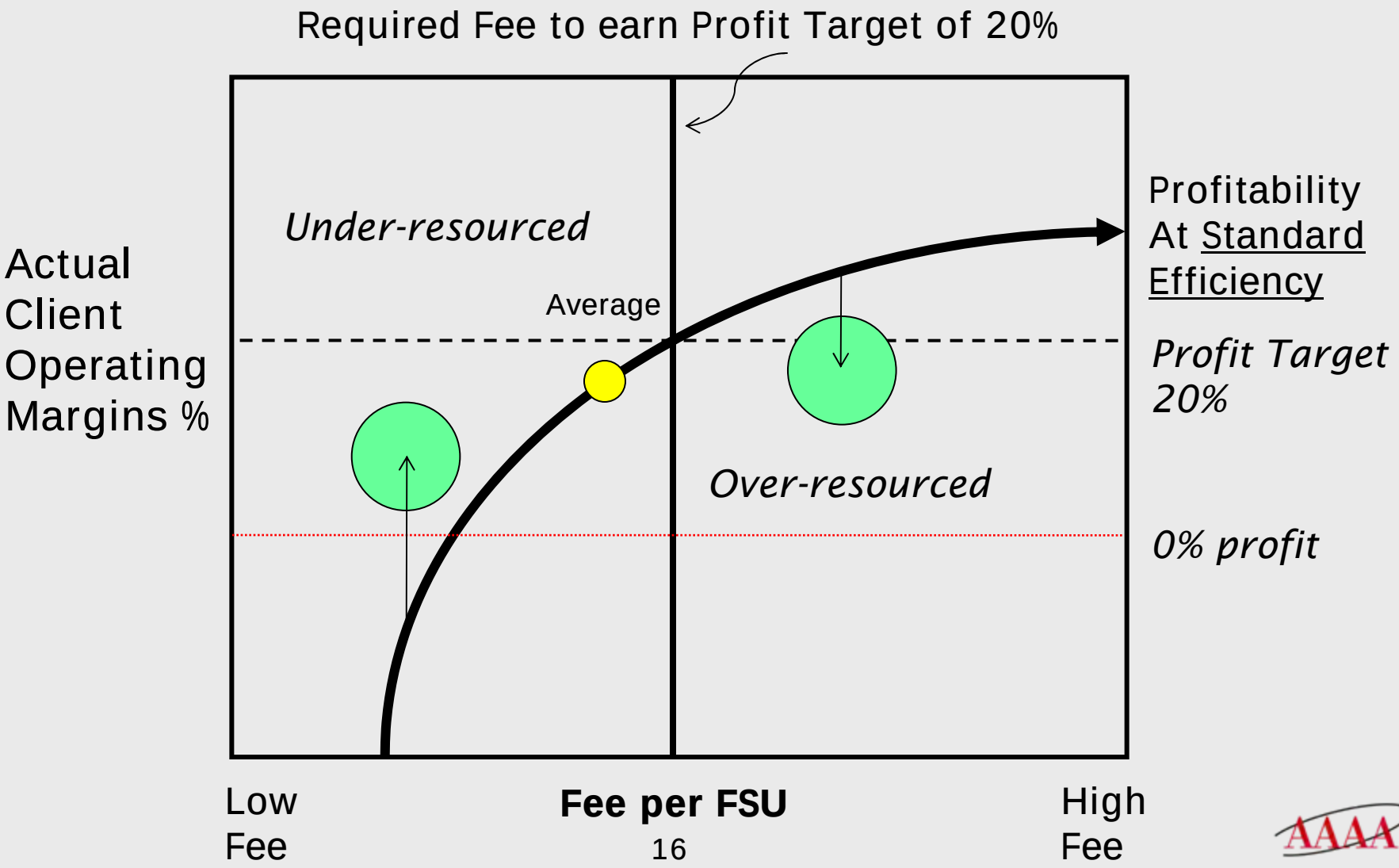
Office Portfolio – potential profit line



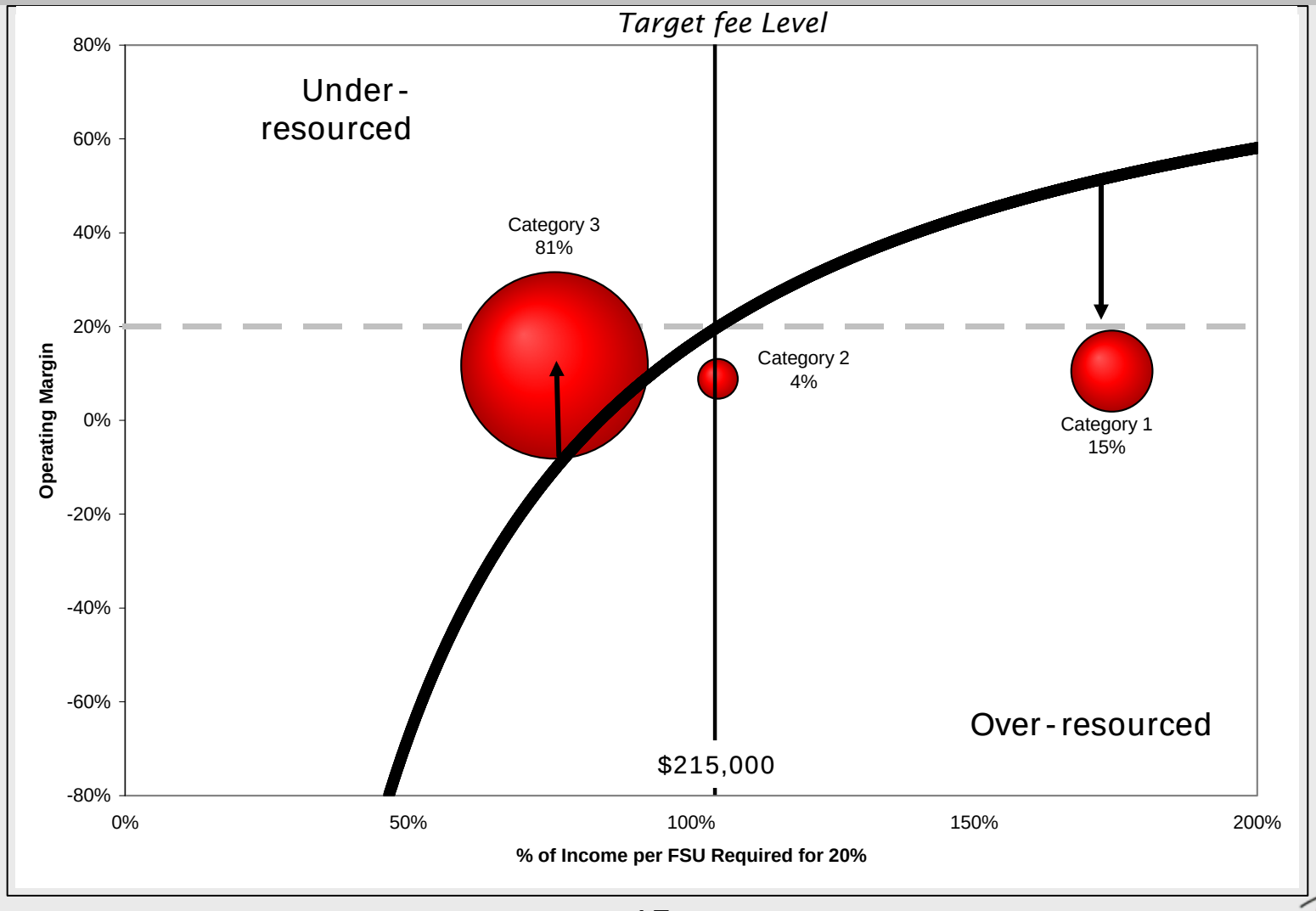
Office Portfolio of 2 Clients -- aligned



Office Portfolio of 2 Clients -- typical



NY Agency – Consolidated Client Portfolio



Summary - - Fees, SOW and Profits

- Fees are agreed (or imposed) without regard for the amount of work to be done
- Actual fees are inadequate for most Scopes of Work
- Scope Creep makes the problem worse
- Agencies are under pressure to deliver Holding Company profit targets
- In response, agencies under-resource most SOW's
- Quality of work is at risk

Scope of Work Recommendations

❶ Every client and agency should have (for each brand)

a) an agreed Scope of Work

b) Agreed Resource Standards

c) an agreed Resource Plan

❷ Fee negotiations should be based on

a) the SOW

b) the Resource Standards (for the calculation of agency resources)

c) the contract

❸ Scope of Work and its resources should be routinely tracked, reviewed and discussed Quarterly

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II – AAAA Compensation Tools and Principles

AAAA Compensation Tools & Principles

- Compensation Dialogue Process
- Pricing Continuum

ANA-AAAA Guide

- ***Compensation Dialogue Process: Rules of Engagement***
  - Step 1 – Goals & objective (scope of benefit)
  - Step 2 – Scope of services, scope of work, level of services
  - Step 3 – Compensation framework
  - Step 4 – Compensation particulars

AAAA Compensation Dialogue Process

All too frequently the remuneration dialog between Marketers and Agencies prematurely begins with negotiating rituals. Marketers often introduce agency compensation discussions by stipulating methodology, tactics, terms and procedures within the context of a commoditized, competitive environment. Agency recommendations often entail trial balloons, guesstimates, contingencies, and boilerplate formulas accompanied by a standard petition for equitable partnership.

In survey after survey marketers and marketing service providers indicate a high degree of skepticism about foundational assumptions, economic parameters and contractual terms that result from even the best intended, good faith negotiations. It is no surprise that many Marketers and Agencies are frustrated with the compensation process.

There must be a better way…and…There is! A logical, bi-partisan process for evolving dialog between Advertiser and Agency that can add credibility to compensation discussions, demystify compensation parameters and restore confidence in working relationships between Marketers and their Agencies. **The AAAA recommend a four-step process that includes:**

1) **Goals & Objectives (Scope of Benefit)**
2) **Scope of Services & Scope of Work**
3) **Compensation Framework**
4) **Compensation Particulars**

Compensation Dialogue Process
Step 1 – Goals & Objectives

- Marketer Business goals
- Marketing Plan Objectives
- Special or Unique Needs
- Program Measurement Procedures
- Definition & Measurement of Success
- Availability of Client Resources
- Critical Path & Time Frame considerations
- The Agency's expected value contribution

Compensation Dialogue Process
Step 2 – Scope of Services and Scope of Work

- Type of Services
- Responsibility for Shared Services
- How will integration & transfers be managed?
- Consumer segments, customers, media types, geographic markets, etc.
- Quantity of Services – Period Deliverables, Initiatives, Campaigns, Events, Executions, Mailings, etc.
- Level of Services
  - Number, experience and proximity of agency staff
  - Stewardship and administrative requirements
  - Re-work parameters
  - Alternative planning & execution considerations

Compensation Dialogue Process
Step 3 – Compensation Framework

- Discussion of each parties compensation goals & objectives
- Advertiser
  - Prioritizing Growth & Flexibility verses efficiency
  - Expectations for continuous innovation & creativity
  - Seniority of staff expectations
  - Cost fluctuation vs. predictable fee
  - Administrative requirements/expectations & scalability
- Agency
  - Long term vs. short term return
  - Revenue potential – expectations
  - Upside potential vs. minimize variability & risk
- Advertiser & Agency
  - Reward/Risk Tolerance

Compensation Basis: Agency contribution or agency cost?

Compensation Dialogue Process
Step 4 – Compensation Particulars

Factors:

- Design of the arrangement
- Magnitude of programs
- Level of investment
- Predictability of underlying assumptions
- Duration of agreement

Specifications:

- Definitions
- Actuals vs. estimates
- Codify rates
- Calibrate performance criteria

Benefits Based Negotiating Existing Client Tool

Goals & Objectives (Scope of Benefit)

Goal of the meeting(s): Develop an understanding of what the client will be trying to accomplish in the future

Purpose of next meeting/phase: Use the Scope of Benefit discussion as the foundation for evolving details of SOS/SOW

Pain based Questions:

1) What are your business goals for the next three-four years? What do we need to do this year to be on track with those l-t goals (Sales, share, profit, growth, diversification, etc)?
2) What goals did we not fully achieve during the past year? What opportunities were not fully exploited?
3) What specific marketing plan objectives do we have over the next 12- 18 months?
4) What resources, beyond marketing, will be available?
5) What critical business initiatives are planned? When?
6) How has/will the competitive environment intensify? What are your major risks?

Benefits Based Negotiating Existing Client Tool

Goals & Objectives (Scope of Benefit)

Budget Based Questions

1) What are the planned expenditures this year? How is the budget established? How does the budget compare with (a) What was spent, and (b) How it was spent, last year?
2) When will budgets be approved and authorizations be issued?
3) Do you have going-in expectations for agency compensation changes (Method or level)?

Decision Based Questions

1) What will be the process for reviewing and establishing next year's business priorities and marketing plans? (Any changes in the process from prior years?
2) Who will be involved with making the final decisions?

Anticipated Objections:

1) *Client Objection*: We can/will discuss goals after…my immediate need is to know your proposed staffing plan and fee components (Labor, overhead and profit)

Agency Response: We will get you our fee information (reverse) but first we need to understand what exactly you are trying to accomplish. Is that okay with you?

2) *Client Objective*: We can not disclose proprietary information such as sales and profit goals. *Agency Response*: We understand your concerns. What do you mean by proprietary information? Doesn't the mutual Non-Disclosure Agreement that we have in place protect and address your concerns about confidentiality?

Benefits Based Negotiating Existing Client Tool

Scope of Service & Scope of Work

Goal of the meeting(s): Arrive at a defined set of elements to be included in SOS/SOW (including level of services) for the coming year

Purpose of next meeting/phase: Finalize SOS/SOW and establish a Compensation framework

Pain based Questions:

1) How should we evolve experimentation with new media and technologies in the year ahead?
2) Did you feel that our level of service was adequate/appropriate over the past year?
3) What are the must do (can't short cut or screw up) programs?
4) What customers, markets and/or consumer targets can be better leveraged?
5) What are the critical timetables?
6) How can we do a better job of coordinating and integrating?

Benefits Based Negotiating Existing Client Tool

Scope of Service & Scope of Work

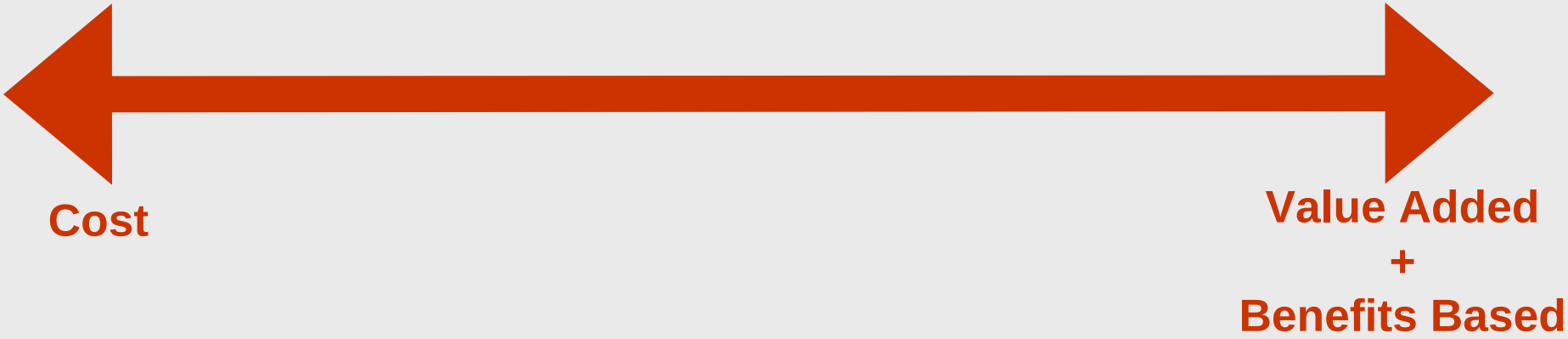
Budget Based Questions:

1) Do you know how much of last year's work was not in the original SOS/SOW plan? (Scope Creep)…How much should we budget for contingencies and experimentation?
2) What is the preliminary budget? What are the key assumptions?
3) How will you fund the increased cost/work associated with_____? New Products? Test Programs? Greater involvement in accountability/stewardships, etc

Decision Based Questions:

1) How will you resolve media mix and marketing program element priorities?
2) How quickly and via what means can we obtain incremental funding for programs that demonstrate business building results? Who will decide?
3) How do we get timely approval on changes so that work is not delayed?

AAAA Pricing Method Continuum



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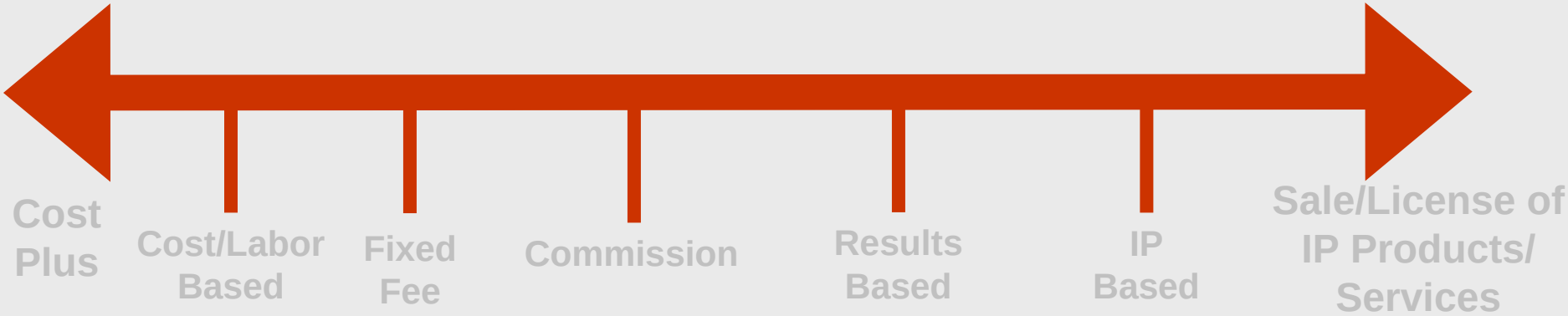


AAAA Pricing Method Continuum

Cost Plus

Cost + Labor Based Variable

Labor* Based Variable

Labor* Based Fixed

Labor Based Fixed with Performance Incentive Overlay

Sale/License of IP Products/ Services

*Labor Rates may be established based upon a range of factors: Market rates, agency price list, budgeted rates, opportunity cost, negotiated rates and/or agency costs & mark-up.

AAAA Hourly Billing Rate Methods Survey (November 2007)

- Multiple Factors Used to Establish Rate

	%	Index
Cost Build-up	69%	43%
Rate Card	42%	26%
Market Pricing	27%	17%
Opportunity pricing	16%	10%
Other	6%	4%
Total	160%	100%

AAAA Pricing Method Continuum

Cost Plus

Cost/Labor Based

Fixed Fee

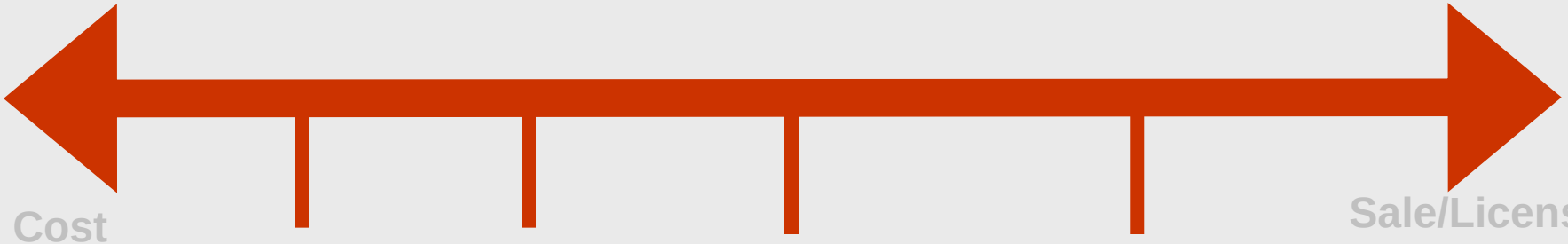
Fixed Fee with Service Guaranteed

Fixed Fee with Change Order

Fixed Fee with Performance Incentive Overlay

Sale/License of IP Products/ Services

AAAA Pricing Method Continuum



Cost Plus

Cost/Labor Based

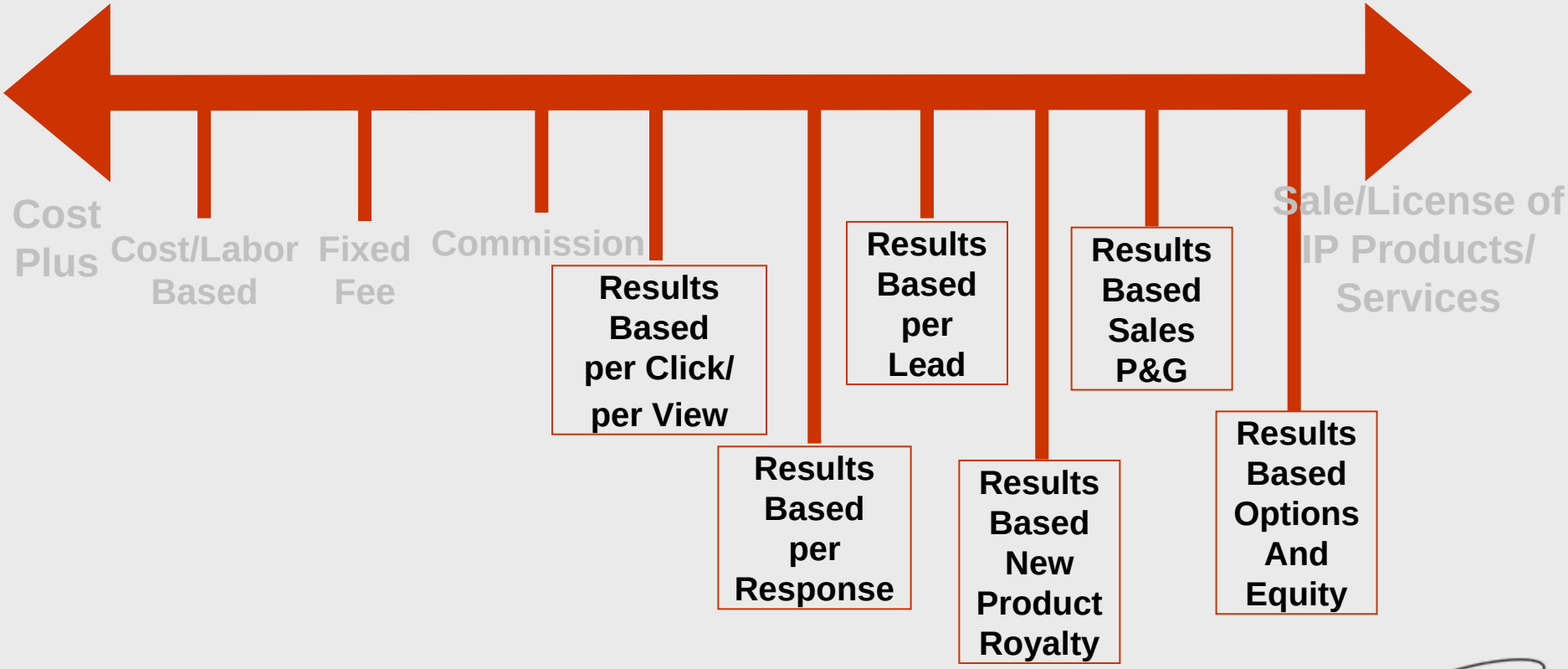
Fixed Fee

Commission Market Spend

Commission Plus Performance Incentive Overlay

Sale/License of IP Products/ Services

AAAA Pricing Method Continuum



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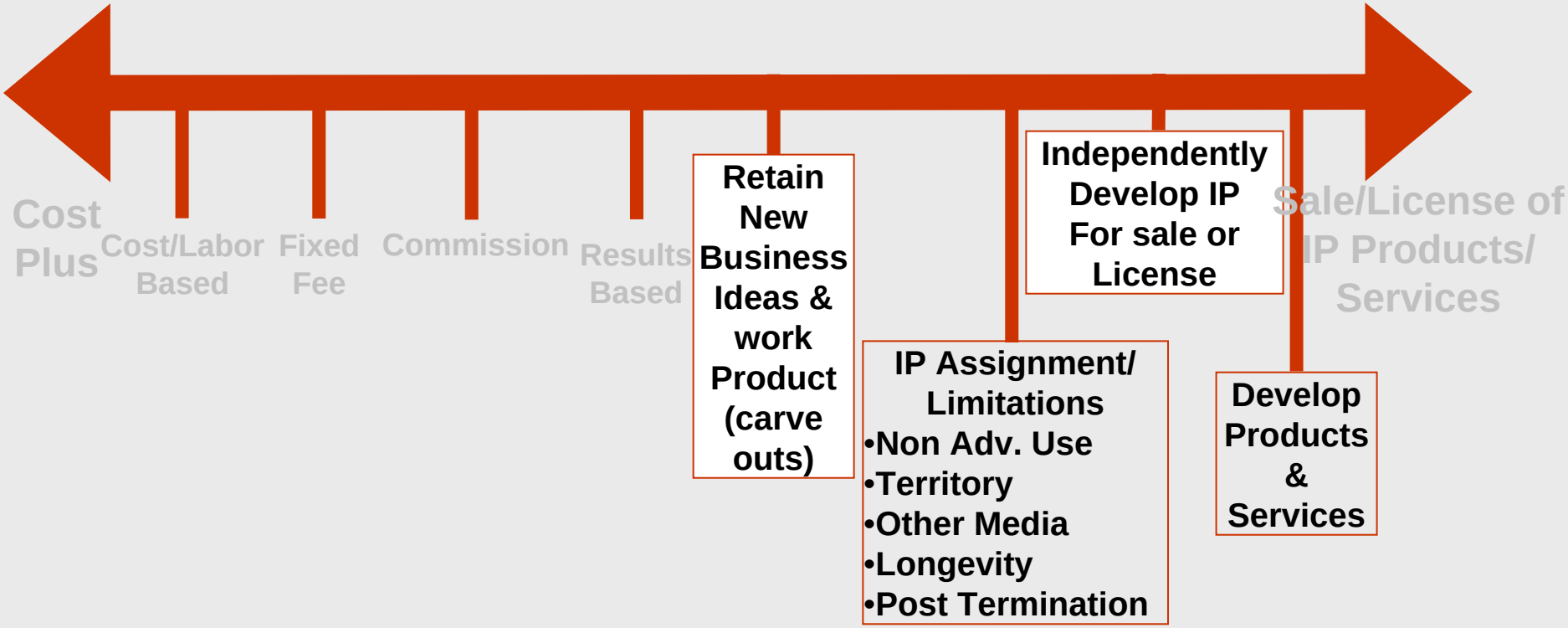

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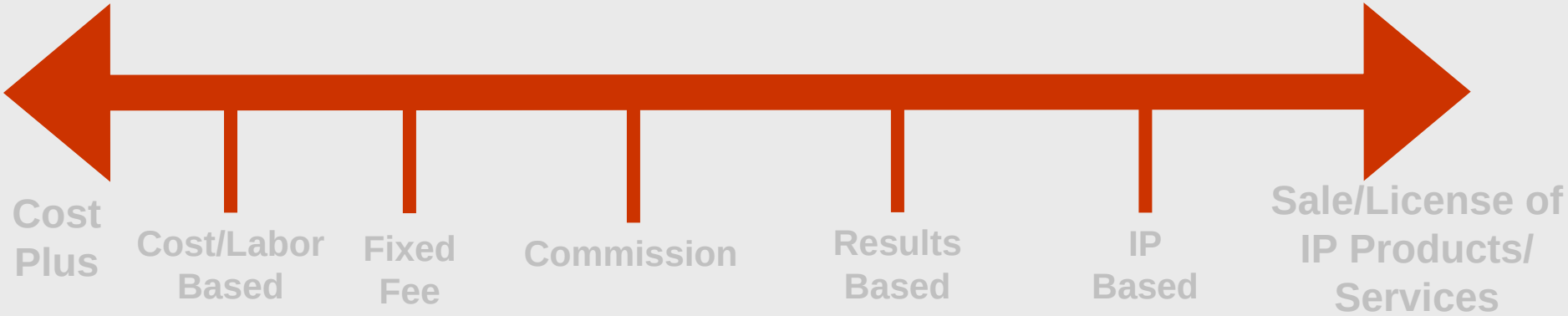

Scope of Work Planning and Activity-Based Pricing

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III – Scope of Work – Projects and Agency Resources

Framework of SOW System

❶ Scope of Work list: each of the agreed briefs and their characteristics (*media, complexity, origination / adaptation, etc.)*

❷ Resource Standards: the resource standards that have been agreed for the staffing of briefs of various types

❸ Resource calculations: the agency resources by headcount and cost, calculated from the Scope of Work list and the Resource Standards

❹ Scope of Work tracking: the system that tracks SOW changes and provides reports to both parties

❶ Scope of Work list

Our recommended “details” for a project in a Scope of Work:

1 *Name, Brand, Media type*

2 *Creative Complexity (Low, Average, High)*

3 *Origination or adaptation*

4 *Full up, creative only, production only*

5 *Strategic purpose / objective of the project*

6 *In Scope; Out of Scope, etc., when Tracking*

SOW Template (1) in Excel

	A	B	C	D	E	F
1		Brand	Project Title	Media Type	Complexity	Project Type
2						

Multimedia
Print - Non-Traditional
Print - Traditional
Radio
TV
Interactive ads - Ad units/banners
Interactive ads - Other
Interactive RM - Direct

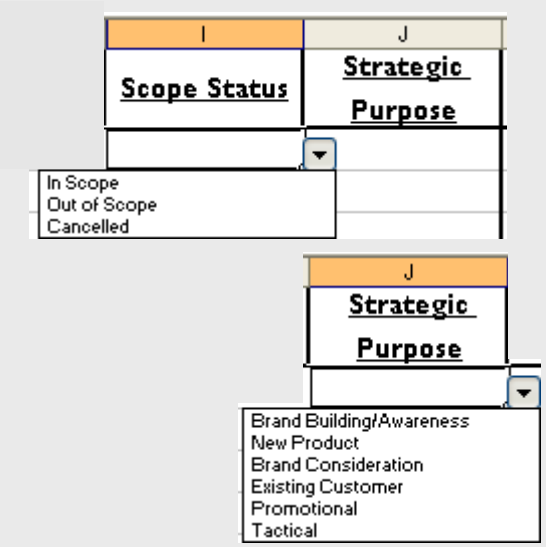
E	F
Complexity	Project Type

Low
Average
High

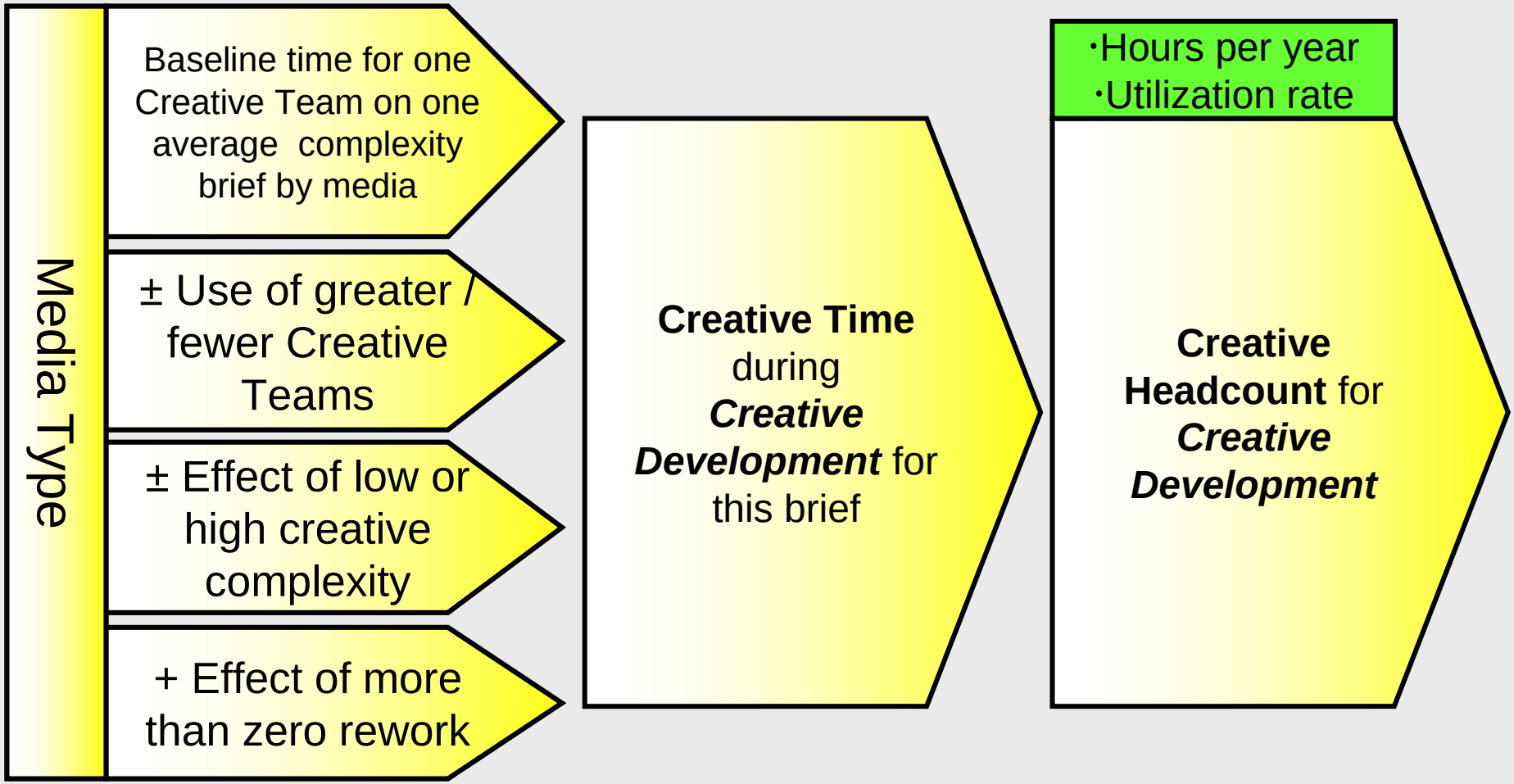
F
Project Type

Origination
Adaptation
Creative Only
Production Only

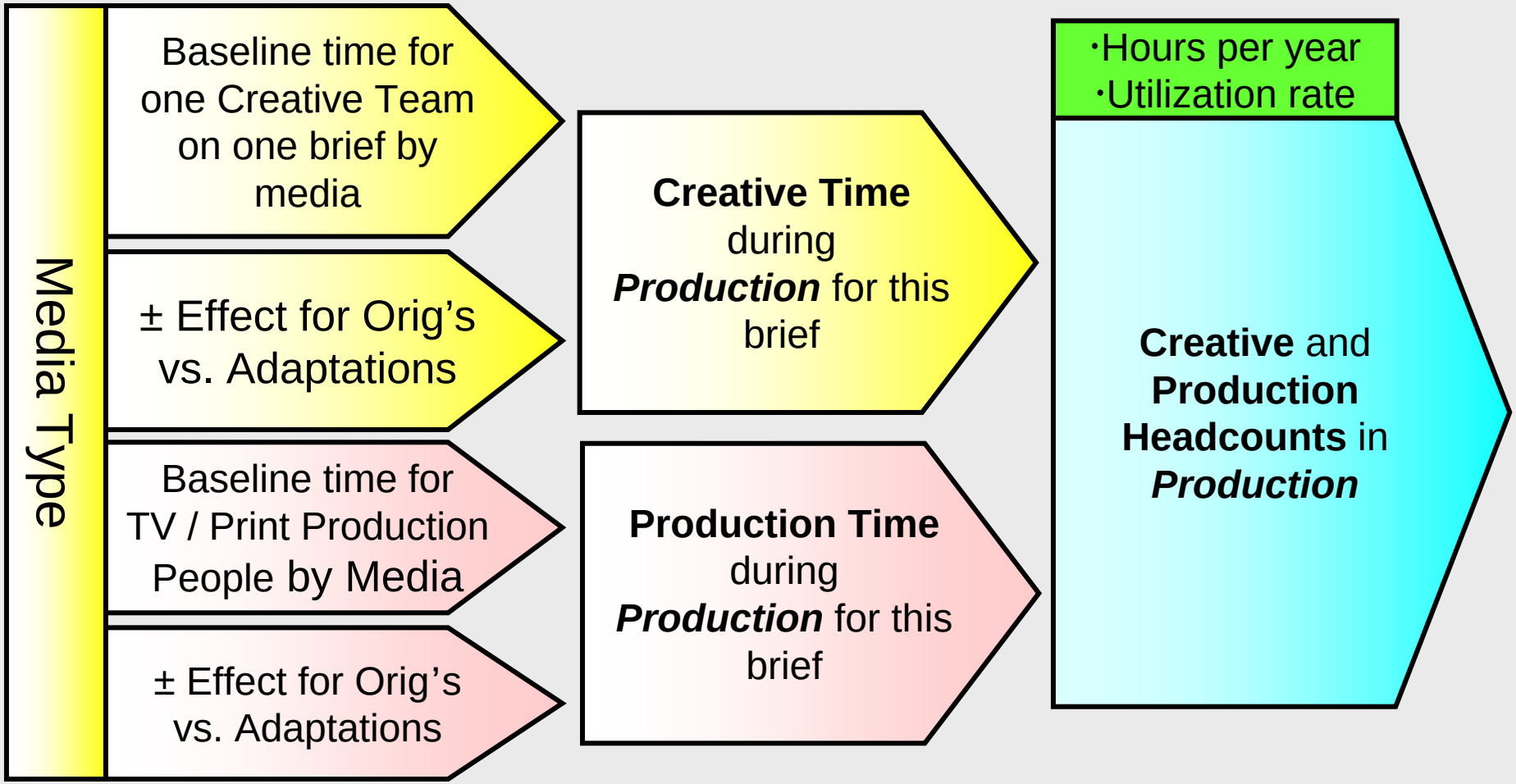
SOW Template (continued)



❷Calculation of Creative Resources
Creative Development Process



❷Metrics: Creative & Production FTE's
Production Process

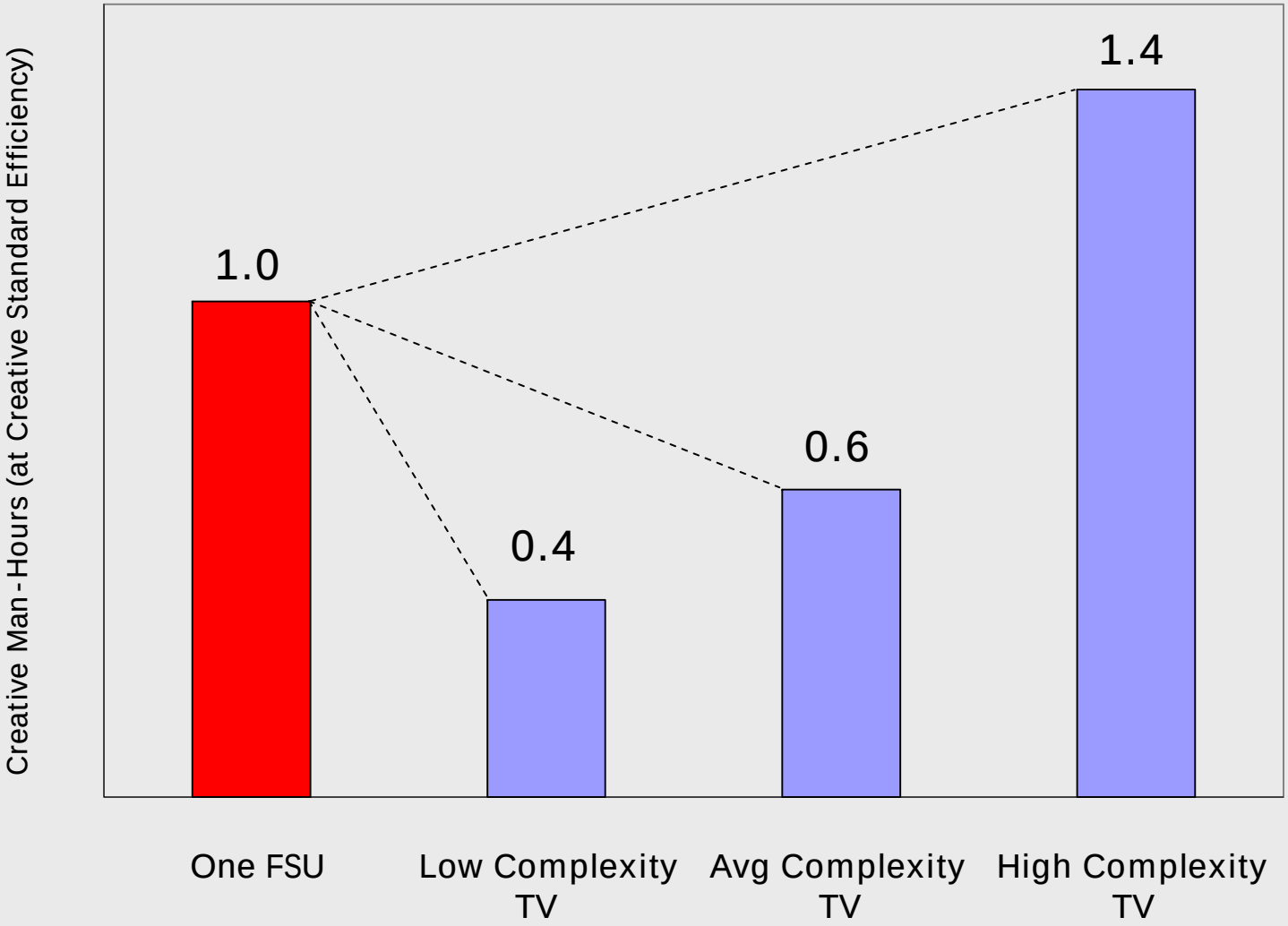


Creative Resource Calculation: TV Origination *Example*

Creative FTE's			
In Creative Development	**TV Origination Briefs**		
TV / Cinema Briefs	**Low**	**Average**	**High**
Baseline Team-days	7	11	16
Hours @ 8 per day	56	90	131
Standard Number of Teams	1	1	2
Hours for Standard Number of Teams	56	90	262
Standard Rework Rate (one team only)	0.5	1	2
Additional Hours for Standard Rework	28	90	262
Total creative hours	84	179	525
Hours per year	1800	1800	1800
Creative Development FTE's	5%	10%	29%
Creatives-during-Production FTE's	5%	5%	6%
Total Creative FTE's at 1800 hours	10%	15%	35%
Number of FSU's	0.4	0.6	1.4

A 'typical' TV brief has a value of 1.0 FSU

FSU's and TV Origination Briefs



Source: Farmer Resource Model

Creative Resource Metrics: TV Adaptations

Creative FTE's			
In Creative Development	**TV Adaptation Briefs**		
TV / Cinema Briefs	**Low**	**Average**	**High**
Baseline Team-days	2	4	5
Hours @ 8 per day	19	28	41
Standard Number of Teams	1	1	1
Hours for Standard Number of Teams	19	28	41
Standard Rework Rate (one team only)	0.5	0.5	0.5
Additional Hours for Standard Rework	9	14	21
Total creative hours	28	42	62
Hours per year	1800	1800	1800
Creative Development FTE's	2%	2%	3%
Creatives-during-Production FTE's	1%	2%	2%
Total Creative FTE's at 1800 hours	3%	4%	5%
Number of FSU's	0.1	0.2	0.2

Resource and Fee Analysis (example)

Creative Teams per brief = 1.0	TV Average Complexity Origination Brief		
Rework Rate = 1.0	Cost per Brief	FSU's	Cost per FSU
Client Service + Planning Cost	$ 23,543		$ 38,168
Creative Cost	$ 23,543	**0.62**	$ 38,168
Production & Traffic Cost	$ 11,219		$ 18,188
Total Labor Cost	$ 58,305		$ 94,525

Multiples at different Income levels:

Fees / FSU	
$215,000	2.27
$200,000	2.12
$175,000	1.85
$150,000	1.59
$125,000	1.32
$100,000	1.06

❸Scope of Work Tracking

- Standardize and formalize changes in agreed SOW's
- Keep it simple and on-line!
- Common-sense tracking
  - Projects added, dropped, changed
  - Number of rounds of changes
  - Who was responsible for the changes
  - At what point was a project changed
  - What is the calculated effect on agency resources (using SOW metrics as before)
- Quarterly reports with standardized / customized outputs

SOW Entry - Windows Internet Explorer

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SOW Entry Page Tools

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mmiller@farmerandco.com Logout

LIVE CHAT OFFLINE

Export to Excel

Add New Brief

Drag a column header here to group by that column

	#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type	S
⊞	Edit	Online Banner Campaign	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	3	6	Jack	average	Creative Only	Ir
⊞	Edit	Fall TV Launch	Client1	Brand1	TV	TV Spot	2	1	Jack	high	Creative Only	Ir
⊞	Edit	Fall Fashion Spread	Client1	Brand1	Print - Traditional	Print Ad	1	3	Jack	average	Origination	Ir
⊞	Edit	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert	0	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
⊞	Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

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⊞	Edit	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert	0	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
⊞	Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

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Add New Brief

Drag a column header here to group by that column

#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type
									average	Creative Only
									high	Creative Only
									average	Origination
									low	Adaptation
									low	Adaptation
									high	Origination
									low	Creative Only

Edit Form

Project Title			
Client		Brand	
MediaType		MT Detail	
Rounds		Versions	
Client Contact		Complexity	
Project Type		Scope Status	
Strategic Purpose		Creative Dev Q	
Production Q		Reason for Change	

Update Cancel

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Add New Brief

Drag a column header here to group by that column

	#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type	S
⊞	Edit	Online Banner Campaign	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	3	6	Jack	average	Creative Only	Ir
⊞	Edit	Fall TV Launch	Client1	Brand1	TV	TV Spot	2	1	Jack	high	Creative Only	Ir
⊞	Edit	Fall Fashion Spread	Client1	Brand1	Print - Traditional	Print Ad	1	3	Jack	average	Origination	Ir
⊞	Edit	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert	0	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2	Jack	low	Adaptation	Ir
	Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
⊞	Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

Edit

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#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type
									average	Creative Only
									high	Creative Only
									average	Origination
									low	Adaptation
									low	Adaptation
									high	Origination
									low	Creative Only

Edit Form

Project Title	Fall Ad Units		
Client	Client1	Brand	Brand1
MediaType	Online - Ad units/banners	MT Detail	Ad Units/Banners
Rounds	4	Versions	5
Client Contact	[redacted]	Complexity	high
Project Type	Origination	Scope Status	In Scope
Strategic Purpose	Brand Building/Awareness	Creative Dev Q	2008 Q2
Production Q	2008 Q2	Reason for Change	Missed Creative deadline; project moving into Q2

Update Cancel

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	#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type	S
⊞	Edit	Online Banner Campaign	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	3	6	Jack	average	Creative Only	Ir
⊞	Edit	Fall TV Launch	Client1	Brand1	TV	TV Spot	2	1	Jack	high	Creative Only	Ir
⊞	Edit	Fall Fashion Spread	Client1	Brand1	Print - Traditional	Print Ad	1	3	Jack	average	Origination	Ir
⊞	Edit	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert	0	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
⊞	Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

Audit

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Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

Notes | Audit

Audit

#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type
	Brand Microsite	Client1	Brand1	Online - Web	Microsite	3	0	Jill	low	Creative Only
	Brand Microsite	Client1	Brand1	Online - Web	Microsite	2	0	Jill	low	Creative Only
	Online Creative Requirements 2009 #7	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	0	0	Jack	low	Creative Only

Edit	Online Creative Requirements 2009 #8	Client1	Brand1	Print - Traditional	Newspaper	0	0	Jack	low	Creative Only	C

Page 1 of 52 (412 items) < Prev [1] 2 3 4 5 6 7 ... 50 51 52 Next >

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SOW Entry - Windows Internet Explorer

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Edit	Fall TV Launch	Client1	Brand1	TV	TV Spot	2	1	Jack	high	Creative Only	Ir
Edit	Fall Fashion Spread	Client1	Brand1	Print - Traditional	Print Ad	1	3	Jack	average	Origination	Ir
Edit	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert	0	2	Jack	low	Adaptation	Ir
Edit	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2	Jack	low	Adaptation	Ir
Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

Notes

Notes | Audit

Add Notes	Note	Date	User Name
New	turnover in Interactive department. Had to find a new creative lead in agency	10/6/2008	mmiller@farmerandco.

Edit	Online Creative Requirements 2009 #8	Client1	Brand1	Print - Traditional	Newspaper	0	0	Jack	low	Creative Only	C

Page 1 of 52 (412 items) < Prev [1] 2 3 4 5 6 7 ... 50 51 52 Next >

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Drag a column header here to group by that column

Sort 1

	#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type	S
⊞	Edit	Online Banner Campaign	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	3	6	Jack	average	Creative Only	Ir
⊞	Edit	Fall TV Launch	Client1	Brand1	TV	TV Spot	2	1	Jack	high	Creative Only	Ir
⊞	Edit	Fall Fashion Spread	Client1	Brand1	Print - Traditional	Print Ad	1	3	Jack	average	Origination	Ir
⊞	Edit	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert	0	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
⊞	Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

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Sort 2

	#	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type	S
⊞	Edit	Online Banner Campaign	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	3	6	Jack	average	Creative Only	Ir
⊞	Edit	Fall TV Launch	Client1	Brand1	TV	TV Spot	2	1	Jack	high	Creative Only	Ir
⊞	Edit	Fall Fashion Spread	Client1	Brand1	Print - Traditional	Print Ad	1	3	Jack	average	Origination	Ir
⊞	Edit	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert	0	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2	Jack	low	Adaptation	Ir
⊞	Edit	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5	Jill	high	Origination	Ir
⊞	Edit	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4	Jill	low	Creative Only	Ir

Microsoft Excel - gvSOW[1]

A1 Project Title

	A	B	C	D	E	F	G	H	I	J	K
1	Project Title	Client	Brand	MediaType	MT Detail	Rounds	Versions	Client Contact	Complexity	Project Type	Scope Status
2	Online Banner Campaign	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	3	6		average	Creative Only	In Scope
3	Fall TV Launch	Client1	Brand1	TV	TV Spot	2	1		high	Creative Only	In Scope
4	Fall Fashion Spread	Client1	Brand1	Print - Traditional	Print Ad	1	3		average	Origination	In Scope
5	Fall Fashion Insert	Client1	Brand1	Print - Non-Traditional	Insert		2		low	Adaptation	In Scope
6	Fall TV :05 Tag	Client1	Brand1	TV	Tag	1	2		low	Adaptation	In Scope
7	Fall Ad Units	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners	4	5		high	Origination	In Scope
8	Brand Microsite	Client1	Brand1	Online - Web	Microsite	4	4		low	Creative Only	In Scope
9	Online Creative Requirements 2009 #8	Client1	Brand1	Print - Traditional	Newspaper				low	Creative Only	Cancelled
10	Online Creative development & production #1	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners				average	Origination	In Scope
11	Online Creative development & production #2	Client1	Brand1	Online - Ad units/banners	Ad Units/Banners				average	Origination	In Scope
12	Outdoor #1	Client1	Brand1	OOH	Billboard	0	0		low	Origination	Cancelled
13	Outdoor #2	Client1	Brand1	OOH	Billboard	0	0		low	Origination	Cancelled
14	Develop & Produce Marketing to women 2 Page insert	Client1	Brand1	Print - Non-Traditional	Insert	0	0		high	Origination	Cancelled
15	Blimp pops #1- Olympics Hurdles	Client1	Brand1	TV	Animated Billboard	8	1		average	Origination	In Scope
16	Blimp pops #2- Cloud	Client1	Brand1	TV	Animated Billboard	10	2		average	Origination	In Scope
17	Blimp pops #3- Olympics High Jump	Client1	Brand1	TV	Animated Billboard	8	1		average	Origination	In Scope
18	Blimp ticker copy #1	Client1	Brand1	OOH	Sign	0	0		low	Creative Only	Cancelled
19	Blimp ticker copy #2	Client1	Brand1	OOH	Sign	0	0		low	Creative Only	Cancelled
20	Blimp ticker copy #3	Client1	Brand1	OOH	Sign	0	0		low	Creative Only	Cancelled
	Develop & produce new CT creative without NASCAR	Client1	Brand1	Print - Traditional	Print Ad	11	2		average	Origination	In Scope

Sheet1

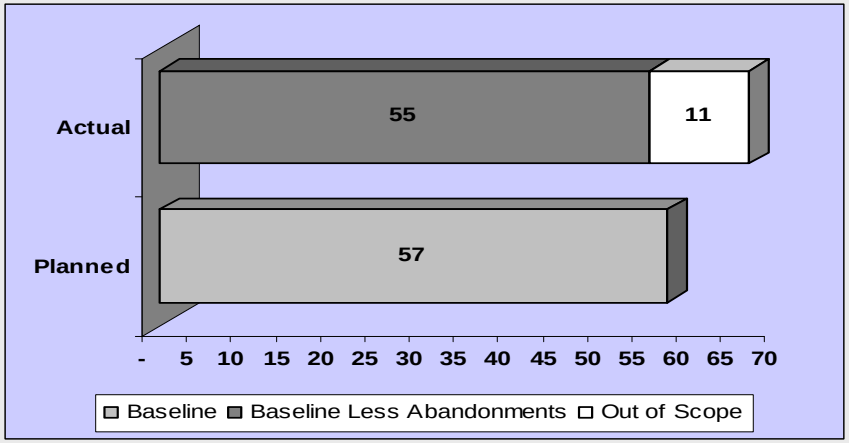
Ready

start | ScopeTrack Demonstr... | SOW Entry - Window... | Microsoft Excel - gvS... | 20:55

Send to Customized Report Templates

Fixed Fee, Added Projects

Total Scope of Work : Project Count

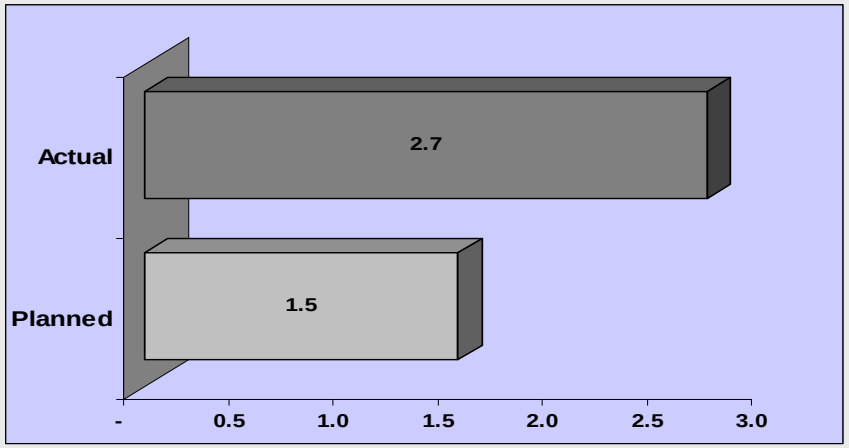


	Plan	Actual	% Difference
Projects	57	66	16%
FSU's	15.1	18.0	19%
Income	3,080.000	3,080.000	0%
PS Costs	1,283.000	1,423.000	11%

- Fixed Fee contract
- Incremental projects led to increased resource requirements
- Professional costs increased at lower rate than FSU's, indicating understaffing or use of junior staff
- Fixed Revenue = diminished margins from Scope Creep
- Use data to support request for incremental income

Project-Based Account, High Rework

Average Rounds per Project

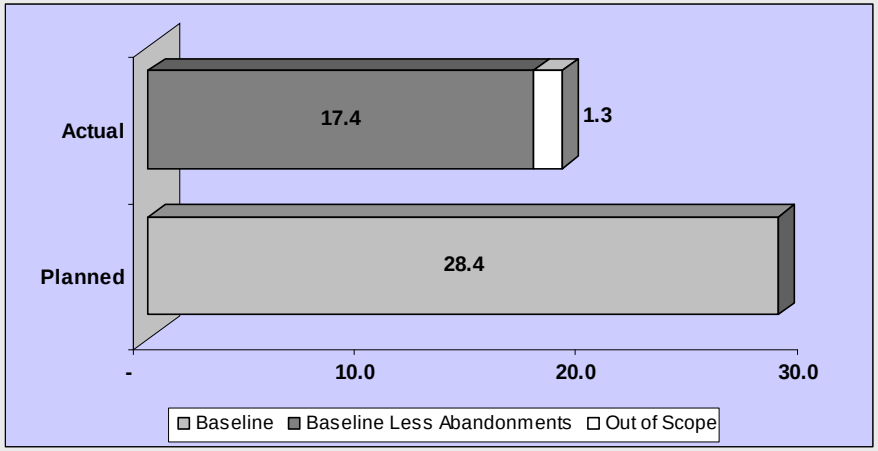


	Plan	Actual	% Difference
Project Count	15	15	0%
Average Rounds	1.5	2.7	80%
Creative Headcount	2.4	3.3	38%
Income	800.000	800.000	0%

- Agency compensated according to project rate card
- Inefficient processes led to excessive rounds per project, increased creative headcount
- Contract reconciled for projects only, so income remained flat
- Use data to re-negotiate project price list in FY09

Arbitrary fee, decreased Scope of Work

Total Scope of Work : FSU's

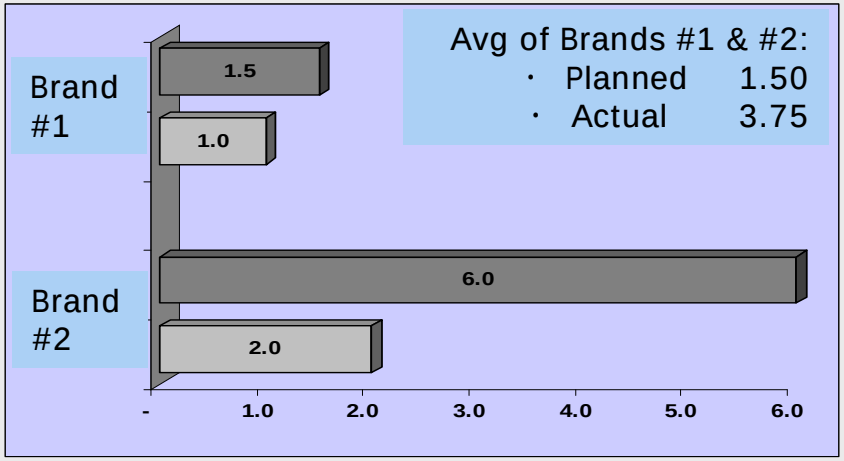


	Plan	Actual	% Difference
FSU's	28.4	18.7	34%
Project Count	87	40	54%
Income	6,248.000	3,124.000	50%
Income/FSU	220.000	167.000	24%

- Arbitrary fee imposed by client, agreed by agency
- Media budget cuts led to cancelling of low complexity projects / adaptations; high complexity projects remained
- Fees were to be cut based on project count reduction
- Resources, though, could not be cut proportionately
- Use data to support lesser fee change based on FSU's, not on project counts

“Reconcilable” Fee, Increased Versions

Average versions per project by Client



	Plan	Actual	% Difference
Project Count	12	12	0%
Versions/ Project	1.5	3.75	150%
PS Headcount	2.8	3.6	28%
Income	1,100.000	1,335.000*	21%

*After Negotiation

- Pending client approval, fee are reconcilable to increased costs
- Higher-than-planned versions drove increased Professional Services Headcount
- Because no projects were added, client initially rejected agency requests for incremental fee
- Used data to prove hour overages were result of SOW changes, not agency inefficiencies

Tracking Basics

- Tracking data should be uniform for all clients
- Updating process should take only 15-20 online minutes per week
- Tracking reports should be customizable to meet agency / client needs
- Quarterly SOW reviews should be conducted

Scope of Work Planning and Activity-Based Pricing

Featuring Michael Farmer, Farmer & Company

***

IV –SOW's: in multiple geographical markets and across multiple disciplines

- Multi-Dimensional SOW's ("*MD-SOW*")

Why are MD-SOW's complicated?

- Gathering MD-SOW's is not complicated
  - Empower the regional / global client head
  - Gather SOW information on a uniform basis
  - Determine office-by-office workloads
  - Determine office-by-office required / agreed resources
  - Examine current fees / commissions relative to resource cost
- *What you do with them* is complicated
  - Use them to rebalance income across offices / disciplines
  - Provide a uniform margin across the office network
- MD-SOW's tend to *disrupt the office status quo*

Regional client profitability - *example*

- Client: **Packagedfood Ikb.** in the country of Origistan
- Total Media spend: **‡260m** (currency is “Ishkabibbles”)
- Country commissions: **10% (‡26m)**
- Country costs across all offices:
  - Prof. headcounts: **‡ 11.5m**
  - Overheads: **‡ 11.5m**
- Operating profit: **11.5% (‡3m)**
- Workload : **120 FSU’s**
- Income per FSU: **‡216,667**

Two country, two office network

- Country: **Origistan**
- Client: **Packagedfood**
- Local Media spend: **‡200m**
- Local commission: **10% (‡20m)**
- Local costs:
  - Prof. headcounts: **‡ 9.5m**
  - Overhead **‡ 9.5m**
- Operating profit: **5% (‡1m)**
- Workload: **100 FSU's**

- Country: **Adaptistan**
- Client: **Same**
- Local Media spend: **‡60m**
- Local commission: **10% (‡6m)**
- Local costs:
  - Prof. headcounts: **‡2.0m**
  - Overhead: **‡2.0m**
- Operating profit: **33% (‡2m)**
- Workload: **20 FSU's**
- Income per FSU: **‡300,000**

Should the Global Client Head rebalance income and op. profits?

Knock-on effects from income redistribution

- Packagedfood Ikb. is the “cash cow” of the Adaptistan office
- Its exceptional profits support other local clients (who have modest budgets but require a lot of work)
  - A local bank
  - A local retailer
  - A local mobile telephone operator
  - A local dairy
- Redistributing Packagedfood income will make the Adaptistan office unprofitable and make it unprofitable for the Adaptistan office to serve local clients
- Redistributing income, though, would be logical
- Serge Pisedovf, the President of the Adaptistan office, has vowed to torpedo the income redistribution scheme

* * *

MD-SOW's:

- Strategically, the agency needs to manage SOW's across the network
- Traditionally, profits from regional clients are not uniform across the network
  - Origination offices are usually less profitable
  - Adaptation offices are usually highly profitable
- Rebalancing network profitability is viewed as the "right thing" to do on behalf of every office
- Knock-on effects for adaptation offices are considerable

Scope of Work Planning and Activity-Based Pricing

Featuring Michael Farmer, Farmer & Company

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V – Evolving Activity-Based Compensation Strategy and Tactics

Evolving process – I

1. Document the existing Scopes of Work on a uniform basis
2. Determine resource standards for various types of projects
3. Identify the “outlier” clients who have either overallocated or underallocated resources
4. Train and empower Client Heads to be accountable for resources on their clients
   a. Provide metrics and documentation
   b. Rebalance resources in a fair manner
   c. Monitor and review
5. Monitor and track changes in SOW and resources
6. Adapt this approach as the “modus operandi” of the agency
7. Communicate the agency’s approach to clients

Evolving process – 2

1. Plan next-year's SOW with clients
   a. Assure strategic alignment with client performance needs
   b. Outline communications projects on the agreed uniform basis
2. Agree on resource standards for various types of projects
3. Calculate resource requirements to carry out SOW
4. Determine fee on an appropriate basis
5. Agree on the handling of Scope Creep / changes in fee
6. Monitor and track
7. Review on a quarterly basis

Scope of Work Planning and Activity-Based Pricing

Featuring Michael Farmer,
Farmer & Company

***

VI – Q&A

Scope of Work Planning and Activity-Based Pricing

Featuring Michael Farmer, Farmer & Company

***

VII – Thoughts on Value Pricing

AAAA: Dedicated to eradicating… the Almighty Billable Hour

"The deleterious effects of hourly billing are virtually endless."

Ron Baker, *The Firm of the Future*

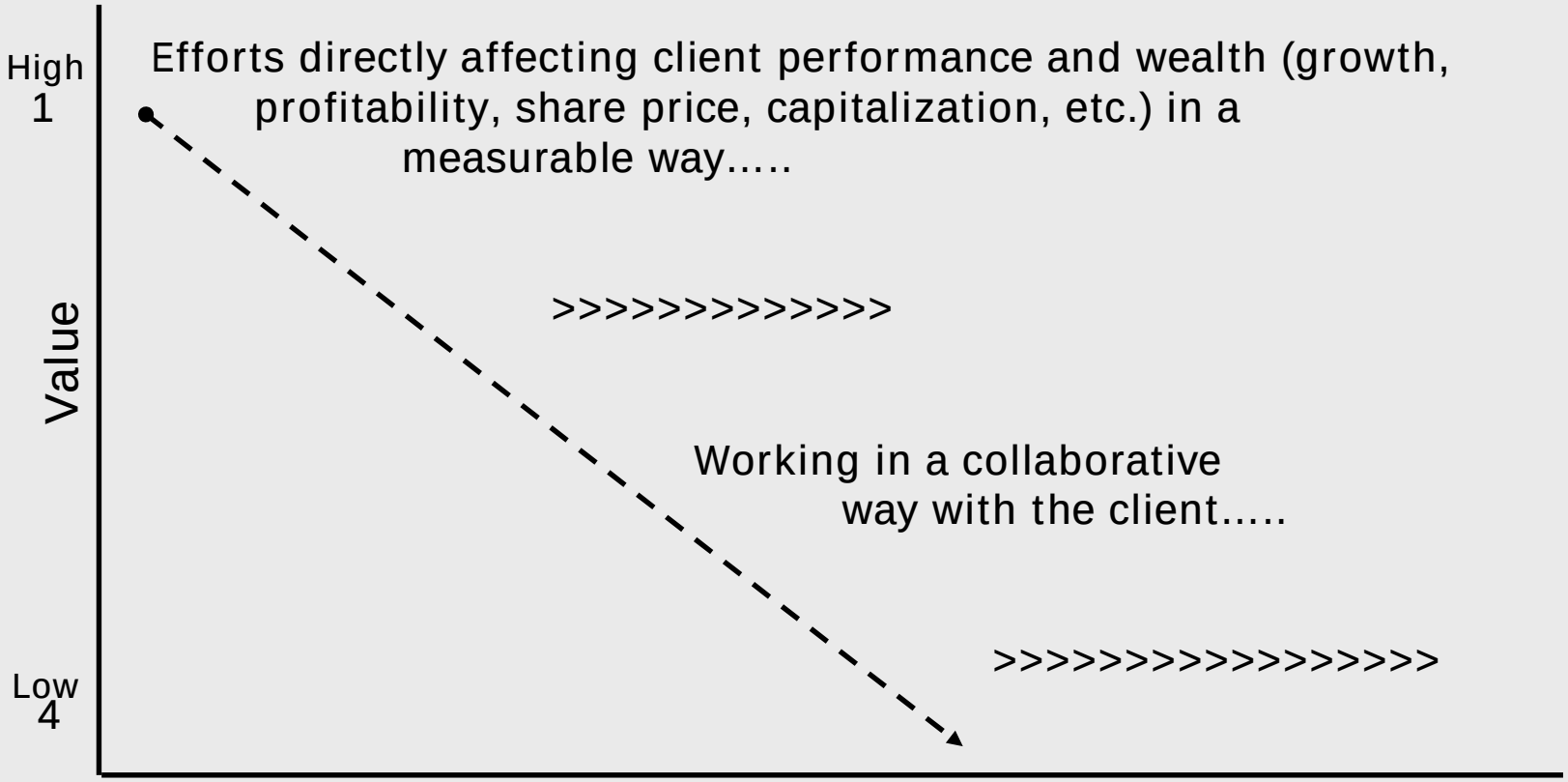
However, Labor-Based Fees are Common – even if they are not all Equal

	Multipliers Charged or Earned for fee purposes
Cravath Swaine Moore *Law firm* *High salaries; charges all its hours*	4x – 6x
Bain & Company *Strategy consulting* *High salaries; long-term relationships*	4x – 6x
Advertising agencies *Advertising* *Modest salaries; hours frequently capped or not remunerated*	2x – 3x

Value – A Pragmatic Point of View

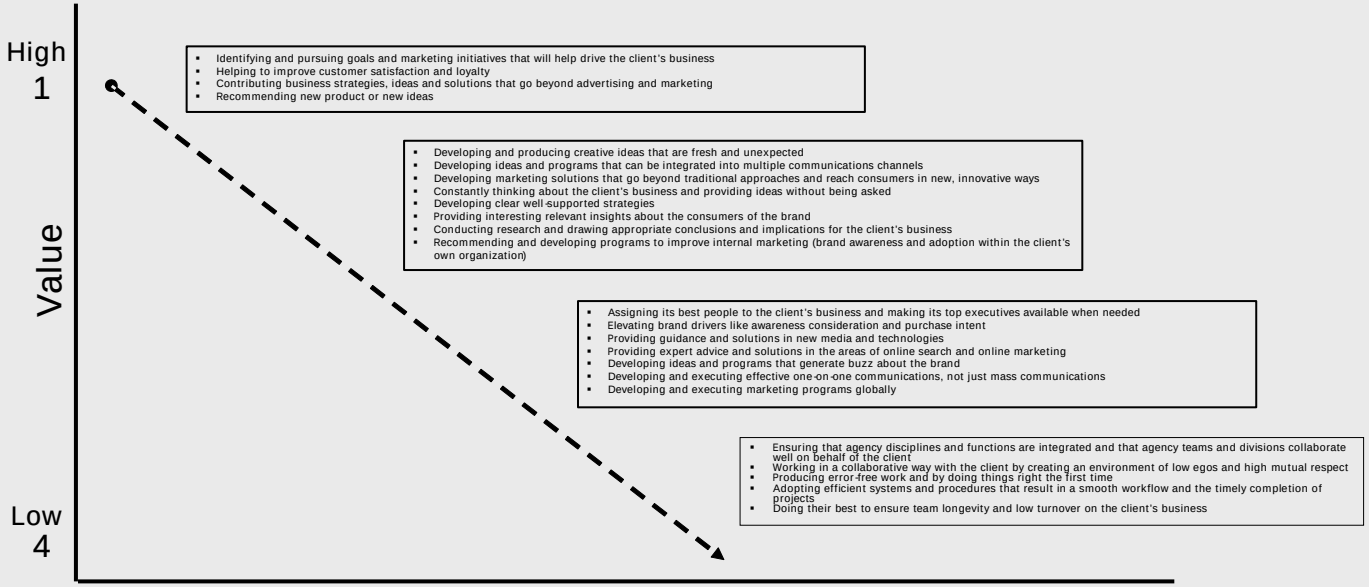
- “Value” is reflected by the magnitude of the multiplier
- Presumably, high multipliers = higher value…
- …and low multipliers = lower value
- The problem with advertising agency remuneration is the low multiplier (2x – 3x)
- The low multiplier is driven even lower when clients disallow cost items (in overhead) or cap agency hours
- Why is the agency multiplier low?

Value Hierarchy



AAAA / ANA Value Survey 2007

- Outlined a useful list of "value criteria" for agencies
  - Ranked for "relevance" by advertisers and agencies
  - Used as a "scorecard" for agencies and advertisers
- Criteria can be rank-ordered along *Value Hierarchy*



#1 - - Highest Value Criteria*

- Identifying and pursuing goals and marketing initiatives that will help drive the client's business
- Helping to improve customer satisfaction and loyalty
- Contributing business strategies, ideas and solutions that go beyond advertising and marketing
- Recommending new product or new ideas

** Farmer & Company qualitative ranking of Value Criteria from AAAA / ANA Value Survey 2007*

#2 - - Second Highest Value Criteria

- Developing and producing creative ideas that are fresh and unexpected
- Developing ideas and programs that can be integrated into multiple communications channels
- Developing marketing solutions that go beyond traditional approaches and reach consumers in new, innovative ways
- Constantly thinking about the client's business and providing ideas without being asked
- Developing clear well-supported strategies
- Providing interesting relevant insights about the consumers of the brand
- Conducting research and drawing appropriate conclusions and implications for the client's business
- Recommending and developing programs to improve internal marketing (brand awareness and adoption within the client's own organization)

#3 - - Third Highest Value Criteria

- Assigning its best people to the client's business and making its top executives available when needed
- Elevating brand drivers like awareness consideration and purchase intent
- Providing guidance and solutions in new media and technologies
- Providing expert advice and solutions in the areas of online search and online marketing
- Developing ideas and programs that generate buzz about the brand
- Developing and executing effective one-on-one communications, not just mass communications
- Developing and executing marketing programs globally

#4 - - Fourth Highest Value Criteria

- Ensuring that agency disciplines and functions are integrated and that agency teams and divisions collaborate well on behalf of the client
- Working in a collaborative way with the client by creating an environment of low egos and high mutual respect
- Producing error-free work and by doing things right the first time
- Adopting efficient systems and procedures that result in a smooth workflow and the timely completion of projects
- Doing their best to ensure team longevity and low turnover on the client's business

Four Levels of Value

1

- Identifying and pursuing goals and marketing initiatives that will help drive the client's business
- Helping to improve customer satisfaction and loyalty
- Contributing business strategies, ideas and solutions that go beyond advertising and marketing
- Recommending new product or new ideas

2

- Developing and producing creative ideas that are fresh and unexpected
- Developing ideas and programs that can be integrated into multiple communications channels
- Developing marketing solutions that go beyond traditional approaches and reach consumers in new, innovative ways
- Constantly thinking about the client's business and providing ideas without being asked
- Developing clear well-supported strategies
- Providing interesting relevant insights about the consumers of the brand
- Conducting research and drawing appropriate conclusions and implications for the client's business
- Recommending and developing programs to improve internal marketing (brand awareness and adoption within the client's own organization)

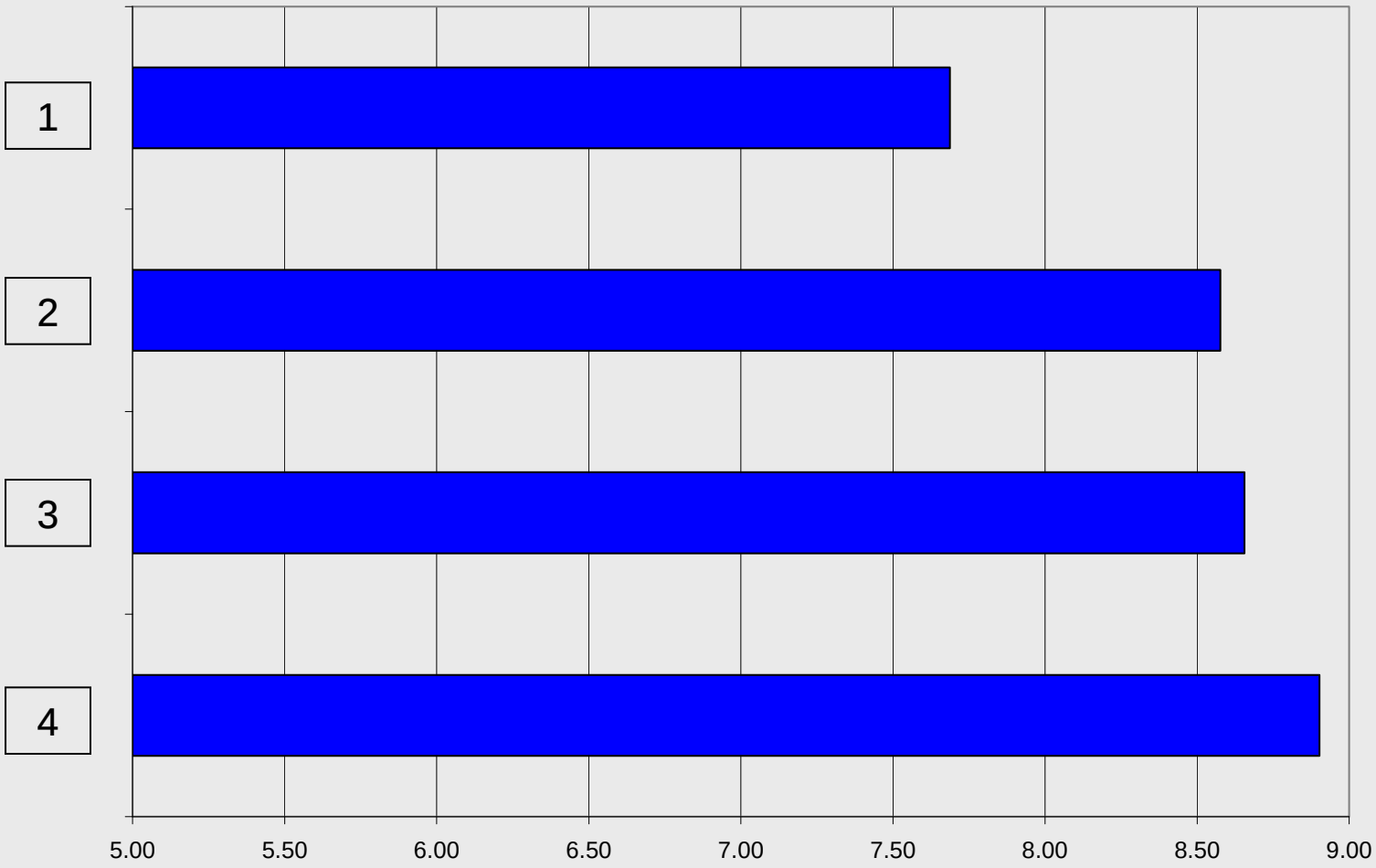
3

- Assigning its best people to the client's business and making its top executives available when needed
- Elevating brand drivers like awareness consideration and purchase intent
- Providing guidance and solutions in new media and technologies
- Providing expert advice and solutions in the areas of online search and online marketing
- Developing ideas and programs that generate buzz about the brand
- Developing and executing effective one-on-one communications, not just mass communications
- Developing and executing marketing programs globally

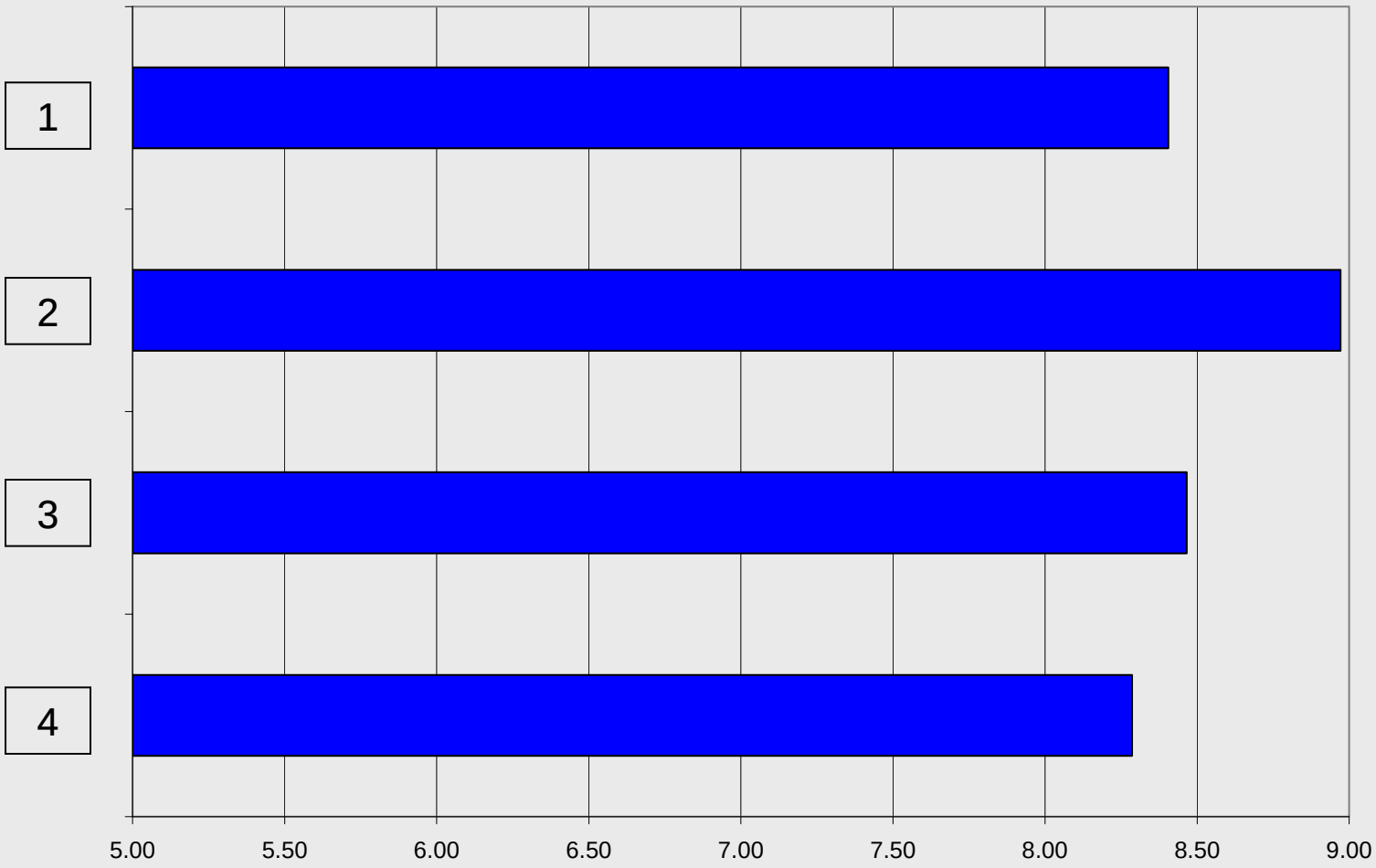
4

- Ensuring that agency disciplines and functions are integrated and that agency teams and divisions collaborate well on behalf of the client
- Working in a collaborative way with the client by creating an environment of low egos and high mutual respect
- Producing error-free work and by doing things right the first time
- Adopting efficient systems and procedures that result in a smooth workflow and the timely completion of projects
- Doing their best to ensure team longevity and low turnover on the client's business

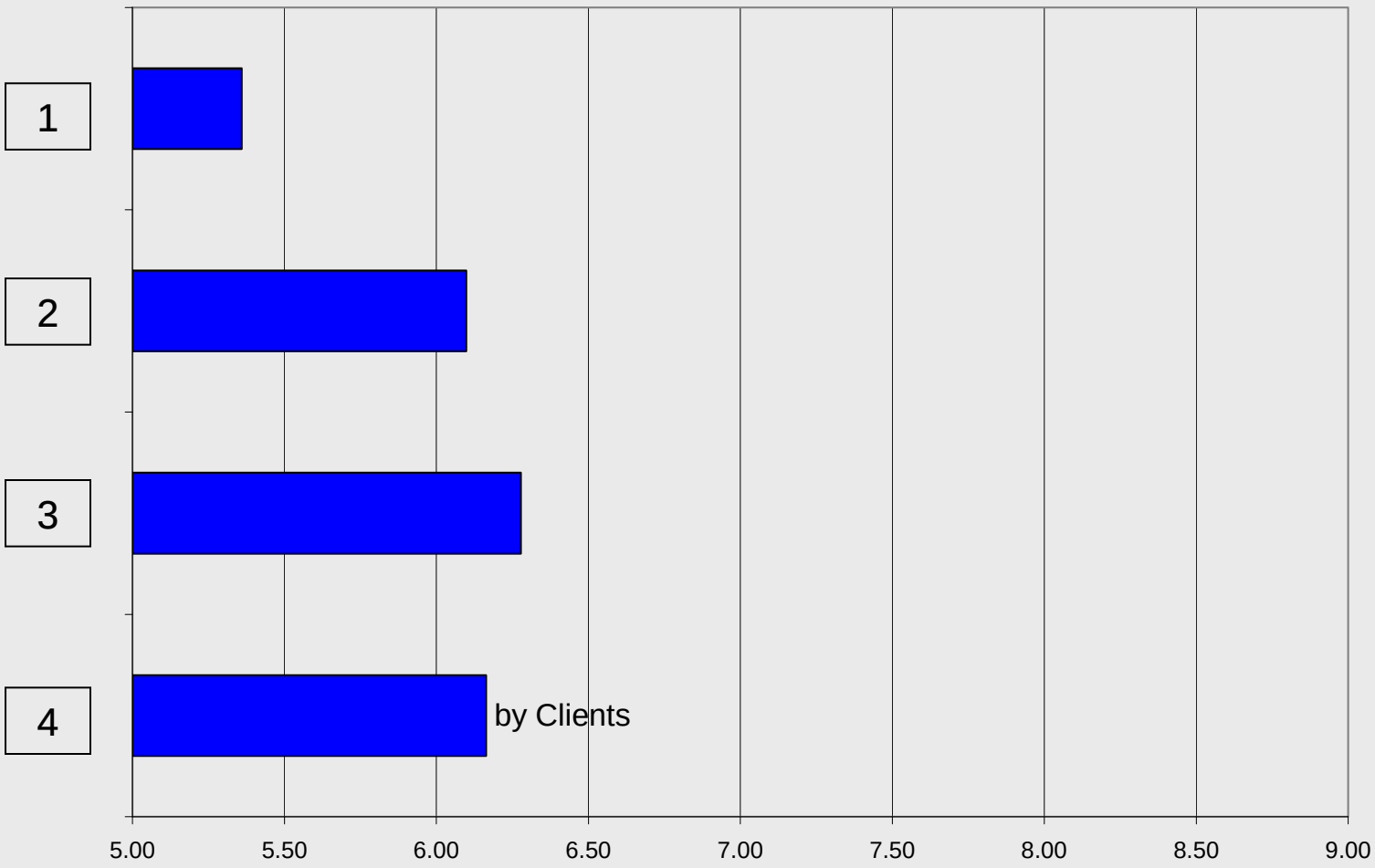
Relevance of Criteria for Agencies (per Client ratings in AAAA / ANA Survey)



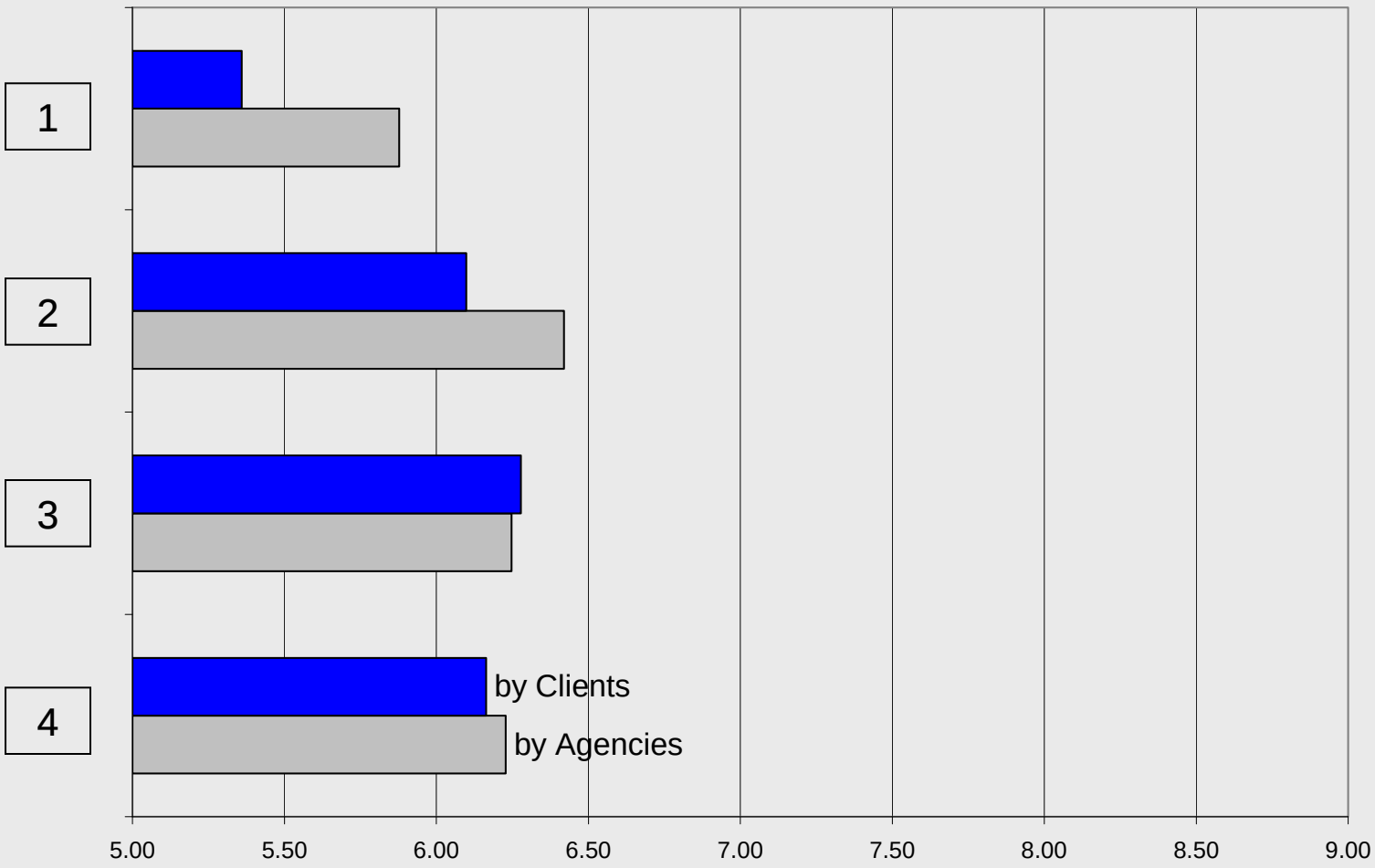
Relevance of Criteria for Agencies (per Agency ratings in AAAA / ANA Survey)



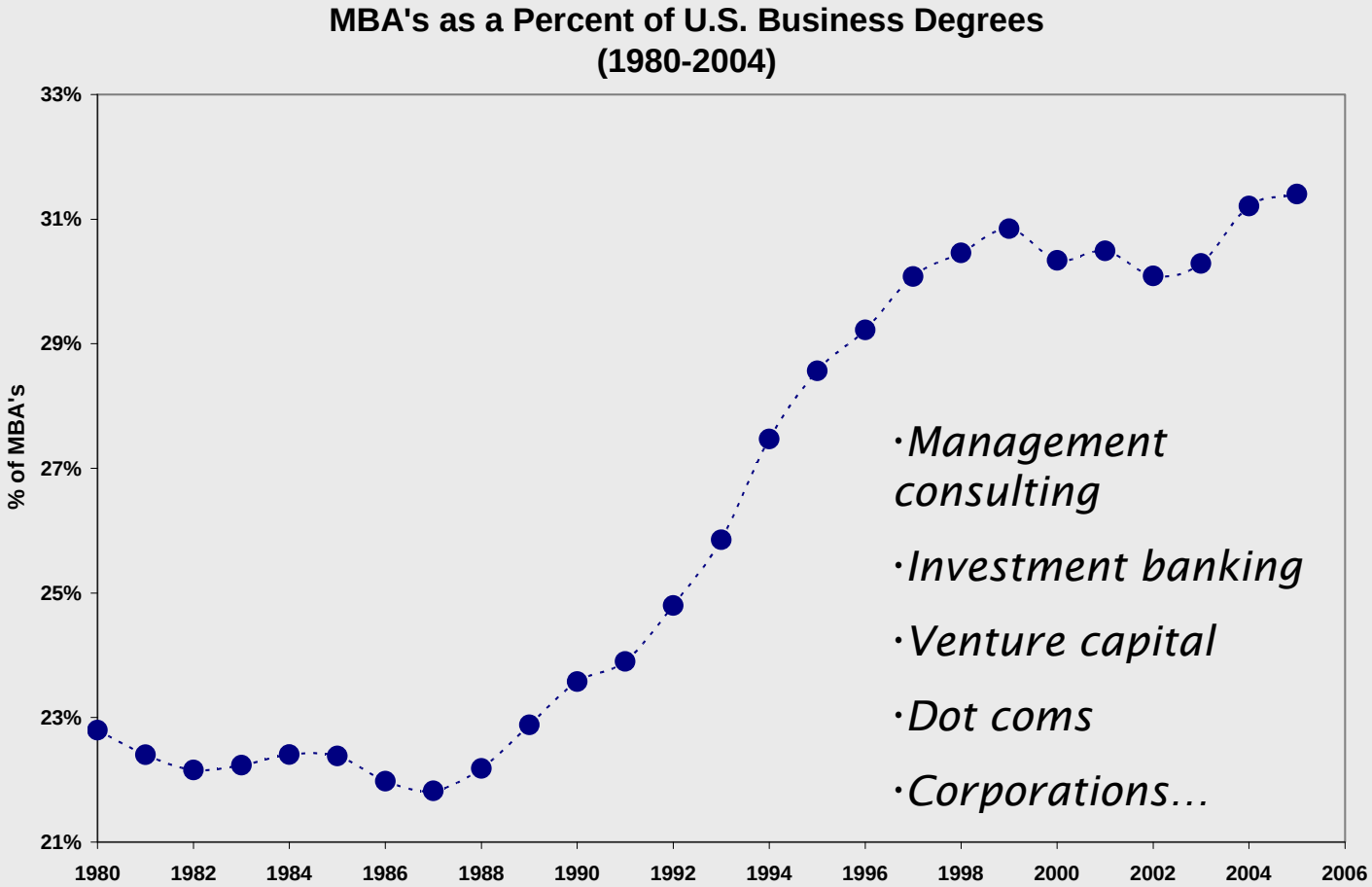
Performance Score of Agencies



Performance Score of Agencies

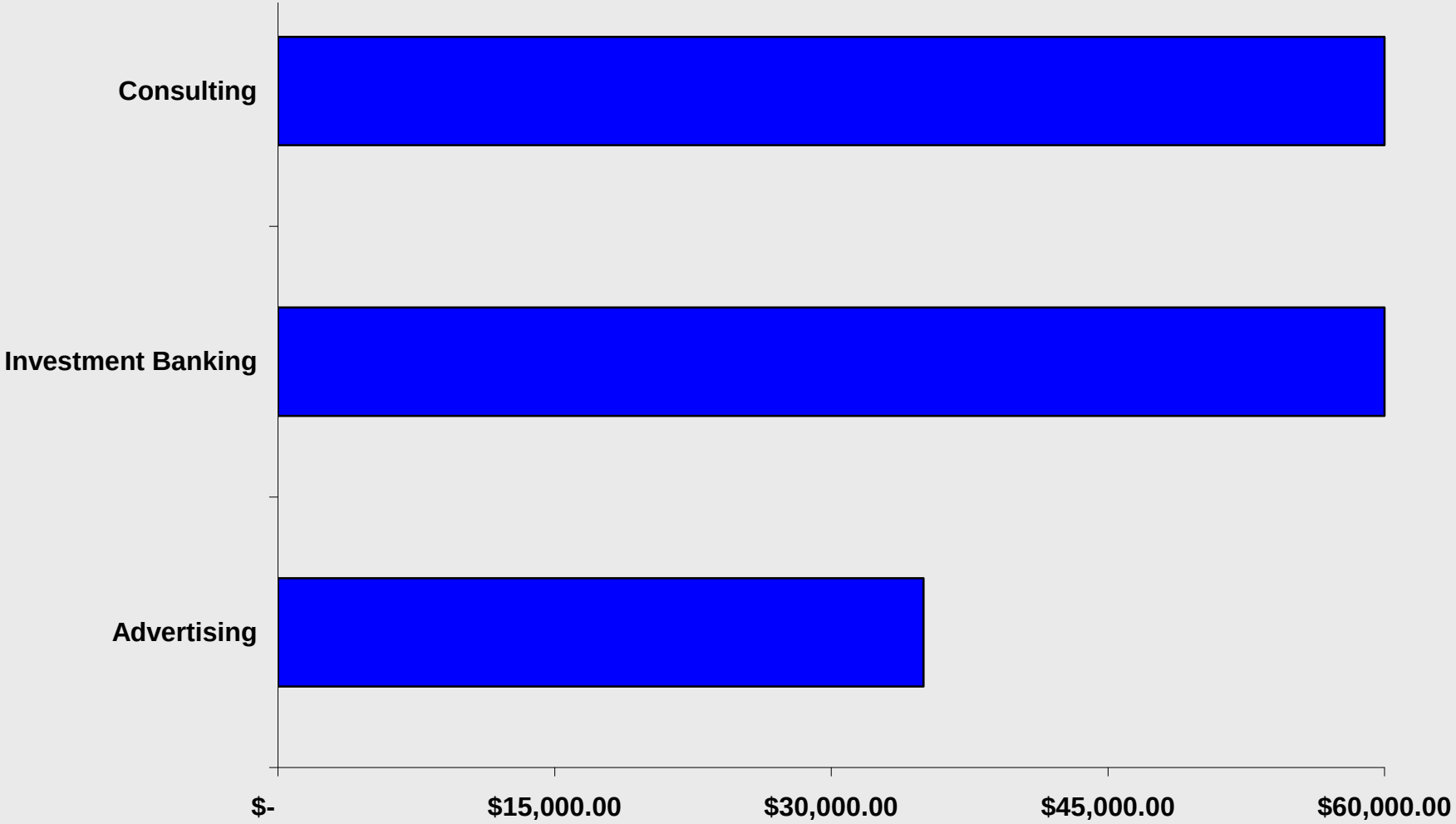


The Advertising Industry sat out the MBA boom of the past 20 years



Source: U.S. Department of Education data, 2006

Non-MBA Starting Salaries (NYC) – 2006/7



Source: Vault salary surveys and Farmer & Co research

Who has the highest-value mission?

Management Consulting

- BCG. *Helping organizations create & sustain competitive advantage*
  - *BCG seeks to stimulate continuous growth and success for our clients*
- Bain. *Helping make companies more valuable*
  - *Our clients outperform the market 4 to 1*
  - *We measure our success by our clients' results*
- McKinsey.
  - *We help leaders make distinctive, lasting and substantial improvements to the performance of their organizations*

Advertising Agencies

- #1. *We believe our job is to help clients build enduring brands that live as part of consumers' lives*
  - *We work not for ourselves, not for the company, not even for the client. We work for Brands*
- #2. *We create ideas for our clients that people want to spend time with*
- #3. *We energize business*
- #4. *The singular purpose that guides us: to build the value of our clients' brands*

AAAA

Summary - I

- Market forces are at work
- High multiple service providers (i.e., management consulting firms) focus narrowly on high value-added missions for their clients
  - MBA's. Strong training programs.
  - Much higher starting salaries. Twice as high as agencies
  - Positive track record has preserved their multiples
  - Fearless about facing their clients' strategic problems

Value Pricing

- *The weak agency multiple reflects the reality of weak perceived agency value at the client*
- The red herring: "How do we get clients to adopt value pricing in lieu of labor-based pricing?"
  - *Answer: they are already paying agencies on a value basis. Unfortunately, the multiple (and the value) is low*
- A new question: "What strategic steps do we need to take so we can get on the path to charging higher multiples?"

Strategic Transformation is Required

- First, defend current fees – prevent erosion.
  - Scope of Work planning and tracking
  - Defensible resource calculations
- Second, upgrade Client Service & Planning
  - Fewer, more professional and consultative agency executives
  - Trained for strategic missions
  - Focused on “solving client growth / profitability problems”
- Third, differentiate “strategic” from “operational” missions, upgrade the mix of “strategic” and price accordingly

Differentiate Multiples by Brief-Type

	High Creative Complexity	Average Creative Complexity	Low Creative Complexity
High Strategic Importance	3.00	2.75	2.50
Average Strategic Importance	2.75	2.50	2.25
Low Strategic Importance	2.50	2.25	2.00

Consequently, differentiate fees per FSU

	High Creative Complexity	**Average Creative Complexity**	**Low Creative Complexity**
High Strategic Importance	*$300,000*	*$250,000*	*$200,000*
Average Strategic Importance	*$250,000*	*$200,000*	*$150,000*
Low Strategic Importance	*$200,000*	*$150,000*	*$100,000*

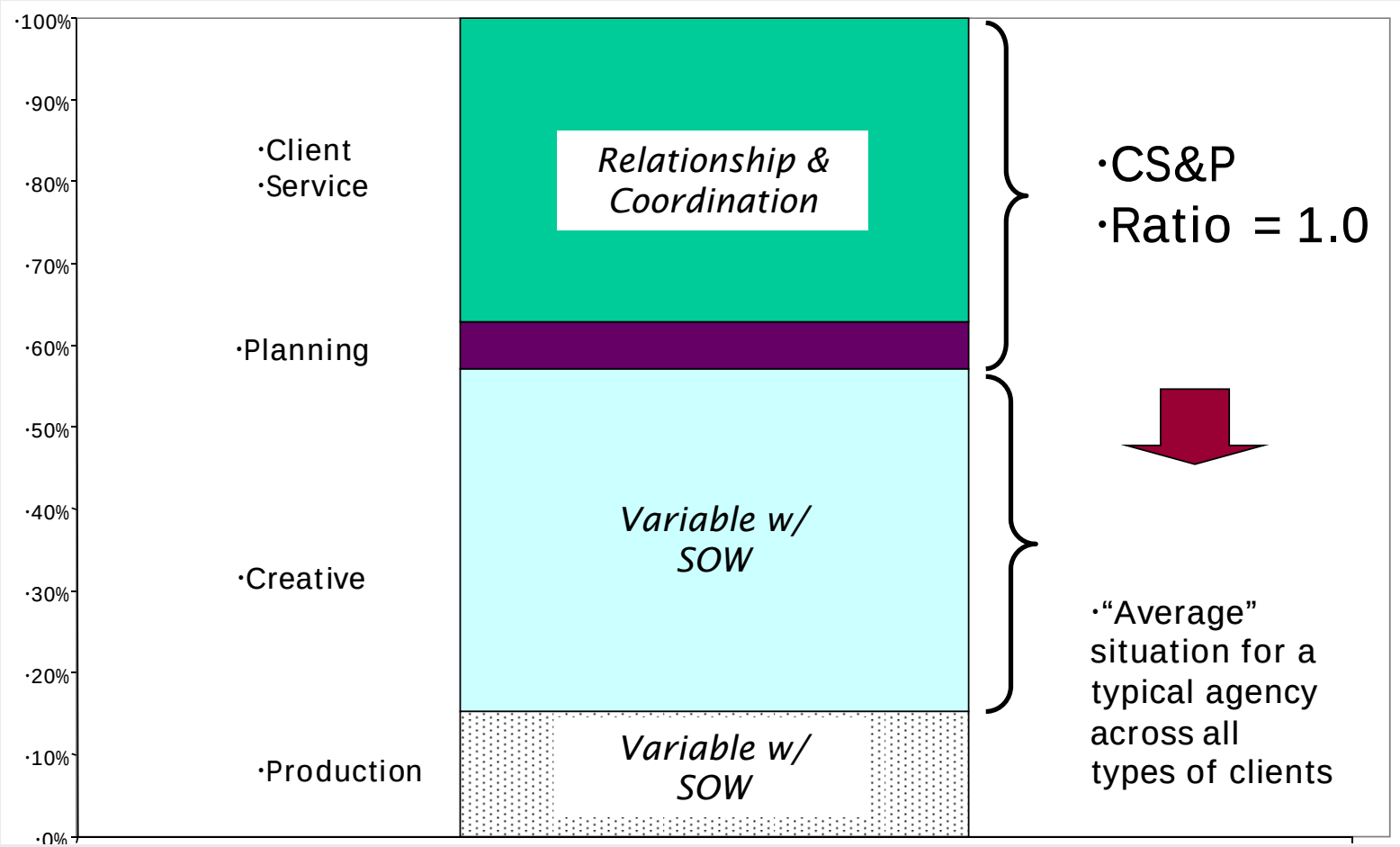
Summary - I

- Remuneration reform is necessary.
  - Agencies cannot continue down the path of receiving fees that are in decline while workload continues to rise.
- Workload planning is essential.
  - Agencies need to be remunerated in a way that reflects not only the quantity of work but its relative value.
- Greater strategic involvement is required
  - Agencies need to “up the ante” and ensure that they are involved in strategic planning *and* are carrying out work that is aligned with their clients’ strategic needs.
- Agency remuneration needs to be based on a combination of workload, value and resources.

Requirements

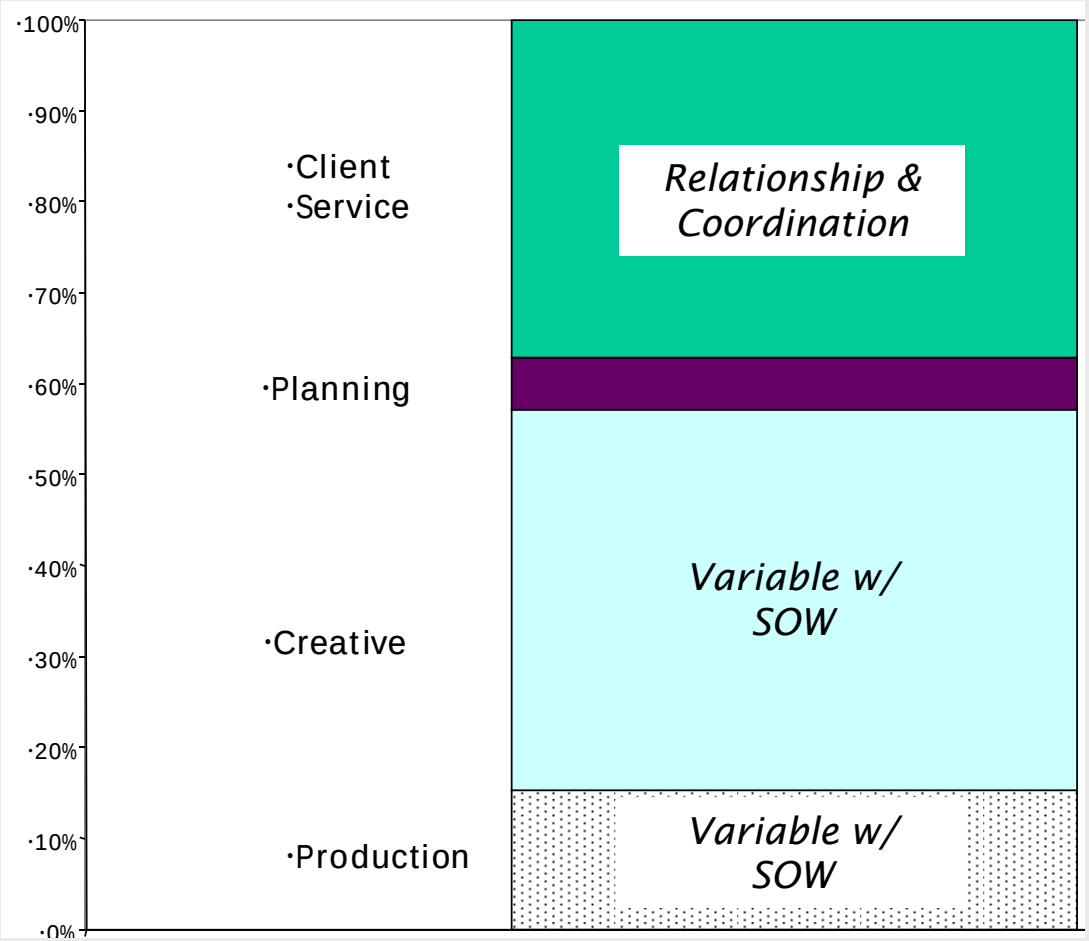
- A vigorous Scope of Work planning process based on the client's strategic needs
- A capability to categorize the Scope of Work along a number of key dimensions;
- An agreed set of resource standards
- An agreed set of multiples
- Client agreement that the methodology is "fair"
- Agency commitment, leadership, training and follow-through

Normal Agency Cost Structure*



* Professional Services Costs only. Ignores agency overhead costs

Normal Agency Cost Structure*



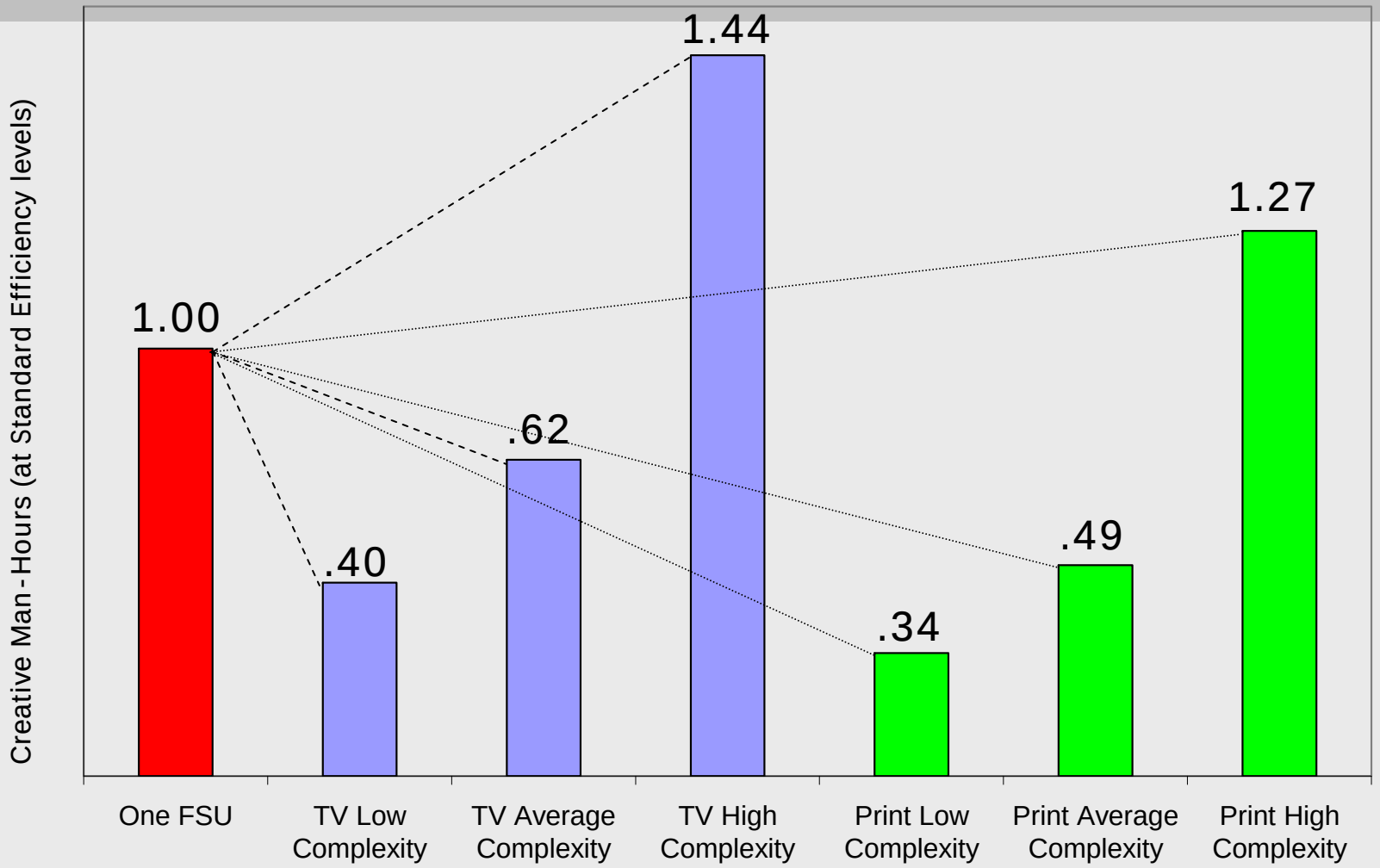
Under-resourcing

* Professional Services Costs only. Ignores agency overhead costs

What is a Standard 'Unit of Work?'

- *Farmer Standardized Unit (FSU)* -- a workload metric:
  - *The amount of work carried out by a typical Creative, working 439 man-hours in an efficiently-run and properly staffed relationship ("standard efficiency")*
- *Thus*: one creative working 1,800 hours can complete 4.1 FSU's *at standard efficiency*
  - *Less than 4.1* is due to excessive rework
  - *More than 4.1* is due to understaffing

FSU Values: TV & Print Originations. *Example*



Source: Farmer Resource Model

Clients - Procurement

- They want “lower cost,” of course
- But they are trained to want “quality processes” as the means
- Thus far, they have been frustrated in efforts to create “quality processes” with agencies.
- Scope of Work planning – with resource calculations – provides the key
- Propose:
  - *Let’s review the workload and required resources. We have a rigorous way of doing this. Rework has been a problem…..*
  - *Let’s then adjust the workload to meet your fee constraints*

Digital & Interactive

- Like traditional advertising, they have Creative Complexity (low, average, or high)
- In addition, they have Technical Complexity (low, average, or high) depending on the programming complexity
- In addition, their “production costs” are in-house rather than outsourced – so the total costs per FSU for a digital / interactive project can very high, indeed
- FSU costs: low for ad banners, high for Web sites

Agency Cost Accounting

- Many agencies have Project Management systems that monitor project costs
  - These systems “look inwards” at operations
- Our Tracking system monitors client-driven changes
  - Our system “looks outwards”
- The two systems complement one another
- We can “reconcile” data from the two systems
  - Seamlessly, through integration
  - Or on an ad hoc basis every quarter

Scope of Work Planning and Activity-Based Pricing

Michael Farmer
Farmer & Company LLC
475 Park Avenue South, 8th floor
New York, NY 10016 USA
1 (212) 909-2650
mfarmer@farmerandco.com
www.farmerandco.com