

A
Client's
Guide
To

Ad Agency
Service
In-House Or
Independent?



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Introduction

As a potential client of an advertising agency, you may be considering whether to go the independent agency route or to handle your advertising program entirely in-house. The purpose of this book is to help you, as you consider the options, to gain a more complete understanding of the value of the independent, full-service agency and how it can enhance the effectiveness of every dollar you spend on advertising. There are a number of arguments for and against either option. We have attempted to outline them for you as fairly as possible, given our obvious preference for the independent agency.

This booklet is based on a speech delivered in December 1992 by O. Burtch Drake, Executive Vice President of the A.A.A.A., before the Florida State Tourism Commission. His speech, in turn, was based on a 1983 booklet, “The Full-Service Advertising Agency: Why It Continues to Grow and Prosper,” by Victor G. Bloede, who was then Chairman of Benton & Bowles. Although the advertising industry has changed considerably in the decade since, many of Bloede’s premises still hold true. In this booklet, we have taken those truths a few steps further—into the decade of the ’90s and beyond.

“A Client’s Guide to Ad Agency Service In-House or Independent” is one of a series of “A Client’s Guide to . . .” publications developed to address the questions and concerns of advertisers as they search for and work with advertising agencies. Especially A.A.A.A. member agencies.

Other titles in the series cover such subjects as agency compensation, working with an agency, what an agency does, conducting an agency search, and agency/client contracts, with additional titles in development.

With each guide, our aim is to provide advertisers with specific and practical information on a key aspect of the client/advertising agency relationship. □

Ad Agency Service: In-House or Independent

Background

A century ago, it was common practice among many large advertisers to prepare their advertising through agencies that they wholly owned. Such in-house agencies were maintained by a number of large firms through the Great Depression of the 1930's and until after World War II. The post-war period, however, found independent, full-service agencies proliferating. They offered specialized talents and established outstanding track records for their clients.

The past 40 years have seen fewer and fewer in-house advertising staffs or agencies. In 1980 (the last time the share of market was quantified), less than 10 percent of 300 large advertisers surveyed were using in-house agencies exclusively. Current estimates stand at about 7 percent.

What Is a Full-Service Agency?

In the simplest terms, a full-service advertising agency is one that is capable of providing all the services necessary to handle your total advertising and marketing program.

This includes the ability to analyze your problems and opportunities, objectively recommend appropriate marketing solutions, and

prepare creative work for all media. It also involves doing the necessary research to insure maximum efficiency and then planning and buying exactly the right media to carry your message.

All along the way, the agency stands ready to support you, the advertiser, in any way that can contribute to improved sales of your goods or services.

With the introduction in recent years of the concept of Integrated Marketing Communications, many agencies have stepped up their commitment to all the available avenues of reaching consumers, while others have been quietly practicing the integration of services on behalf of their clients for many years.

Today, you will quite likely find your full-service agency able to render services in public relations, event marketing, sales promotion, direct response marketing, package design—all under a unified strategy that speaks with a single voice to your customers. Beyond that, many agencies provide specialized services in such fields as recruitment advertising, business-to-business advertising, medical and pharmaceutical advertising, and yellow pages advertising.

The ability to provide full service has little to do with the size of the agency. This full range of services can be available to you from the smallest as well as the largest of U.S. agencies.

Then Why Go In-house?

Most advertisers who take their programs in-house like to cite three reasons: cost savings, greater control, and convenience.

- 1. Cost savings.** The vast majority of advertisers who move their advertising in-house quickly realize that there is just not that much

money, if any, to be saved. They soon discover that it takes not only people to try to replicate what an independent agency can do. It also takes office space, furniture, word processors, computer-graphics hardware and software, syndicated media research, art supplies, life insurance, health insurance, FICA, retirement plans, and so on.

No evidence has been found that you, as an advertiser, can buy these basic needs and maintain an employee at any less cost than an independent agency can. Nor is there any evidence that an in-house operation can produce advertising while using fewer people than an independent agency needs. You can, of course, hire cheaper people. But you will quickly learn that first-rate talent doesn't come cheap.

In short, it costs about as much to staff and operate an in-house agency as it does to staff and operate an independent agency. How, then, can you save money? Perhaps by not paying bonuses, or not distributing earnings, you might save as much as the profit that an agency hopes to make in handling an account. The key word is "hopes," for an agency does not always make money on every account.

How much profit does an agency make? Suppose your advertising budget is \$10 million. And suppose you are paying the agency the traditional 15 percent commission. After paying the media and production bills, the agency has \$1.5 million to cover its internal costs. It spends about 71 percent on payroll, benefits, and bonuses, and about 16 percent on rent, utilities, postage, and supplies. About 10 percent goes to travel, media research, etc. That leaves about 3 percent, or \$45,000, as an operating profit (see chart on page 10). The potential cost saving to the advertiser who keeps the work in-house rather than hiring an independent agency and paying a 15 percent commission, then, is only 0.45 percent.

And what if the commission is even less? Say about 10 percent. In this case, the agency's income on a \$10 million account is an even \$1 million. On that, it earns \$30,000 in pre-tax profits, or three-tenths of one percent of the total \$10 million budget (see chart below)—not a large saving, by any standard.

Pro Forma Ad Agency P&L			
<u>Expenses</u>	<u>%</u>	<u>Income</u>	
		<u>\$1.5MM</u>	<u>\$1.0MM</u>
Payroll, Benefits & Bonuses	71	\$1,065	\$710
Rent, Utilities			
Postage, Supplies	16	240	160
All Other Expenses	10	150	100
Total Expenses	97	1,455	970
Operating Profit	3	45	30
Profit as a % of billing (\$10MM)		0.45%	0.3%
<i>Source: 1992 A.A.A.A. Analysis of Agency Costs Agencies with annual gross income of 1.5MM – \$3MM.</i>			

Suppose your advertising budget is much larger—say, \$40 or \$50 million. The potential cost saving is four or five times larger—perhaps \$180,000 to \$225,000—but still not an appreciable amount, given the total dollars involved, compared to what is *not* gained by keeping the work in-house.

2. Control. If you want control, you will certainly get it with an in-house agency. The people creating the advertising will be your employees. They will have to do what you tell them to do.

But is that good? Experience has shown that a “do this—do that” atmosphere soon becomes pervasive in in-house advertising operations. The in-house staff is busy executing somebody else’s ideas, because no one is listening to their ideas. Objectivity—the willingness to pitch the unusual, the unconventional, the big idea—is stultified.

3. Convenience. Some advertisers believe that bringing the work in-house is a good way to shorten reaction time and reduce the length of communication lines. With the agency physically in-house, they feel, everyone speaks the same corporate language and has access to the same information. Ideally, this minimizes wheel-spinning.

But in this era of the communications explosion—faxes, videoconferencing, E-mail—your agency can be located halfway across the country and still respond instantaneously.

Why Hire an Independent Agency?

The reasons are several. They can be summed up in seven words: people, objectivity, accountability, experience, flexibility, innovation and creativity.

1. People. The advertising business is a people business. An advertising agency’s only real assets are the talents and skills of its people. The agency that has the best people, motivated by the most capable and dedicated leaders, is usually the most successful.

Advertising attracts the competitive, the ambitious, the entrepreneurial—the people who are highly creative in their approaches to solving problems. Such people—writers, art directors, television and radio producers, researchers, media experts, account directors—thrive in the working ambiance of an independent agency. Their natural

habitat is the highly charged atmosphere of such an agency. They wither and stagnate in the relative safety and security of a manufacturing or service company or in-house agency.

That's because the full-service advertising agency rewards people in three ways. First, it gives them the opportunity for financial return commensurate with the risks of an entrepreneurial business. Second, it gives them an unparalleled opportunity for personal growth and promotion. Third, and perhaps most important, it rewards them professionally—the standards are high, the competition is tough, and talent is recognized.

And that's not all. The really valuable creative people in the agency business thrive on diversity. They want and need to work on a variety of account assignments. But if you bring them into an in-house agency, you give them only one client to work with. Over time, this becomes an extremely limiting factor. It is one of the primary reasons why an in-house agency has real difficulty in attracting and keeping first-rate creative people.

2. Objectivity. A “yes man”—or a “yes woman”—produces precious few good ideas. An insider's view cannot be as objective as an outsider's. That is why one of the most valuable contributions the independent agency can make to you is the objectivity of its recommendations.

The agency is not a partisan of any one medium or any single advertising idea. Its people are trained to look at a client's products and services from the consumer's point of view—not from the advertiser's. They understand the difference between a product or service feature and a product or service benefit. A product feature is the product seen through the eyes of its manufacturer; a product

benefit is the product seen through the eyes of the consumer. Agency people know that consumers buy product benefits, not product features.

The agency knows how to say “No” to the client when it must be said. Advertising history shows that some “No’s” have saved clients from very costly marketing and advertising mistakes.

In short, a decent agency doesn’t have to be afraid to tell it the way it is. Such objectivity is at the core of the concept of the independent agency.

3. Accountability. Responsibility and accountability are the hallmarks of the independent advertising agency. During every step of its work for you, the agency accepts the fact that it will be held accountable for the results of its labors. The agency knows that its own future rides on the successes it is able to produce for its clients’ products and services. This is the challenge an agency accepts every time it takes on an assignment from a client.

Call it the centralization of responsibility. Whether the results of the advertising are excellent or not up to par, it’s easy for you, working with an independent agency, to know where to heap the credit or place the blame.

4. Experience. When you hire an independent agency, you gain a treasure-house of knowledge. The agency’s collective experience in solving many different kinds of problems for many different types of advertisers can be of inestimable help to you.

The benefits can be quite direct. Suppose you are bringing a new grocery-store product to market. Experience gained by an agency in

selling packaged goods can be invaluable. Or suppose you are offering a service. Your agency's experience in promoting one service can translate into real guidance in an unrelated service area. In fact, collective agency wisdom often works less directly, as experience in such an area as packaged goods often helps a service advertiser to marketing success.

Over the past decade, scores of new businesses have turned to advertising for the first time: home computers and software, video games, cable TV suppliers, money market funds, credit cards, legal services, HMO's and medical services, and many more. In each of these new categories, marketers have benefitted from the experience their independent agencies gained in advertising other products and services.

It is all but impossible for even the largest client to match the breadth and depth of advertising experience offered by the typical independent agency.

5. Flexibility. Jay Chiat's "virtual agency" may not suit everyone, but the flexibility inherent in his new kind of internal agency architecture is becoming more and more important in all agencies as client needs change, the media multiply and the world becomes wired.

Some large agencies have spun off smaller groups to handle the needs of a single client, to work in specialized areas, or to offer a la carte services on a project basis. Smaller agencies are quick to respond to any and all client needs; their lives depend on it.

All agencies know that no two clients are alike and that their requirements can differ radically. One client may want a highly structured agency team while another might prefer a simpler organization. One

client might need major research involvement on a continuing basis; another, heavy sales promotion activity; yet another, help in field work with dealers. The independent agency can adapt its forces to meet virtually every kind of client need.

In addition to organizational flexibility, agencies are also flexible in how they charge for their services. Most agencies are paid in a variety of ways, including commissions from media billings (the percent of which may vary), on a fee basis, or through a number of different combinations of both.

Finally, the agency has great flexibility in the assignment of people. It can add people or change people to meet new client needs and opportunities. Thus, it is easy for a client to have a fresh team working on his business without disrupting his own organization. A smart advertiser appreciates this flexibility.

6. Innovation. Advertising is a remarkably efficient marketing tool. The ability to identify groups of potential customers, to find an appeal that will motivate them, and to reach them efficiently has been refined remarkably over the years. And the work goes on, even as the mass market of 20 or 30 years ago continues to fragment into ever more specialized consumer groups and media choices.

Virtually all these advances in effective commercial persuasion have come from the independent advertising agencies.

From the first use of radio as a commercial medium in the 1920's to today's promise of 500 cable television channels, the innovations in creative work and media strategies have been led by agencies.

Agency innovation does not stop with advertising. The imagination of

agency people has provided clients with packaging, product names, even new product ideas and improvements.

The smart advertiser knows that the people at his agency do not turn off their imaginations when they leave their office—that he is getting the benefits of an idea factory that operates around the clock, looking for new ways to help his business.

Innovation is one big reason for an advertiser to select an independent agency.

7. Creativity. A powerful advertising idea gives the advertiser more leverage than anything else in his marketing arsenal. Nothing else can produce such dramatic market change, so quickly, with no change in your advertising expenditure.

You have seen them, one after another: great advertising ideas that have revolutionized the market in such diverse categories as coffee, toothpaste, soft drinks, furniture polish, automobiles, detergents, computers. The best are not only powerful. They live long lives. Who can calculate the value to your company of an idea that lasts five or 10 or even 20 years?

No one has yet been able to put a price on the value of an idea that has helped lift a brand to dominance in the market.

Saving Money: the Forlorn Hope

The dream of saving money often convinces advertisers to experiment with house agencies. But the income from a house agency's one account is seldom enough to support a competent staff.

In advertising, as in most things in life, you get what you pay for. You may search long and hard but you will not find a famous advertiser or marketer that gained high reputation by cost-reducing its way to success. In almost any product or service category, you will find that the value of a share point far surpasses the possible value of a reduction in advertising costs.

Today More Than Ever . . .

. . . the independent advertising agency offers a unique advantage. Its radius of expertise is constantly extending, widening the circle of services that you, as an advertiser, in good times and bad, most need. The independent agency has a long heritage of leadership in times of change. Helping guide its clients through tough challenges is a role its people assume with imagination, intelligence and commitment. The agency is an ally you can't afford to be without. □

Books in the “Client’s Guide To . . .” series include:

- . . . Working with Your A.A.A.A. Agency
- . . . the A.A.A.A. Agency: What It Is and What It Can Do For You
- . . . Agency Compensation
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