Compensation Overview: Challenges & Opportunities

It’s a fact.

Current macroeconomic issues are

- pressuring marketing budgets.
- empowering procurement and finance departments.
- reducing the freedom of the CMO.
- limiting the profit margins for marketers and agencies.

Advertising industry economics are further complicated as

- marketing dollars are spread more broadly.
- scope lines blur and overlap.
- specialty agencies continue to pop-up.
- crowd sourcing/UGC is on the rise.
- pitches/jump-ball projects become more popular.

“Advertising groups issue dire slowdown warnings”

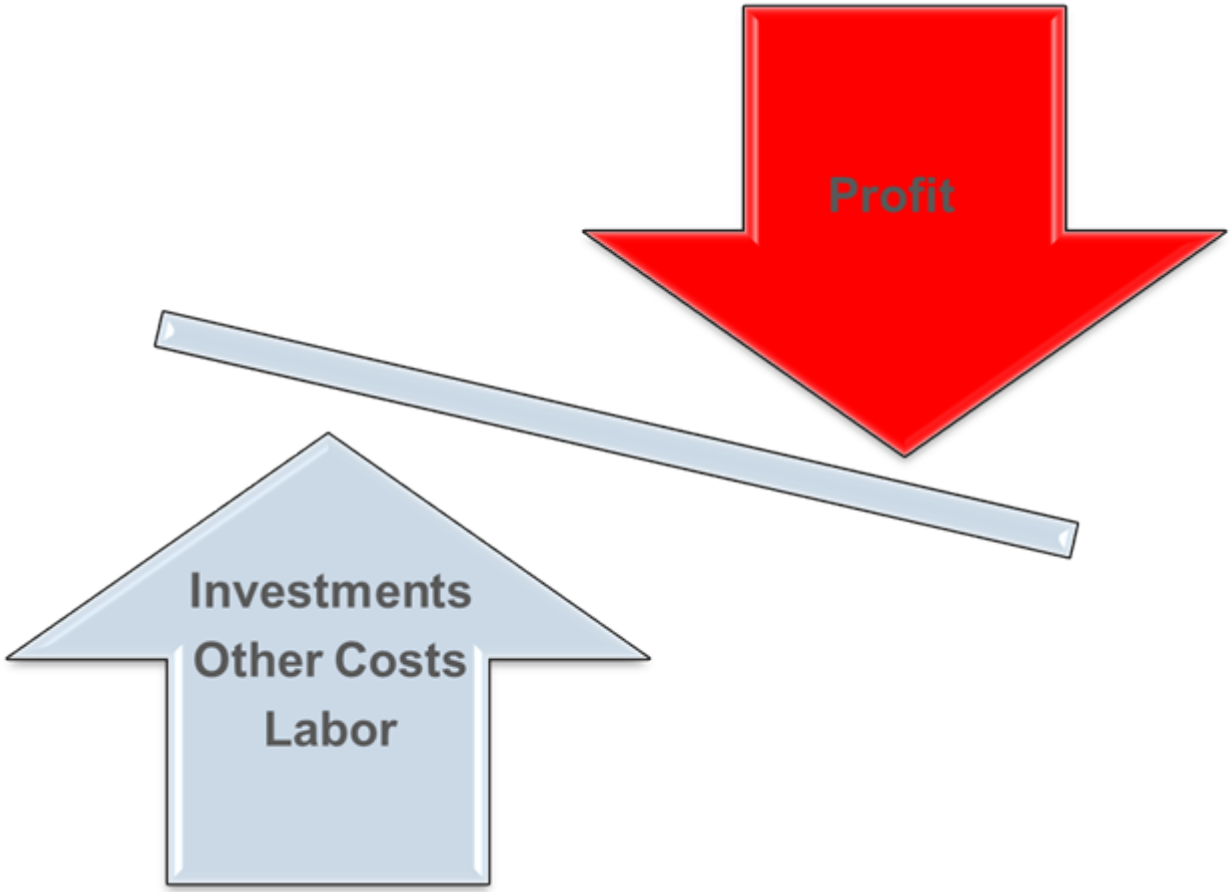
“Listless ad spending expected to worsen”

“Growth Curbed as Ad Cuts Spread to Web”

“Forecast: Hold on to your hat”

LET'S MAKE A DEAL: Agencies Find More Wins Tied to Compensation Compromises

The economic model for agencies continues to tighten.

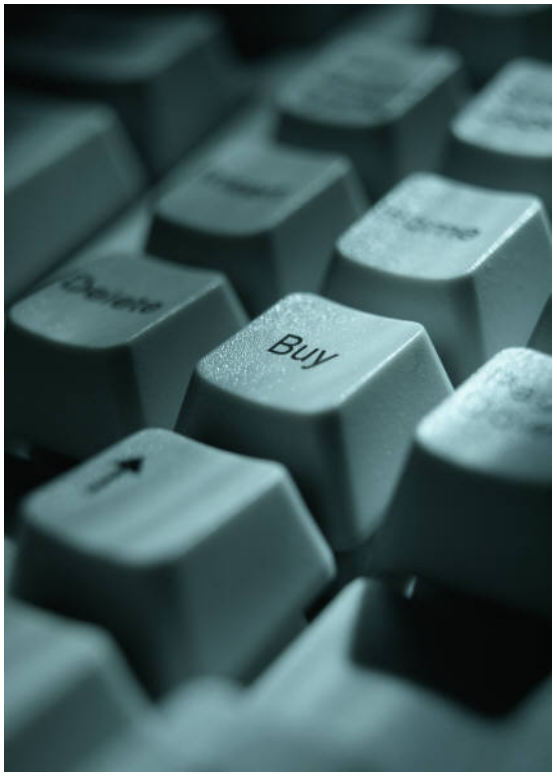


“Clients have difficulty defining, measuring and aligning on the “value” of their marketing, let alone figuring out how to define and measure their agency’s specific contributions. The degree of difficulty increases when a marketer is working with multiple agency partners.”

Source: Ad Age, “Why Value Based Compensation is Going Nowhere Fast” 5/3/10

The financial pressures have empowered clients and their procurement “friends”.

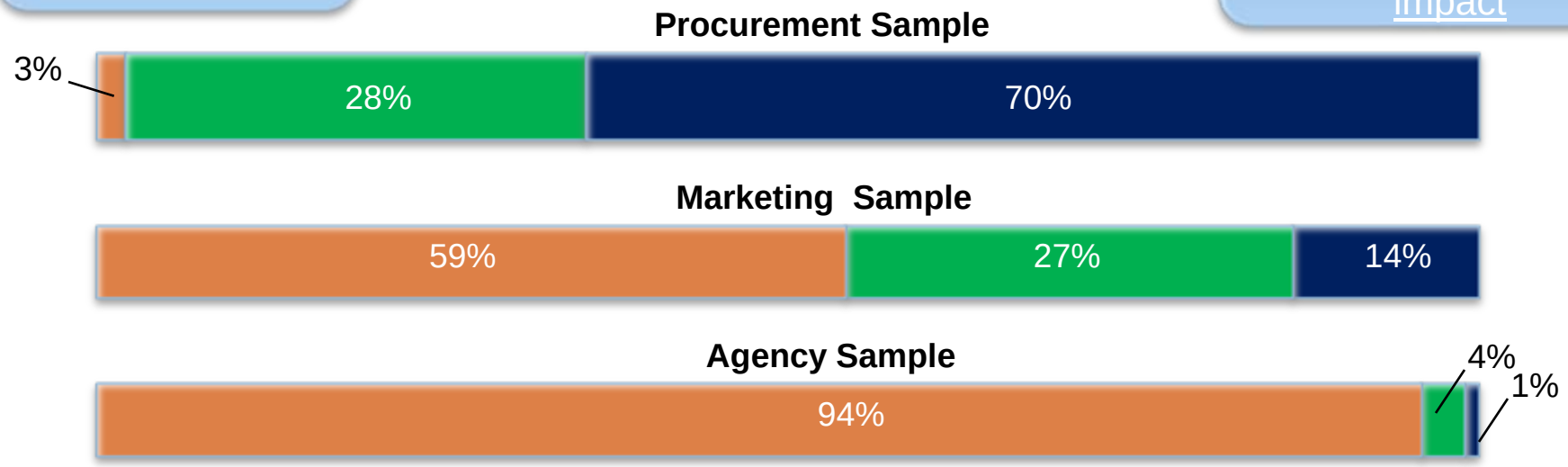
Agencies are viewed as a commodity more and more every day.



Perceptions of how Procurement defines "Value"

Procurement's definition of value is lowest cost

Procurement's definition of value is maximum growth & impact



- Q23: Please indicate where on the continuum below the procurement group stands in terms of its definition of what constitutes "value".

Lean Left | Neutral Rating | Lean Right

Source: ANA, 2010

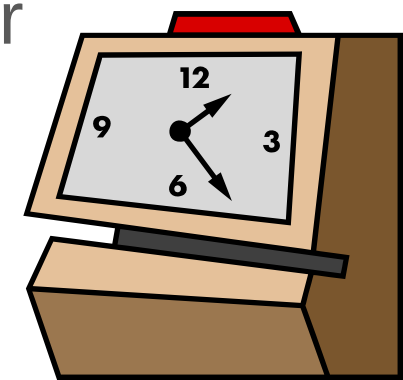
Note: May not add to 100% due to rounding.

Our industry has been forced into a labor-based compensation model.

We are forced to defend: staffing, overhead and profitability rates.

There is little value placed on great work and significant focus on the hourly rate to make the work.

This change in philosophy has turned our fee structures into a limiting economic model.



Our industry is not the only one with these challenges.

Others have overcome this model…

TARGET

McKinsey&Company

jetBlue AIRWAYS

So how do we?

LEADERSHIP
COMMUNITY
ADVOCACY
GUIDANCE

The 4A's Agency Compensation Pillars were introduced last year as a starting point.

Agencies should:

- Be sure Agency Principals are involved in comp discussions.
- Make "value" the crux of the conversation.
- Develop and live by their own comp principles.
- Engage key stakeholders on both sides to be part of the comp discussion.

Agency management should develop a plan that works for your own agency.

At the core of the plan should be the agency's own compensation principles. The agency needs to be able to articulate these internally and to clients – and then live by them.

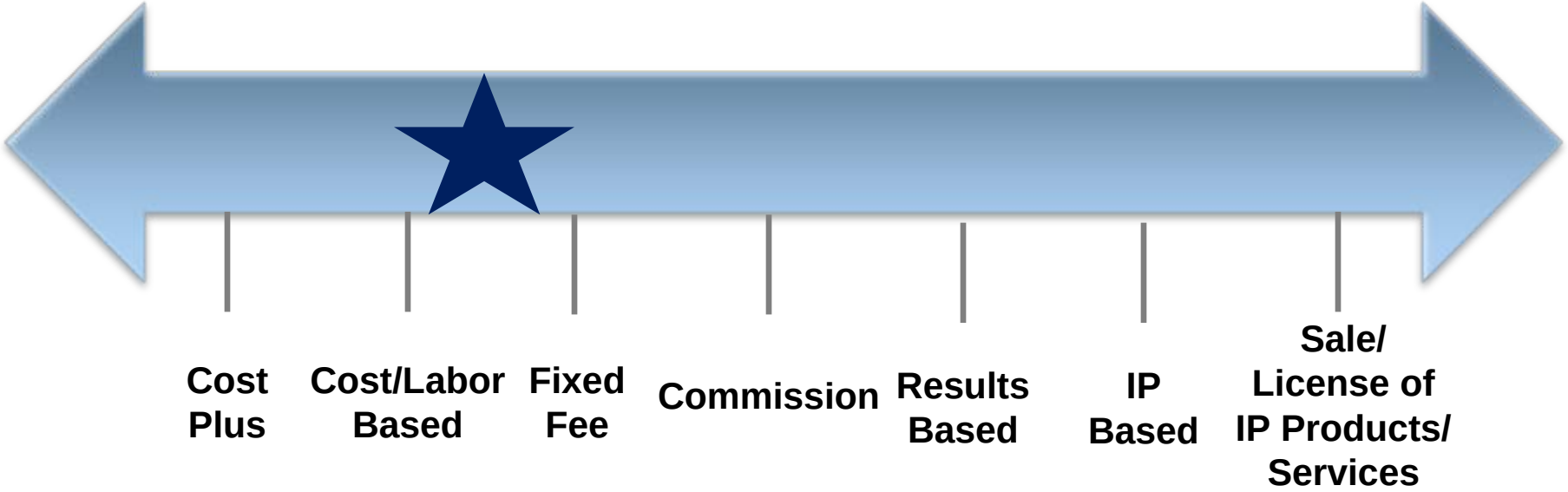
We also need to understand our numbers better than any client procurement person ever could, including labor costs, overhead rates and profits.

We need to understand the scope of work in detail and focus the conversation on the services we will provide.

We need to talk to the client about the “investment” that they are making in marketing in order to have an open dialogue about how the agency will add value.

Agencies should evaluate tools that help them to work with clients to develop a comp structure.

Comp Continuum



Grossman Grid

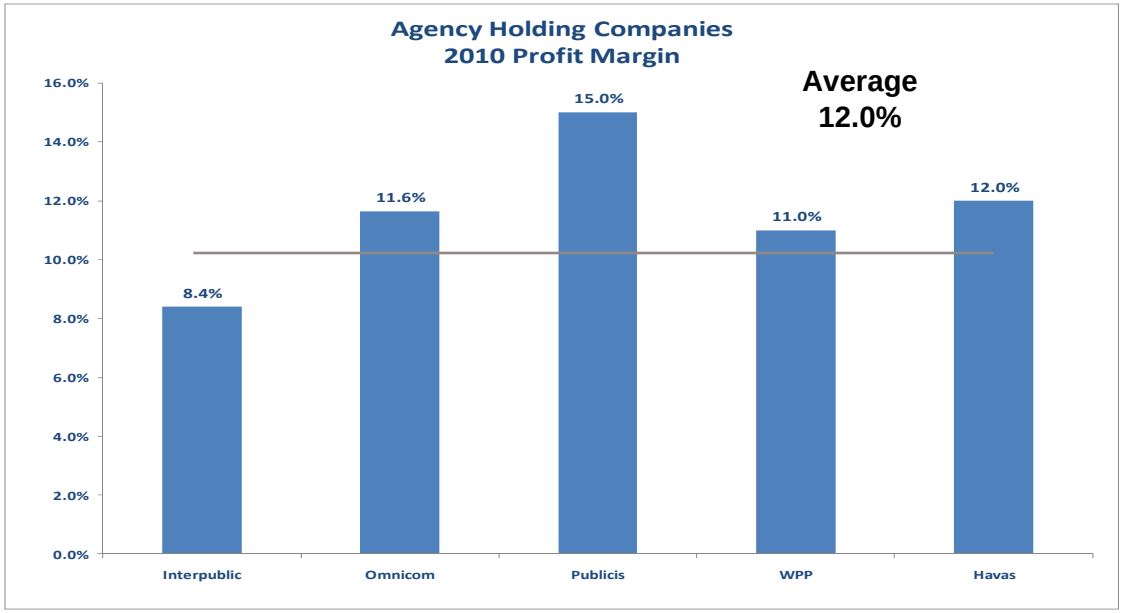
Major Compensation Options
ANALYSIS

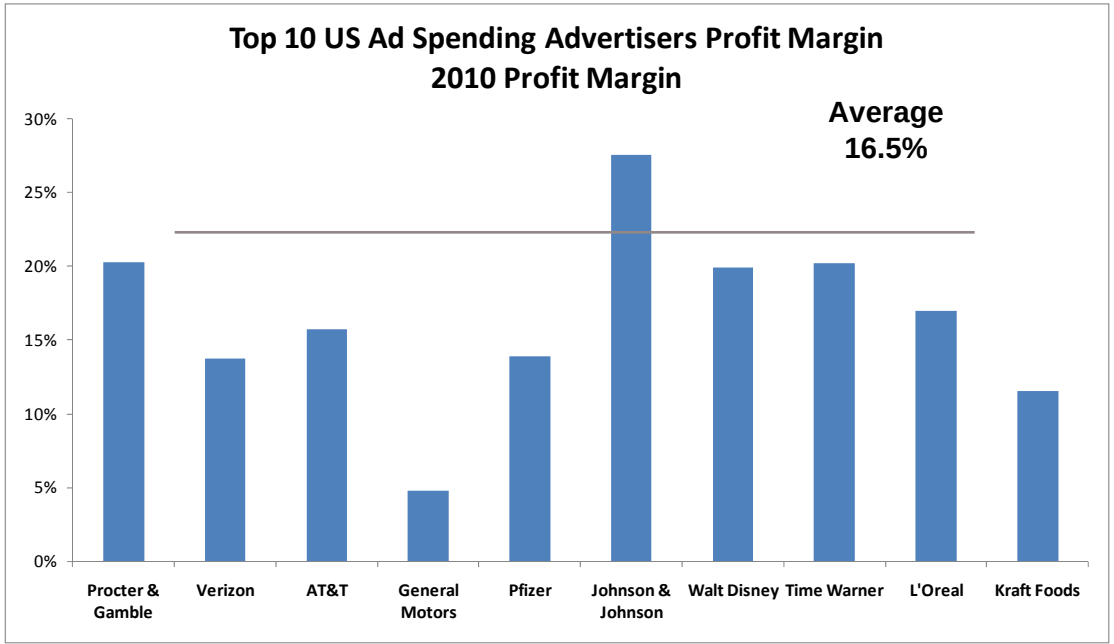
characteristic	SIMPLICITY	ADMINISTRATION	FAIRNESS	ALIGNMENT	FLEXIBILITY	LONGEVITY	COMPARABILITY	COST EFFECTIVE	VALUE FOCUSED	FORECASTABLE	
weighting	2 Simple & Easy to Understand	2 Easily Administered	3 Fair to both Client and Agency	3 Aligns interests & Priorities	1 Adaptable / Flexible Enough to Accommodate Changes	1 Capable of Standing the Test of Time	2 Easily Comparable	3 Cost Efficiency and Cost Effectiveness	2 Allows Client and Agency to be Focused on Value of Outputs, Not Just Price of Services	2 Predictability / Ease of Budgeting and Forecasting	**Weighted Score**
Commissions on Media Spending and Production Markup	4 (simple formula; information readily available)	4 (easy to calculate; easier to apply to global accounts)	1 (ignores non-traditional media; higher risk of agency being overpaid or underpaid)	1 (not media neutral)	2 (compensation adjusts automatically with change in media spend but not reflective of work performed)	1 (applicable only to mainstream advertising)	3 (commission rates easily comparable but difficult to compare unless similar scope of work)	2 (no incentive for agency to negotiate best pricing on media and production)	4 (up to agency to manage its costs)	2 (risk associated with unanticipated increases or decreases in spending can result in significant swings)	53
Commissions on Total Marketing Spend	4 (simple formula; information readily available)	4 (easy to calculate; easier to apply to global accounts)	2 (higher risk of agency being overpaid or underpaid due to changes in marketing spend)	3 (media neutral)	3 (compensation adjusts with fluctuation in spend but may not entirely correlate to work)	3 (rates should not have to be adjusted on an annual basis)	3 (commission rates easily comparable but difficult to compare unless similar scope of work)	2 (no incentive for agency to negotiate best pricing on media and production)	4 (up to agency to manage its costs)	3 (compensation can vary within a certain range)	67
Commission on Client Sales (Units or $'s)	4 (simple formula; information readily available)	4 (easy to calculate once rates established)	2 (may be factors beyond agency's control that either positively or negatively impact sales)	4 (both agency and client are tied to the same measure of performance; media neutral)	3 (compensation adjusts with fluctuation in sales but may not entirely correlate to work)	3 (rates should not have to be adjusted on an annual basis)	2 (comparability limited to competitive set)	3 (maximizing client budgets support increased sales which is in agency's and client's interests)	4 (up to agency to manage its costs)	3 (consistent with client's ability and history budgeting and forecasting sales)	71
Cost-Plus Fee	1 (extremely complex due to number of variables, definitions, etc.; example--govt contracts)	1 (extremely time consuming negotiating, monitoring and recordkeeping)	4 (agency compensated for every hour worked)	3 (media neutral)	4 (adjusts with scope of work; applies to all agency services; fee adjusted plus or minus based on actuals)	3 (each year, should only need to update scope of work and staffing, not the structure of compensation)	2 (since agencies vary in how efficiently they work, results of compensation can vary significantly -- e.g., Nissan vs. Toyota agency staffing)	1 (no incentive for agency to be cost efficient or cost effective since actuals are paid regardless of cost)	1 (heavy focus on agency costs)	2 (fees could vary significantly up or down based on actual time/ costs)	46
Labor Based Fee Fixed Cost	2 (complex due to number of variables, definitions, etc.)	2 (time consuming negotiating, monitoring and recordkeeping)	3 (agency may or may not be compensated for every hour worked; lower risk of being over- or under-paid)	3 (media neutral)	3 (adjusts with scope of work provided such flexibility is built into contract; applies to all agency services)	3 (each year, should only need to update scope of work and staffing, not the structure of compensation)	3 (requires intimate knowledge of details of scope of work in order to do valid comparisons)	3 (scope of work, staffing and costs are reviewed as part of compensation negotiations)	3 (partial focus up front on agency costs but then up to agency to manage its costs)	4 (compensation does not change except for significant changes on business)	64
Labor Based Fee Variable Cost (Mac Methodology)	2 (complex due to number of variables, definitions, etc.)	2 (time consuming negotiating, monitoring and recordkeeping)	3 (agency may or may not be compensated for every hour worked; lower risk of being over- or under-paid)	3 (media neutral)	3 (adjusts with scope of work, provided such flexibility is built into contract; applies to all agency services)	3 (each year, should only need to update scope of work and staffing, not the structure of compensation)	3 (requires intimate knowledge of details of scope of work in order to do valid comparisons)	3 (scope of work, staffing and costs are reviewed as part of compensation negotiations)	2 (focused largely on agency costs)	3 (compensation can vary within a certain range)	59
Fixed Fee	3 (arrival at fee may or may not be simple but once agreed to its easily understood)	3 (arrival at fee may or may not be simple but once agreed to requires little additional work)	3 (agency may or may not be compensated for every hour worked; lower risk of being over- or under-paid)	3 (media neutral)	2 (adjusts with significant changes in scope of work, provided such flexibility is built into contract; applies to all agency services)	3 (not rigidly structured)	3 (requires intimate knowledge of details of scope of work in order to do valid comparisons)	3 (scope of work and staffing are generally reviewed as part of compensation negotiations with possible reference to costs)	4 (up to agency to manage its costs)	4 (compensation does not change except for significant changes on business)	70
Fixed Fee With Change Orders (to accommodate major changes in plans and/or activities\)	3 (arrival at fee may or may not be simple but once agreed to its easily understood)	3 (arrival at fee may or may not be simple but once agreed to requires little additional work)	3 (agency may or may not be compensated for every hour worked; lower risk of being over- or under-paid)	3 (media neutral)	3 (adjusts with significant changes in scope of work)	3 (not rigidly structured)	3 (requires intimate knowledge of details of scope of work in order to do valid comparisons)	3 (scope of work and staffing are generally reviewed as part of compensation negotiations with possible reference to costs)	4 (up to agency to manage its costs)	4 (compensation does not change except for significant changes on business)	71
Project or Hourly Fees	3 (generally based on agreed upon rate sheet and/or estimated hours and negotiated rates)	3 (easy to administer provided agency maintains accurate and timely timesheet information)	4 (agency compensated for every hour worked)	2 (more suited for integrated services or niche approach)	4 (compensation adjusts with changes in actual work performed)	2 (short-term focused rather than long-term relationship and brand building; more difficult to staff and ensure continuity)	3 (hourly rates are easily comparable with project fees less so)	2 (for hourly fees, no incentive for agency to be cost efficient or effective; less so for project fees)	4 (up to agency to manage its costs)	2 (fees could vary significantly up or down based on actual time/ costs)	64
Performance Based Bonuses	2 (formulas and weighting of criteria can add level of complexity)	2 (time consuming and may require use of quantitative advertising measures)	4 (agency compensated based upon mutually agreed upon performance criteria)	4 (performance criteria mutually agreed upon)	4 (adjusts purely based upon agency and client performance)	4 (provided performance criteria is evaluated annually for relevance, performance bonuses are expected to continue)	1 (criteria varies so significantly from client to client, comparability is limited)	4 (links compensation to performance; management of client budgets often a performance criteria)	4 (focused on outputs of performance rather than inputs/costs)	2 (fees could vary significantly up or down based on performance of agency or client)	70

Profits are necessary for any business to remain healthy, and to allow for the investment needed to remain viable.

Agencies are no different. We need to price in profitability and defend it.

Agency vs Client Profitability





On average the operating profit margin level of the top 10 US advertisers is ***one third higher*** than for the holding companies of the agencies they engage.

Source: 4As Profit Presentation, 3/23/11

So while macro and industry trends have made agency profitability tighter, we also need to be sure, as an industry, we are not making it worse.

We need

- to be prepared.
- to have a plan and principles that we live by.
- to have agency principals actively participate in these discussions.
- to be able to clearly articulate our numbers and comp structures to client and procurement.
- to manage SOWs more tightly and charge properly for OOS services.
- to defend fair and profitable compensation.

Thank you.