Decoding Compensation Models & Implementing the Right Model

April 2024

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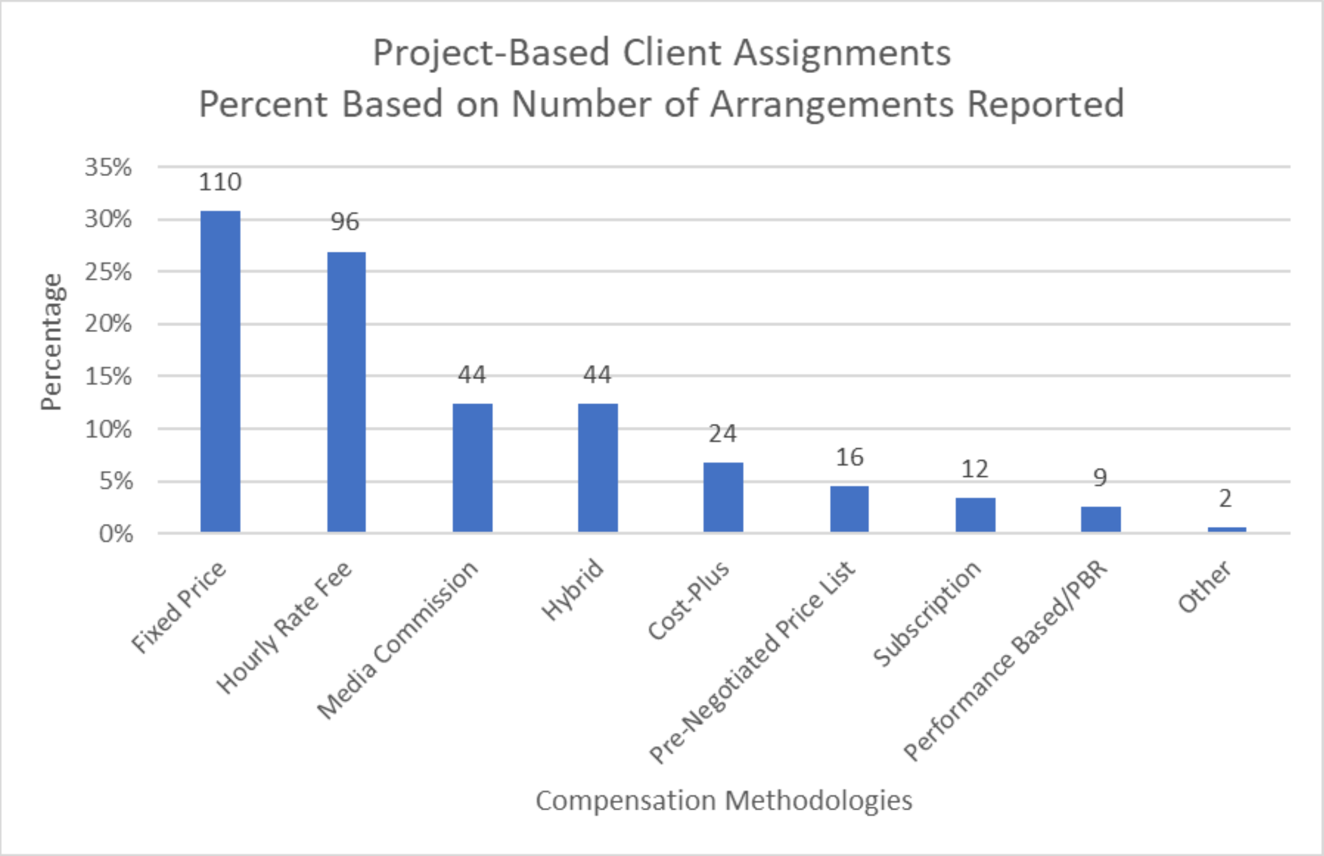
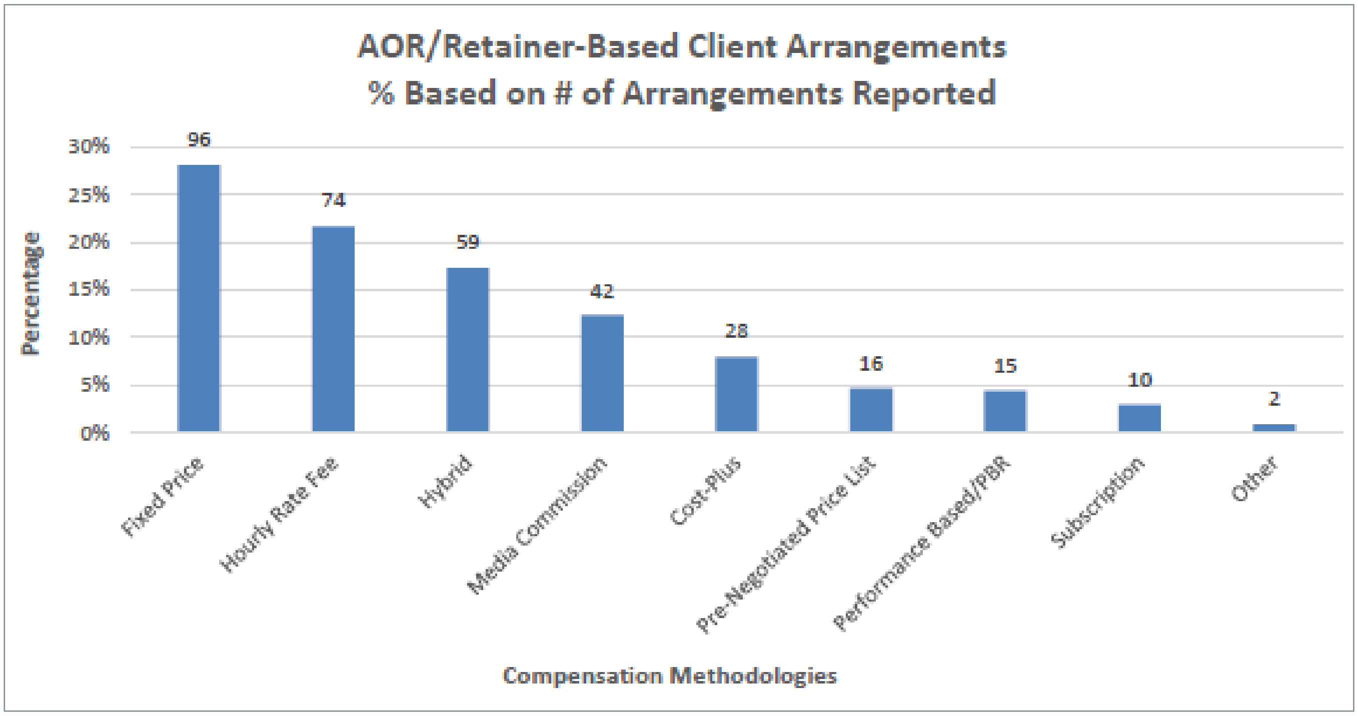
I. The Genesis of the Task Force

Marketing has changed dramatically over the last decade, but agency compensation models have predominantly remained static and often fail to align with the growing complexity of the industry or with the objectives of the marketers they serve. While agencies and advertisers are adapting and evolving how they work together, compensation structures have not kept pace with the rapid industry changes. Some agencies and advertisers have fully converted to new models, others now use hybrid models. However, the majority of agencies and advertisers are only starting to consider new approaches, which incorporate input, output, and outcome-based models according to the *ANA's Trends in Agency Compensation, Section IV: RESPONDENTS' FUTURE PLANS FOR AGENCY COMPENSATION (page 19).*

In response to this issue, the 4A's and the ANA established a collaborative task force to share insights, establish a common nomenclature to describe the existing compensation methods, inform stakeholders and advocate for exploring different approaches. The goal of this paper is to inspire agencies and marketers to venture beyond their current compensation arrangements, help remove obstacles, and employ models that reflect the dynamics of today's industry, ultimately enhancing relationships and delivering positive impacts on business outcomes for both agencies and advertisers.

According to a recent survey by the 4As in Q1 2024, Fixed Fee emerged as the most utilized compensation model among the 149 participants surveyed (72 percent independents/28 percent network-owned) in both project and retainer based relationships.





II. Challenges in Transitioning to a New Compensation Model

Navigating the unknown is never a straightforward endeavor. In the initial discussions of the task force, the predominant theme of changing models revolved around the apprehension and uncertainty associated with the lack of established frameworks, standardization, and the lack of historical benchmarks - making it difficult to measure and compare different ways of paying an agency. The concerns expressed by the members included potential financial risk, operationalizing anything new and the cultural changes needed to try something new. Dismantling an existing structure becomes an onerous task when long established arrangements are firmly in place, making it a significant investment to disentangle the operational intricacies.

The alignment of organizations, the time required for implementing and adopting a new model on both sides, and various other factors demand leadership. These include considerations such as evaluating potential investments, determining (ROI), assessing organizational impact by both sides, measuring the benefit, and the willingness to let go of the familiar frame of reference, which can make it difficult to compare prices when models change.

However, the potential benefits of reshaping the relationship into a more strategic partnership and reimagining what is achievable (akin to moving from desktop computers to cloud computing) can outweigh the challenges. Like all substantial transformations, success is entirely dependent on achieving alignment among all of the key parties – in this case the agency, marketer, and marketing procurement.

III. Mutually Beneficial Compensation Methodologies

A compensation methodology should be clearly defined, support the advertisers' marketing goals, be easy to manage, and contribute to marketing initiatives that generate overall value for the marketer's enterprise. The compensation structure should effectively support the recruitment of the necessary talent required to address the marketer's business needs. Above all, it should align with the mutual interests of both the agency and the marketer and be fair to both parties. Fair compensation methodologies promote a healthy and productive working relationship and fosters an environment where both advertisers and agencies can thrive resulting in a win-win scenario.

We strongly encourage agencies and marketers to embrace experimentation. Begin with smaller projects or engagements to test and learn from various structures. Be prepared for setbacks, as they often yield valuable insights that can guide your journey towards more effective practices.

IV. Categorizing and Standardizing Naming Conventions of Models

Initial task force conversations immediately revealed the need for agreement on the various types of models in use and the naming conventions for the models being reviewed. In every instance, a model or its components could go by multiple names, which can create confusion when exploring new approaches. For the purposes of this paper we've categorized these models into three types:

Output-based	Input-based	Performance-based

The sections of this paper follow these three categories and each section aims to standardize the model name while referencing the other names commonly used.

A. Category 1: Output-based Models

These models are characterized by advertisers paying a set fee, based on an expected set of outputs or deliverables. Several approaches are used for output-based pricing with the primary ones listed below:

1. Fixed Price:

Description:

A negotiated price for a defined set of deliverables. The fixed price for the agreed work remains constant regardless of the time, effort, or resources invested by the agency to fulfill the requirements.

Proposed Common Name (s)	Names in Use (AKA)	Additional Characteristics
Fixed Pricing	Firm Bid Guaranteed Price Project Price Phase Price Sprint Price	May include a reconciliation of actual deliverables.

Best Application:

The fixed price model is useful for projects with clearly defined deliverables, where the scope can be tightly controlled, and risks are largely manageable by the agency. It works well when the goal is cost control, timely and effective delivery, and minimizing administrative burden for both parties. This model is highly useful when there's trust between the agency and advertiser for delivering outstanding work and results. Additionally, advertisers looking for greater flexibility with multiple agencies find the fixed price model appealing.

Core Components:

A well-structured fixed priced compensation plan should consider both value to the advertiser, complexity, and resource needs of the agency to ensure fair pricing. By carefully assessing the value the agency brings to the advertiser and the pricing variables associated with execution, both parties can establish a mutually agreed price that aligns with the project's goals.

Considerations an agency should use when determining a Fixed Price Proposal:

Value Factors*:

- Strategic Importance to the Brand:
  - Assess how critical the project is to the advertiser's overall brand strategy.
  - Determine if the project aligns with the advertiser's long-term goals and vision
- Long Term Value Creation:
  - Consider the potential impact of the project on the advertiser's business growth and sustainability.
  - Calculate the projected value the work will bring over an extended period of time.
- Specialized Expertise Required:
  - Evaluate the unique skills and expertise needed to execute the project effectively.
  - Consider if the agency possesses specialized knowledge that sets them apart.

- Qualifications of the Relationship/Partnership:
  - Consider the history and experience with the advertiser.
  - Consider the agency's track record in delivering successful projects.

Price Factors*:

- Talent Level/Expertise:
  - Determine the skill level and expertise required from the team members.
  - Assess the cost of hiring or retaining such specialized talent.
- Scope Complexity:
  - Break down the project scope into various tasks and complexities.
  - Estimate the resources and effort needed for each aspect of the project.
- Resource Requirements:
  - Calculate the number of team members, tools, and technology requirements needed for successful execution.
  - Factor in both direct and indirect costs.
- Client Responsiveness:
  - Consider the responsiveness of the advertiser in providing necessary information and approvals as delays can affect project timelines and costs.
- Size and Duration of Assignment:
  - Evaluate the scale of the project in terms of deliverables and reach.
  - Estimate the project's timeline and duration. Lengthy or larger projects might require more resources and effort. Longer projects may require ongoing resource allocation and management.
- Decision-Making Process:
  - Consider the complexity of decision-making within the advertiser's organization.
- Unknowns and Variables:
  - Account for uncertainties and potential risks that might arise during the project.
  - Allocate a contingency budget to handle unexpected challenges.

**Price and Value Factors created by Tim Williams of the Ignition Consulting Group*

How to Calculate:

- Ensure the deliverables are clearly defined and agreed upon by both parties.
- Scoring System: Use a rating and weighting system to assign scores that can be used to categorize projects into different pricing tiers.
- Value-Adjusted Pricing: Add or deduct from the base pricing using the value factors identified.
- Pricing Tiers: Create pricing tiers based on the type of project and expected value to the advertiser.
- Negotiation and Flexibility: While the pricing may be fixed, allow some flexibility for requirement changes while ensuring that the overall value considerations are maintained

Example

Fixed Pricing Options

	Scope of Activities	Comprehensive	Enhanced	Essential
Foundation	Executive Summary of Immersion Findings	✔	✔	✔
	KPI Framework	✔	✔	
	Learning Agenda	✔	✔	✔
Strategy Development	Category and Audience Whitespace	✔	✔	
	Identification of Key Audience Moments that Matter	✔	✔	
	Tensions & Strengths to Build Upon	✔	✔	
	Campaign Vision & Strategy	✔	✔	✔
	Creative Brief	✔	✔	✔
Creative Platform Development	Up to 3 Creative Platform Ideas	✔	✔	✔
	Experience Concepts	✔		
Communications Plan	Comms Strategy	✔	✔	
	Media Strategy	✔	✔	✔
	Engagement Concepts	✔		
	Measurement Strategy	✔	✔	✔
Tactical Plan	Flow Chart of Overall Plan	✔	✔	
	Specific Media Partner Outreach	✔	✔	
	Budget Ranges for Execution to Allow for Prioritization	✔	✔	✔
	Detailed Plan for Each Track of Work	✔	✔	
		$xxx	$xxx	$xxx

Once a fee for the project is calculated, offering multiple pricing options, helps the advertiser understand the context of the proposal and choose what works best.

Pros and Cons

Pros	Cons
The pricing is based on the complexity of the advertiser's needs rather than the time it takes to solve them, thus encouraging the agency to focus on finding effective and efficient solutions.	A lot of time is spent on scope definition, constant scope management and potentially frequent change orders
The Fixed Price model encourages a clear definition of the scope of work and deliverables, reducing misunderstandings and scope creep during the project.	The absence of standardized benchmark data poses challenges for advertisers seeking to benchmark fixed-price deliverables against industry standards.
By providing a fixed price, discussions about agency overhead and margins are minimized, streamlining the negotiation and agreement processes.	Shifting from traditional hourly rates to a fixed price model requires training and a change in mindset for both agency staff and advertisers. It may take time to educate all parties involved and adjust to the new approach.
The model emphasizes achieving business objectives and outcomes, aligning the agency's efforts with the advertiser's goals. Unlike some other models it is not tied to specific advertising channels, giving both the agency and the advertiser the flexibility to choose the best channels to achieve the desired outcomes.	If the project requirements evolve significantly over time, adjusting the fixed price accordingly may pose challenges, potentially affecting the project's financial viability.
The pricing structure shifts the focus from who is performing the work to what needs to be done to achieve the desired results, promoting a results-oriented approach.	

In a fixed-price agency compensation model, balancing deliverables, time, and unanticipated changes becomes particularly critical. Ensuring that the scope is well-defined, timelines are managed effectively, and changes are incorporated promptly, while maintaining the agreed-upon compensation structure are keys to success. To help navigate this model:

Develop a comprehensive and detailed SOW with phases

Build a scope tracker to track progress against the deliverables.

Track deliverables and activities, not hours

2. Pre-negotiated Price List:

Description:

A negotiated price for a defined set of deliverables. The fixed price for the agreed work remains constant regardless of the time, effort, or resources invested by the agency to fulfill the requirements.

Proposed Common Name (s)	Names in Use (AKA)	Additional Characteristics
Pre-Negotiated Price List	Asset Price Deliverable Price Menu Price Output Price Product Price	A menu of assets/outputs and may be characterized by complexity.

Best Application

High Demand or Consistent Demand: Used for high volume and repeatable products and/or services that are configured and priced to scale easily.

Core Components

- Catalog or Menu of Outputs
    - The asset specifications and prices will be negotiated, published, and made available for advertisers.
- Well-Articulated Descriptions and Assumptions
    - Inherent in the model are thorough descriptions of the products and services included in the pricing and any assumptions made to ensure both parties are clear on what is being delivered. See example below:

How to Calculate

Agency and Advertiser define list of outputs required. A list of outputs by channel or other way to categorize the work that is required to service the business. If available, start with historical deliverables and the amount paid to the agency in the past.

Agency and Marketer define descriptions and assumptions of the work. After the deliverables are agreed upon, both parties should collaborate on defining descriptions of the outputs and any assumptions (e.g., number of rounds, reviews, and versions; fidelity of the output; level of finish of the produced work; 2D renders, 3D renders)

Align on output pricing. Agency creates prices for each deliverable which will consider a variety of factors including resource costs and value factors. Other factors may include volume and frequency, likely time savings, increased efficiency, quality, convenience or impact on sales.

Typically, pricing will correlate to the level of complexity (e.g., easy, moderate, or complex). These classifications can be quite subjective so it's important to align on principles that allow for a constructive dialogue about the complexity of a project. Other considerations may include premium pricing options for accelerated timelines and quick-turn delivery.

Define Ways of Working. Once both parties have aligned to a menu of outputs and descriptions, documenting the ways of working between both parties is critical for success. A way of working document or service level agreement (SLA) provides clarity and guardrails around the governance of the model. Topics that may be covered:

1. Briefing process
2. Project cancellation process
3. How to manage incremental rounds of review
4. Change management process
5. Stakeholder review and approval process
6. Process for agreeing on prices for new deliverables
7. Approvals and legal clearance process
8. Third-party coordination
9. Define how ad hoc work (outside price list) will be handled

Test Pricing Against Baseline. A testing period should be agreed upon for select products and markets. A comparison between old and new pricing should be reviewed with the results analyzed to identify any significant variances. Both parties will explore various options, with the goal of getting closer to their respective target pricing. Adjustments may be needed to the ways of working or pricing to achieve acceptable pricing.

Example

A recommended approach from moving from an old model to an output model is to classify prior years deliverables into discrete categories and defined deliverables. The advertiser can easily choose the needed assets using this method. This model provides the marketer more flexibility to tailor the scope to the changing needs of the business with clarity about how much the agency will be paid. Below is an example of a commercial production asset:

Asset	Description/Components
Television ad from conception through post production = $X	**Planning:** Basic TV campaign planning session to discuss creative and strategic approach. Output as a document of five to 10 pages with treatment examples. **Research:** Field research into multiple customer/user sets in multiple markets. Output as a document of 10 to 20 pages. **Creative Concept:** Creative concepting sprints involving, strategy, creative team, and design to develop a unique look and feel for TVC campaign. Output as series of concept boards/ creative territories (up to three). Assumes up to three rounds of creative revisions once a master is chosen. **Script Development:** Script produced for a short form TV spot, based on a mix of new and existing creative direction/established campaign footage. Three scripts; client chooses one. Assumes up to three rounds of creative revisions to a chosen script. **Storyboarding:** Production of a single storyboard for a 30 second film/ animation with copy and art direction annotation. Assumes three rounds of edits/revisions to storyboard layout. **Pre-Production:** Pre-production exercise for a TV shoot suitable for a single market campaign. Includes three or four creative production options (a mix of known and unknown suppliers / 3rd parties / stakeholders). Assume a 30-second TVC with cutdowns with five second CG sequence. **Production:** Two-day filming session with full agency team. Includes hire of venue/third-party suppliers and talent management. Assume one location, covering four set-ups and four talent for a 30-second TVC. **Post-Production:** Detailed post production phase. Can include very complex/bespoke graphics treatments (including CG builds), full grade online work. Assume for a 30-second TVC with five-second CG sequence. Assumes up to three rounds of creative edits.

Pros and Cons

Pros	Cons
Price visibility: Pre-negotiated list provides visibility on the cost of each deliverable (directly ties agency compensation to the deliverables and output).	Time and training are needed. Requires defined responsibilities to ensure detailed scopes are managed appropriately.
After the price has been agreed upon, project pricing provides visibility for budgeting purposes.	Menu pricing needs to have strict assumptions that clearly define all roles in the process, including response times and approval levels to provide guardrails for the model.
Specificity is required if the advertiser wants more focus on individual project statements of work versus annual staff plans.	Difficult to establish prices. Mutual alignment for codifying descriptions, levels of complexity, and corresponding level of effort to deliver can be challenging.
Pricing is immediately available as scope changes to meet evolving business needs – once the model is mature. May help accelerate market readiness.	Requires advance planning with an estimated annual scope to secure the appropriate resources and to ensure continuity of staff.
Can work across multiple channels with mutual alignment on definitions and parameters.	Longer lead time upfront to establish prices and to train both advertiser and agency staff, but much faster to market once the model is mature.
Better for standard offering from the agency.	Can run the risk of creating a more transactional versus strategic relationship if not administered correctly.
Focuses on deliverables, not inputs.	No direct link between compensation and effectiveness.
Can work across channels provided there is mutual alignment on definitions and parameters.	Rarely covers all the outputs since the discipline of marketing requires innovation. Exceptions to the pre-negotiated list can become onerous.
No confusion about overhead definitions, margins, or resource plans and hourly rates.	Challenging to implement when new bespoke deliverables are requested by advertisers.

3. Subscription Pricing:

Description:

The model requires a set monthly payment for a certain number of services or deliverables provided. This works for regular or repeatable monthly services or deliverables. It is a fixed price ("use it or lose it") and can also be used for access to agency developed IP or third-party tools that aid in data tracking, research, creative, or workflow or other tools designed around the delivery of marketing services ("SaaS").

Proposed Common Name (s)	Names in Use (AKA)	Additional Characteristics
Subscription Pricing	License Usage IP Usage	Price per user, per company, per output, per use or any other trackable mechanism.

Best Application:

Best used for longer, recurring/repeatable work.

- Access to a Software as a Service (SaaS) platform designed by the agency, offering widespread services. Access should require minimal ongoing involvement from the provider.
- Consistent regular consulting services or deliverables, such as reports or maintenance. This requires distinguishing which deliverables would be included in a subscription price versus in an existing scope of work for general services or ad hoc projects.

Core Components:

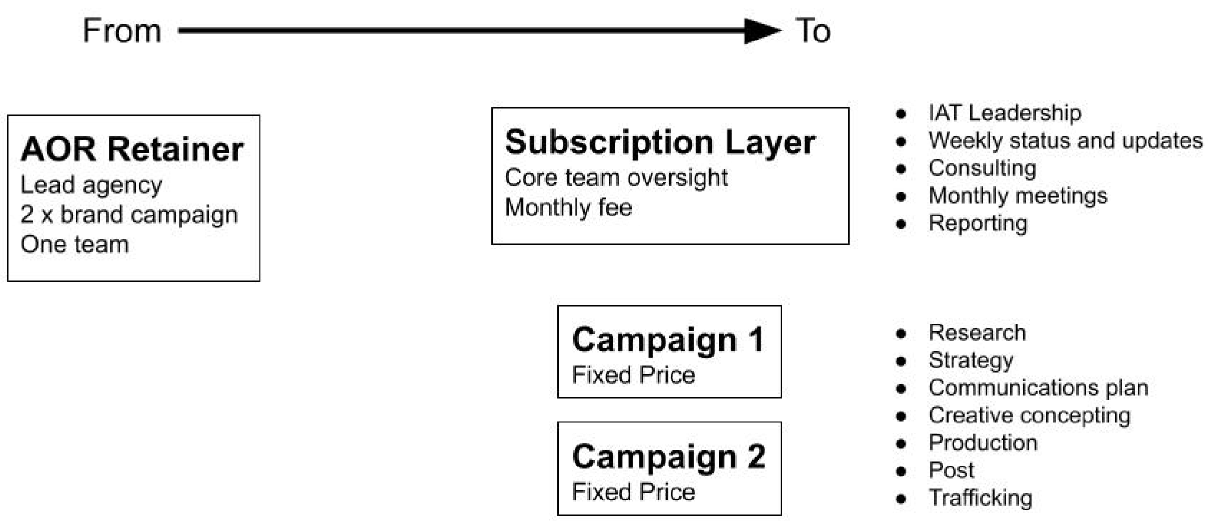
Clearly defined timing and deliverables. It is essential that the type and quantity of services and deliverables remain largely consistent each period. Throughout the term, there should be a monthly requirement for these services and deliverables. In the context of SaaS models, buyers should verify that the model is accompanied by a robust SLA. This agreement should clearly outline each party's responsibilities and cover aspects like response to downtimes, ensuring a comprehensive understanding of responsibilities and commitments from both sides.

How to Calculate:

> Agency and advertiser define which regular or standardized services are required each period (e.g.,, number of briefs, meetings, reports, presentations)
>
> Marketer assesses the value for these regular services, which will either be in the form of efficiencies (more efficient/time savings than doing it internally) or effectiveness (for specialist skills that are required regularly but do not justify hiring staff in-house). Agency to assess the effort or resources to deliver. For SaaS-based models, assess the set-up costs and maintenance requirements of the platform.

Example

In a normal AOR model, a number of work streams would be combined into one model, typically FTE-based. However, if priorities change significantly, scope and time tracking can become difficult. If the workstreams are broken out into those that relate to projects and those that fit under a subscription model, it becomes easier to identify how the work streams are performing.



Pros and Cons

Pros	Cons
Marketers know what deliverables they will receive monthly for a pre-agreed price.	Can lead to multiple SOWs for AOR engagements; necessary to consider the ability to manage volume of agreements.
Alternative model for agencies to recover capital investments.	Not appropriate if technical work requires frequent modifications.
Provides ability to separate work streams that have different parameters and allows easier tracking of services and deliverables.	Not appropriate for work where there are frequent scope changes or where the workflow fluctuates from month to month.
Easy to budget and allocate resources.	Not appropriate for periods of six months or less or for one-off projects.
Can be expanded based on needs.	May be burdensome to set-up.

As with all scope definitions, it is important to agree the outputs expected (the quantity and quality required) as well as the parameters and conditions that affect their delivery. Some key points to consider for a successful model:

- **Set-up:** Determine how much effort is required.
- **Relationship management:** Subscription models are useful for relationship management (regular meeting attendance and general access for consulting), normally from a small number of agency individuals.
- **Meetings:** Determine the level of regular interactions required (e.g., monthly basis) and separate from output-based scopes of work (status meetings, reporting, points of contact).
- **Term:** Most benefit is gained when the regular services are delivered each month over an annual period. It should be easy for either agency or advertiser to start or stop at short notice.
- **Personnel involved:** Ideally, this should use the same consistent personnel who are the decision-makers on both sides. This will lead to better alignment and agreement.
- **Regular assessment:** The service-based model is flexible and allows for deliverables to be added or removed

4. Commission:

Description:

Compensation is based on a percentage of the media spend. Multiple percentage levels may be established for different media types to recognize the complexity or effort required of each media type such as network or spot TV, radio, social, out of home and digital.

Proposed Common Name (s)	Names in Use (AKA)	Additional Characteristics
Commission	Percentage Markup Media Commission	May include a declining percentage rate as advertiser's spend increases. Commission amount paid may be calculated on the actual media spend - or planned media spend.

Definitions:

- **Gross Cost** is the price traditionally listed by the media owner. In cases of TV and radio, gross costs are quoted to buyers, and it includes a default amount of 15 percent as historically reserved for agency commission.
- **Net Cost** is the cost that the agency will pay the media vendor on behalf of the advertiser. The amount excludes any agency commission. Net Cost is the most common metric used in today's media environment.
- **Industry Variations:** Media commission models may vary by sector. Some advertisers have shifted toward alternative compensation models like hourly rates or hybrid models that augment the commission. A hybrid of commissions plus a fixed fee, hourly, or performance-based arrangements are often used together.

Best Application:

- When the services are limited to media planning and buying.
- Short-term or seasonal engagements between advertiser and their agency.
- Flexibility is needed when an advertiser's spend changes frequently. The model has the ability to pivot quickly with market variations without renegotiating staffing plans and fee amounts.

Core Components of Model:

Media dollars, percentage agreed by media type.

How to Calculate:

The fee is calculated as a percentage of the media spend. For example, if an agency commission is agreed at 15 percent and the advertiser spends $100,000 on media placements, the agency would receive $15,000 commission. Commissions can be calculated as a percentage of the gross media cost or an equivalent percentage calculated as a markup on the net media cost. Using historical commissions, a 15 percent commission on Gross Costs is the same as a 17.65 percent markup on the Net Cost.

Pros and Cons

Pros	Cons
Simple to understand.	Media agency compensation is tied to the cost of media. In times of rising inflation, the agency could be disproportionately rewarded; however, the reverse is true in times of media deflation.
Ease of implementation and administration.	The agency could be perceived to be motivated to recommend increasing media spend levels.
Flexible and variable for when budgets are uncertain and spending levels change frequently. Spend more, pay more; spend less, pay less.	When media is canceled by the advertiser, agencies may have to fund staffing resources that are not covered by commission revenue.
One inclusive fee provides greater flexibility, as agencies will execute all agreed-upon media-related services within the commission structure.	Agency compensation and resourcing may be difficult to predict when media budgets are not established annually or need to change frequently.
	Commission fee rarely covers all services required by most advertisers, which then requires additional compensation models.

Key Factors for Consideration: Understanding the complexity and effort of each media type is important to negotiate commission rates. It is common to have a tiered commission structure, with different commission rates for each type of media. This accounts for differences in complexity and the workload required for the agency to manage the media investment. Media commission levels should be reviewed periodically and when there is a shift in spend from one media type to another.

B. Category 2: Input-based Models

The most common models involve advertisers paying agencies based on the time the agency estimates will be spent by its staff for a specific scope of work. The fee is determined through hourly billing rates, categorized by role or level, or using a cost-plus method by person or role. These methods result in a price per hour, price per day, or the annual or monthly equivalent for each full-time staff equivalent.

For long-term engagements, time-based input models are often structured as retained teams, with compensation paid in installments throughout the scope's duration. The fee agreement is typically fixed, aligned with an agreed statement of work. In other cases, the fee is reconciled based on the time spent or the total resources utilized. The retained team is alternatively referred to as a retainer, core team, allocation model, or project team.

The most common methods in use:

1. Hourly Rates:

Description:

Fee is based on the unit rate times the hours or, alternatively, the days worked. Hourly or day rates can be either by title, level, a single blended rate or a blended rate by level or department.

Proposed Common Name (s)	Names in Use (AKA)	Additional Characteristics
Hourly Rates	Ratecard Hourly FTE Model Staff Plan	The fee agreement may be fixed, aligned with an agreed statement of work, or reconciled and adjusted based on the resources utilized.

Best Application:

Hourly rates can be a suitable pricing model when there's uncertainty or potential changes in a project's scope. Hourly rates offer flexibility and simplicity in calculating a fee. For highly customized or specialized advertising services, agencies can use hourly rates to reflect the time and expertise required. Consulting services, such as projects involving testing and experimentation for campaign effectiveness, or ad hoc work streams with variable workloads are also well-suited for hourly rates. Hourly rates provide an adaptable compensation structure that doesn't fit neatly into other predefined models.

Core Components:

Staff positions, hours per position and hourly rates by position.

How to Calculate:

Rates can be established using a cost-plus (see Cost-Plus section) calculation or by referencing competitive market rate data. Comprehensive data on competitive rates is accessible through the 4As survey report, fielded every two years. You can find more information and purchase the 4A's 2023 Billing Rate Benchmark Survey HERE.

Pros and Cons

Pros	Cons
It's comfortable and familiar and easy to understand.	The focus is on the agency costs rather than value created.
Helps agencies predict what resources will be needed to forecast revenue and costs.	Discourages process efficiencies to reduce time spent.
Resources are easily adjusted when the scope is not defined upfront and can flex with changes of work.	Too much focus on individual rates can create friction during a negotiation.
Well-known in the industry and easy to set up.	Doesn't align to technological advances or promote meeting the requirements of the advertisers business.
The calculation of the fee is easier to validate by advertisers with available benchmarks. 4A's 2023 Billing Rate Benchmark Survey HERE.	There's an expectation that an agency should fit into specific ranges versus accounting for differences in talent and technologies.

2. Cost-Plus:

Description:

Cost-plus pricing is a model where the price is determined by adding a mark-up on the staff costs to cover agency operations and profit. The calculation is complex and relies on the agency calculating its forecasted direct labor costs and then applying a percentage to recover its operation expenses, typically referred to as overhead costs. Then a further markup is added to allow for a reasonable profit margin. The result of the calculation can be expressed as a multiplier.

Note: overhead costs and profits are not fixed amounts. Overhead varies as a function of direct labor costs. The more time and costs required, the larger the amount of overhead applied.

Proposed Common Name (s)	Names in Use (AKA)	Additional Characteristics
Cost-Plus	Multiplier	N/A

Best Application:

- The advertiser prefers to pay for a defined group of people representing the talent and time expected to be deployed on their business.
- The advertiser prefers a predictable cost stream. This model sets the amount to be paid each month through the year.
- The advertiser and the agency agree that a fee, calculated by role or by title is the best way to hire agency resources for the account (Hourly Rate model also works here).
- The agency and the advertiser agree the fees will adjust, up or down to reflect changes in the size or level of the team. (Hourly Rate model also works here).
- The deliverables are difficult to define in advance and are shifting often.

Core Components:

To prepare a fee proposal using this model, the agency will estimate the resources and time required to deliver the scope of work. The price to the advertiser includes employee compensation costs and a markup for overhead and an agreed profit margin.

How to Calculate:

Position and Seniority of Talent: Positions and seniority (junior/mid/senior) are identified and agreed upon with the advertiser. This agreement drives the costs that the agency will apply in the fee calculation.

Direct Labor Costs: Includes employee salary, benefits and taxes for the time each staff member is required to work on the Advertiser's projects.

Overhead Costs: Defined as the Agency expenses that are to support the running of the Agency's business and not included in the direct labor costs (above). Overhead is calculated as a percentage of Agency operating expenses divided by direct labor costs. The main components of overhead costs are indirect payroll and related expenses, such as management, human resources, and finance, technology expenses, general office expenses; professional fees, and space and facilities expenses.

Direct Client Expenses: Non-reimbursable, out-of-pocket expenses that are directly attributable to an advertiser's account. These may include travel costs, entertainment, research, presentation costs, and storage, legal or courier fees.

Example

If the agency determines that the labor costs of the team required to deliver the SOW is $350,000, and applies an overhead rate of 100 percent and a profit margin of 20 percent, the fee paid by the advertiser would be $875,000.

Direct Labor x (1 + Overhead %) / (1 - Profit Margin %)

The math of the model is fairly easy to understand and communicate, which facilitates reaching an agreement easier. However, the specifics of what costs are in direct labor versus overhead requires detailed discussions between the advertiser and the agency as there is no standard definition in the industry.

The following definitions and principles need to be discussed and agreed upon upfront:

1. overhead and profit rates
2. reconcilable or fixed fees
3. annual billable hours
4. what to include in Direct Labor versus Overhead (payroll taxes, benefits, bonus, pension etc.)
5. reporting frequency

If an agreement can't be reached easily, benchmarks may help resolve this issue.

Pros and Cons

Pros	Cons
It is familiar and has been in use since the 1990s.	Discourages agency investment in tools and initiatives to lower required resources to deliver SOWs.
Predictable cost stream and easy for advertiser to budget each month.	It ignores the concept of competitive market pricing, relying instead on a formula.
Helps agencies predict resources, revenue, and cost.	Similar to Hourly Rates, the model focuses on costs rather than the value of the services.
Has built in flexibility where components are easily adjusted to reflect changes in the workload which helps manage resourcing talent.	Very difficult to benchmark the relative costs of overhead and direct labor costs. There is no standard benchmarking that evaluates important factors such as the size of an agency, the type of services it offers, or the economics of the market where it is based.
As with hourly rates, the scope isn't easily defined upfront, the level of effort is easily adjustable.	Can create friction during a negotiation when definitions are not agreed upon upfront.

When set up correctly it can flex with salary inflation pressures to retain agency talent.	Burdensome to set-up and maintain. Requires education and significant time for agency and advertiser to agree and document their understanding.
	Overhead is not universal. The overhead is different across countries and types of service, This complicates the negotiation.
	Staff salaries can not be disclosed, making the largest cost element of the fee difficult to evaluate.

C. Category 3: Performance Compensation

This is an advanced approach to compensate agencies for the services provided, which is associated with performance. There are two primary models. One is Outcome Compensation which is based solely on achieving the advertiser's primary business goals. This eliminates the use of hourly rates, cost-plus or asset-pricing. More common is Incentive Compensation which is incremental compensation to a base fee. It rewards the agency for its service and for helping the advertiser achieve certain business results.

1. Incentive Compensation

Proposed Common Name (s)	Names in Use (AKA)	Description	Additional Characteristics
Incentive Compensation	Agency Performance At Risk Compensation Outcome-Based Bonus/Malus Risk/Reward Pay for Performance Performance-based remuneration	In addition to a base fee agreement, a portion of the total agency compensation may be generated through advertisers business results and/or agency performance. Advertiser's business metrics are tied to the advertiser's financial performance, volume performance or other metrics tracked by the advertiser. In some cases, the agency agrees to accept a risk to its base compensation for achieving the agreed metrics.	Agreed up-front and tied to well defined and tracked KPIs. Reviews and results should be shared monthly or quarterly. Metrics should be within agency's control, in return for the opportunity to earn more compensation Deals with downside risk will provide for greater upside when results are achieved. Evaluations may include customer satisfaction surveys and agency agreed upon metrics.

Description:

The model involves incremental compensation (or risk) paid by the advertiser or refunded by the agency. Metrics are aligned with the business goals of the advertiser that can be affected by the services by the agency. This compensation structure is typically incremental to a base fee determined by another compensation model.

Best Application:

When there are clear shared objectives that can be translated into metrics that are tracked and both parties are aligned on how to achieve the objectives. The most critical elements of a successful incentive compensation plan include a clear definition of what success looks like and alignment on evaluation metrics prior to implementation. These include:

- The metrics are aligned with the day-to-day mission of the marketer.
- The targets are achievable.
- The targets are within the agency's control or influence.
- Advertisers share metrics on a regular and agreed upon frequency.
- All stakeholders at the advertiser are aligned with paying a bonus to the agency.

Core Components:

- Targets are based on metrics the agency can control or at the very least significantly influence. If not, agencies will have little appetite to pursue the plan.
- There is mutual agreement on:
  - Specific metrics.
  - Performance targets.
  - Evaluation/measurement methodology.
- Performance against targets is reviewed regularly, at minimum quarterly.
- Targets have incremental award levels, avoiding all-or-nothing cliffs.
- Advertisers are transparent in sharing past, current and projected performance against metrics in use.
- Bonus for the full incentive payout is accrued within the advertiser's budgets.
- Program is implemented only once the agency and advertiser have worked together for a sufficient period (often at least one year).

Example – Sample Evaluation Profile

Metric Type	Weighting	Metric
Advertisers Business	10%	Sales growth
Marketing Program	50%	1. Total Brand Recognition and Total Brand Regard 2. Lead generation/Lead delivery
Agency Performance	20%	360 degree delivery/relationship assessment via Aprais or similar tool
Agency Performance	20%	Media savings and optimization delivery

Sample Payout Based on Evaluation

Score (out of 5)	Implication	Impact on Agency Revenue
0 to 1.9	Agency fails to meet all objectives	Agency rebates revenue to advertiser up to 5%
2.0	Agency meets minimum objectives	Agency rebate is 0%
2.1 - 2.5	Agency meets minimum objectives	Agency revenue increases up to 2.5%
2.6 - 3.5	Partially exceeds objectives	Agency revenue increases up to 5%
3.6 - 4.5	Exceeds objectives	Agency revenue increases up to 7.5%
4.6 - 5.0	Outstanding performance	Agency revenue increases up to 10%

Pros and Cons

Pros	Cons
Better performance = higher pay	The ability to establish and agree on baselines against which to measure performance can be challenging and requires transparency on the part of the client.
Drives desired behavior.	The agency's work must be in the market to generate results.
Shared accountability/in it together.	When things change it can call into question the KPIs originally established.
Demonstrates mutual trust.	Takes time and effort to administer and maintain.
Can drive efficiencies – clear on upfront/not reworking.	Potential for struggles with budgeting on the advertiser side – holding budget for something that might not happen and can't invest elsewhere.
Shows what's working and what's not working.	Can be too many elements out of the agency's control. Typically no single attribution that links to agency performance; usually multiple driving forces.
Provides agencies with a better view into the advertiser's businesses.	The emotion of "paying agency too much" if it over-delivers.
Forces advertisers to prioritize where they want agencies to direct their focus.	

Consideration of risk-reward compensation involves evaluating the potential outcomes and consequences associated with a particular compensation structure. It's important to review the inherent risks to determine the most suitable arrangement for motivating and aligning the interests of individuals or teams. It is essential to ensure that the agency has control or influence over the agreed metrics, fostering accountability and fairness.

Additionally, the risk element of an incentive program and chance of a downside should be carefully weighed, as an improperly designed compensation program can backfire with the agency reducing levels of service when a downside is inevitable. Regular communication of the metrics on a monthly basis, using the same metrics that marketers are incentivized by, is crucial for transparency and alignment.

The program's design should be a collaborative effort involving the teams responsible for owning and delivering the work. Metrics that are too distant from the goals of the marketing team or unrelated to the actual work being completed may undermine the effectiveness of the compensation structure. Striking the right balance can lead to a compensation model that not only motivates but also contributes to overall organizational success oft both the agency and the advertiser.

Sample Approach

Discover (~4 weeks)

Business Assessment

- Review historical trends.
- Review existing metrics and models.
- Review in-market data.

KPI Exploration

- Identify possible KPIs.
- Map the above possible KPIs on Performance/Attribution grid.

Data Mapping

- Map data sources to selected KPI possibilities.
- Identify marketing investment KPIs and external factors.
- Establish technical requirements for tracking.
- Establish roles and responsibilities for tracking.

Compensation Principles

- Full versus partial performance.
- Single KPI versus weighted average.
- Performance caps (top and bottom).
- Performance bands/slope.

Design (~4 weeks)

KPI Selection

- Select KPIs.
- Refine KPIs based on technical feasibility.

Compensation Model Design

- Jointly design incentive model based on Performance-based remuneration principles agreed upon during Discovery.

Calibration Stage Design

- Finalize tracking.
- Design analysis methodology.
- Define timing of calibration stage (depending on data volume and variability).

Intermediate Compensation Model

- Agree on intermediate compensation model to be put in place during calibration period.
- Sign off on intermediate compensation model.

Calibration (~3-12 months)

KPI Tracking

- Ongoing tracking of KPIs.
- Exploratory trend analysis.

Compensation Model Simulations

- Enter test data into compensation model.
- Run compensation simulations.
- Assess stability/sensitivity of financial outcomes.

Compensation Model Calibration

- Recalibrate compensation model if necessary.

Causal Analysis

- Build test models based on real data.

Implementation (~4 weeks)

Contractual Language

- Agree on timing of PBR contract.
- Agree on measurement timing (e.g.,, quarterly).
- Write up an agreed and calibrated compensation model in contractual language.
- Sign off.

Management

- Regular reviews of performance against KPI targets.
- Ongoing assessment of KPI metrics and target levels.
- Optimization or recalibration as required.

D. Hybrid Models

Description:

Hybrid models use multiple compensation methods within a single relationship and possibly within a single scope of work. If one model doesn't fit the situation, then using multiple models may be the best solution. Under hybrid model scenarios, there is usually a base model, e.g., Fixed Price, Commission, Hourly Rate or Pre-Negotiated Price List and then other models can be added on to the base model when a different method would be more optimal for the other service types. Many of the models listed in this paper complement each other to create 'hybrid" models.

Best Application:

When you need flexibility or the type of work varies greatly. They are particularly well-suited for large complex relationships and become essential when a single compensation model cannot adequately address the complexities of the work. In such instances, employing model A for one service and model B for another service can optimize outcomes. For example, in an agency relationship some of the work is highly predictable, while other services will be variabile or unknown at the time of scoping. In this instance, a Subscription model or retainer could be used to include resources for managing account service, strategy, and ideation, and a Fixed Price or Pre-negotiated Price List model would be more advantageous for execution of specific deliverables or project-work.

Hybrid scenarios are also useful for risk tolerances. Risk scenarios include attempting innovative solutions or entering new markets. In such cases, implementing a Fixed Price model for a segment of the relationship can mitigate marketers' risk, while Incentive Compensation may offer incentives for the agency for delivering outstanding work.

How to Calculate:

See specific models above.

Example

Most common combinations:

1. Media Commission (planning/buying) + Fixed fee for strategy, creative (may include certain reporting)
2. Core Retained team + Pre-negotiated Price List
3. Hourly Rates + Subscription + Incentive Compensation
4. Core Retained team + Fixed Price projects
5. Cost-Plus + reconciled deliverables + Incentive Compensation (quantitative and qualitative)

Pros and Cons

Although the hybrid model brings the best of multiple models together, it can have some downsides. On the positive side, using multiple models provides flexibility. In most situations, a combination of multiple models creates an overall compensation model that fits the business needs more effectively compared to one single model. But one risk in the hybrid model is that confusion can be created if the teams don't know which model is in place for a given project or solution. The advertiser and agency teams must align on compensation strategies and how to manage each project/workstream before, during, and after the project to avoid any misalignment.

Pros	Cons
Not boxed into one way of doing things.	Requires a lot of effort up-front to determine which models work best for different types of work.
Provides more flexibility to both the advertiser and agency. Can look for efficiencies together.	Harder to reconcile and manage the work because there are multiple approaches in use.
May be able to provide more cost savings: tactical work is more cost-effective and strategy more high-level.	Teams can forget which model is in place for various types of work..
Caters to the needs/requirements of the business to be able to mix and match.	Must consider – how many models is too many to manage.
Works well for media agencies.	Multiple models creates more negotiation across more items.
Works better for integrated models.	

V. Evaluating the Right Model for an Engagement

This section introduces an approach for determining what model might be right for an advertiser-agency relationship. The scoring will vary by advertiser based on the needs and preferences of that advertiser. The evaluation framework is a simple Pugh matrix designed to help rank multiple options based on the need of the scope of work or the engagement. There is no "one size fits all" solution, and this tool helps align specific needs.

VI. Characteristics of a Good Compensation System

This section introduces an approach for determining what model might be right for an advertiser-agency relationship. The scoring will vary by advertiser based on the needs and preferences of that advertiser. The evaluation framework is a simple Pugh matrix designed to help rank multiple options based on the need of the scope of work or the engagement. There is no "one size fits all" solution, and this tool helps align specific needs. Use this example worksheet to evaluate the compensation system you are considering.

Characteristic	Explanation
Simplicity	Easy to understand
Administration	Easy to administer
Fairness	Fair to both advertiser and agency
Appropriateness	Is designed for the work at hand
Agility	Ability to evolve over time, working across multiple types of engagements
Cost-Appropriate	Neither over-pays or under-pays
Focused	Aligned to the advertiser's goals
Drives Best Behavior	Encourages optimal performance by individuals
Timeliness	Does not delay getting the work done
Channel Neutral	Does not promote the use of one marketing channel versus another

Scoring Recommendations:

Grade each of the characteristics on importance to the advertiser, or the agency.
(5 = Most Important; 1 = Least Important)

Score each model against the 10 characteristics.

- 5: maximum score (high correlation to the characteristic)
- 1: minimum score (poor correlation to the characteristic)

Resultant Score (Sum of the Following):

Characteristic 1: Importance x score
Characteristic 2: Importance x score
Characteristic 3: Importance x score
.
.
.
Characteristic 10: Importance x score

= TOTAL SCORE FOR THE MODEL

The evaluation framework allows an advertiser to score each model based on its own ranking of characteristics and how the model scores. Scores will differ by advertiser based on its individual marketing efforts, budgets, and channels.

VII. Strategies for a Successful Transition or Implementation

For advertisers seeking to optimize their compensation models or embrace a new approach, here are suggestions for effectively navigating the transition:

- **Identify owners:** Identify owners from both agency and advertiser to administer the model and ensure compliance.
- **Adequate preparation:** Do the legwork. Everyone tends to want to jump to the end and negotiate pricing, but the key is aligning on goals, definitions, and assumptions.
- **Understand and align to goals and requirements:** Actively listen to each other's needs and concerns and have them guide the solution.
- **Present the value proposition:** Align on the benefits (speed to market, price visibility, flexibility).
- **Negotiate and compromise:** Flexibility is important. Find areas where the agency and advertiser can meet in the middle and compromise. Be open to adjusting pricing and the requirements to accommodate constraints. Be open to addressing the specific needs of both parties.
- **Demonstrate value:** Align on the benefits. Mutually agree on how the model will address the business challenges and pain points to deliver on each other's business goals.

- **Finalize:** Document everything. Once both parties are aligned on the terms, ensure that the agreement is well-documented in a contract. This should include definitions, pricing, scope of work, deliverables, timelines, templates and any other relevant details.
- **Training and rollout:** Develop a roadshow to introduce the model, including its usage, process, and workflow. Continue training throughout the engagement for new employees and any updates/adjustments.
- **Ways of Working document or SLA:** Create and adhere to a Way of Working document, with a focus on the change management process.
- **Continuous communication:** Maintain open lines of communication and address any concerns or changes as they may arise. Conduct monthly reviews to assess progress and adjust the agreement as needed.
- **Software to assist:** Create tools to enable the pricing model within a software platform to facilitate adoption, ensure compliance, and use as reference.
- **Flexibility:** Acknowledge the need for flexibility, especially in the first year. Establish a mechanism to modify definitions, prices, and contract terms. Add items, such as new marketing assets, as required.

Like any behavioral change, careful oversight is crucial during the initial stages until the model matures.

VIII. Summary

While there are many choices of remuneration models available, the committee's recommendation is to prioritize those models that yield the most favorable outcomes for both the engagement and the relationship, with an aim to drive advancement in remuneration practices within the industry. This paper comprehensively outlines definitions, optimal applications, advantages, and disadvantages of various models, providing valuable insights for successful implementation alongside a practical evaluation tool. We underscore the significance of agencies and marketers embracing experimentation, advocating for a test-and-learn approach through the utilization of smaller projects.

In summary, this quote from the WFA Global agency remuneration trends update of 2022 is worth considering.

> “Ultimately the chosen remuneration model will dictate the type of relationships clients want to have with their agencies. A focus on outcomes instead of input enables agencies to become integral partners to a client's growth and performance, that's why it's great to see that more clients want to reward not just performance but also quality through sustainability, diversity, and talent,” said Laura Forcetti, Director of Global Marketing Sourcing Services at the WFA. You can view the full article here.

IX. Task Force Members

Task Force Chairperson (representing both ANA and 4As members): Rick Brook

4A's Leadership

Name	Title	Company Name
Mollie Rosen	Executive Vice President, Strategy, Insight and Innovation	4A's
Nicole Rizzo	Senior Vice President, Business Intelligence and Insight	4A's

4A's Members

Name	Title	Company Name
Michael Asaro	SVP, Director, Client Operations	WPP
Mark Bachmann	Partner/Owner	Marcus Thomas LLC
Scott Chapin	Chief Operating Officer	Marcus Thomas LLC
Raphaela Cristiano-Davis	SVP, Finance Managing Director	Eversana Intouch/ Chicago
Andrew Graff	Chief Executive Officer	Allen & Gerritsen
Erwan Guillou	Chief Financial Officer	TBWA\Chiat\Day
Sharon Napier	Executive Chair and Founder	Partners + Napier
Elaine Naum	SVP, Managing Director	Partners + Napier
Mark Piazza	Chief Financial Officer/Chief Operating Officer	Oxford Road
Richard Tan	Partner and Chief Operating Officer/Chief Financial Officer	FIG
Rick Weber	Chief Commercial Officer	Interpublic Group of Companies

ANA Leadership

Name	Title	Company Name
Bill Duggan	Group Executive Vice President	ANA
Greg Wright	Senior Vice President, Brand and Media	ANA

ANA Members

Name	Title	Company Name
Denis Budniewski	Associate Vice President, Marketing Investment and Transformation	Verizon
Amol Chopra	Assistant Vice President, Strategic Sourcing	Travelers
Paul Haggerty	Global Marketing Operations and Partnerships	General Motors
Rene Lassauzet	Head of Brand and Creative Excellence	Nestlé
Melissa Lewis	Sr. Director Target Creative Operations	Target
Kwan Yim	Director, Head of Global Agency Management	Citi

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