# AGENCY REMUNERATION

## A best practice guide on how to pay agencies

**Joint industry guidelines for marketing professionals in working effectively with agencies**

IPA ISBA MCCA PRCA

# IT HAS BEEN SAID THAT THE SERVICE MOST AGENCIES PROVIDE IS NOT DEFINED BY ‘ART’, NOR IS IT DEFINED BY ‘SCIENCE’,

## AND MOST WOULD AGREE IT FALLS SOMEWHERE IN BETWEEN, MAKING THE AREA OF REMUNERATION DIFFICULT.

While agency services that are process driven are relatively easy to cost, it is the ‘idea’ or ‘magic’, for which agencies are mostly renowned, that is much more difficult to value or quantify. It is this crucial aspect, which has the power to transform the client’s product, service or corporate brand, that agency remuneration systems must get to grips with.

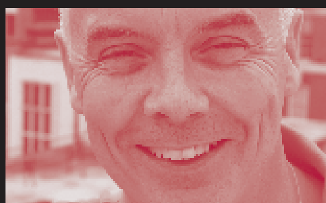
Many businesses, which have previously been focused on inputs and costs, are now beginning to re-align their focus on top-line growth and this means winning new customers, building strong relationships with them and retaining their loyalty to increase revenues i.e. focusing on the growth of their key asset – their brand.

Looking at a company such as Coca-Cola we can see the importance of this focus on the brand. The difference between its physical asset value and its market capitalisation is striking: according to Interbrand, Coca-Cola’s physical assets are only 46% of the value of the company. The remaining 54% are intangible assets – most importantly the brand.

That is why we are encouraged to see the area of Payment by Results being discussed in this guide, as well as the licensing of the intellectual property that agencies create. We should strive to reach remuneration agreements that reflect the contribution that creativity makes to a client. The approaches that do so are eminently more fair, equitable and appropriate than just relying on the traditional areas of commission and hourly fees.

We hope this guide will help both clients and agencies come to a fair solution that rewards inputs, outputs, and of course outcomes in terms of the brand. If we do this successfully it will ensure future growth and success for both sides of the business.

GRAHAM KEMP
MCCA - Chairman
The Marketing Store - CEO



CRISPIN MANNERS
PRCA - Chairman
Kaizo - CEO

DAVID PATTISON
IPA - President
PHD Media - Chief Executive

# AT THE END OF THE DAY, ADVERTISERS AND AGENCIES WANT THE SAME THING: PROFITABLE GROWTH IN THEIR BUSINESSES.

DEBBIE MORRISON
ISBA - Director of Membership Services

ISBA receives many calls from advertisers seeking guidance on the development of agency remuneration models. In fact we also receive calls from many agencies asking for advice on what clients are looking for in their negotiations.

It seems everyone is searching for remuneration Nirvana: that perfect balance of cost effectiveness and fairness – a solution which is motivational enough to inspire business-transforming solutions and to encourage the growth of the advertiser and agency businesses … and all this built on a perfectly transparent platform.

Much has changed in terms of remuneration practices over the last decade from the relatively simple days of commission, where virtually no negotiations took place on price, to the more complicated fee-based arrangements of today, which now constitute the majority of payment arrangements.

We live in times where everything is negotiated. Many companies are also handing over responsibility for agency negotiations to the professional procurement teams within their organisations. These specialist commercial teams tend to be more analytical and make greater demands on agencies to justify remuneration proposals and practices. Whilst they may demand greater transparency, they are also more likely to understand the agency and its needs as a business, not just its needs as a communications specialist. At the end of the day, advertisers and agencies want the same thing: profitable growth in their businesses.

So we felt that the marketplace would welcome a little clarity in terms of what the current array of practices are, a little guidance on best practice tools and techniques for negotiation, and a little inspiration to help influence the development of future models. Hence this guide.

As with all negotiations, preparation and understanding of the subject are key to the development of a win/win situation, so we are delighted to commend this new guidance to you, which we do hope will help clarify and inspire better practices.

We will continue to monitor trends and develop our thoughts on remuneration practices and work with both advertisers and agencies to help create more effective remuneration models into the future.

# WHY DOES THE INDUSTRY NEED A NEW GUIDE ON AGENCY REMUNERATION?

Because it isn't a straightforward issue any more. We have progressed from the age of commission to the age of fees to the age of ***what on earth are we going to do next?***

And because both sides are worried. Clients have serious concerns about cost. There is pressure on every aspect of the marketing budget, and the cost of all agency services is in focus – especially from the procurement function. Clients are seeking greater accountability. Agencies face an annual battle to retain revenue levels. They are equally worried about profitability, and indeed about the long-term future of the industry.

In the commission era, growth or reduction in media spend was a self-regulating mechanism. Agencies did not have to justify higher revenue when ad spend went up, nor did they expect any consideration if it went down. Clients were not obliged to make any special provision for paying the agency. Their revenue was automatically generated by media spend. The move to fees has changed all that. Now agency remuneration has to be negotiated at the outset, and on an annual basis thereafter. The following sections set out a 10-point checklist of qualities shared by best practice remuneration agreements, plus a summary of the principal payment systems, with notes on the advantages and disadvantages in each case.

## TEN-POINT CHECK LIST

The best client–agency remuneration agreements share a number of qualities:

**1. Simple to understand and easy to administer**
A remuneration agreement should be simple and clear enough for all involved to understand and execute. A complex and poorly understood agreement may cause too much attention and energy to be diverted to administration and conflict resolution. This does not encourage the development of great advertising or marketing ideas.

**2. Fair to both client and agency**
A client should expect to pay, and an agency should expect to earn, equitable remuneration, including a fair and transparent profit.

**3. Aligning client and agency interests and priorities**
It is important that the remuneration system be designed to align the agency's aims with the client's priorities and needs. Both parties should feel they are working toward a common goal.

**4. Finalised before agency resources are committed**
There is usually an urgency to get started in new relationships. To avoid unnecessary risk to the agency and the client, work should not commence until the terms of the agency agreement are clearly understood by both parties, and heads of agreement at least have been signed.

**5. Recorded in a ratified client–agency contract**
A written contract provides reassurance and clarity over time. If there is no clear written agreement there is no basis for dispute resolution. New versions of **industry contracts** are available. It is important that all parties understand the contract and the obligations it imposes.

**6. Flexible enough to accommodate possible changes in the future**
It is important that remuneration terms remain flexible to accommodate significant changes in scope of services, budgets, timing of services, mix of resources, new products being developed, new and foreign markets, changing corporate objectives, and product, service, or corporate brands with limited or erratic spending.

**7. Involving senior management stewardship, with principles clearly communicated to the teams on both sides**
Senior managers who are responsible for the effectiveness of marketing communications should be accountable for establishing the objectives and operating mechanics of the agency remuneration system. Those working on the business in both organisations should make themselves responsible for understanding the detail to avoid conflict in their day-to-day dealings.

**8. Capable of standing the test of time and being understood by any future marketing director when he/she joins**
As a result of adopting the guiding principles listed above, both client and agency can expect a remuneration agreement that endures over time. It is inevitable that a client's business plans will change from time to time, and in turn, impact the agency's scope of service. But the client–agency remuneration agreement should be robust enough to survive.

**9. Based on agreed and understood terms and definitions**
Agency management and their client counterparts should employ the same words and phrases when discussing agency remuneration arrangements (see OVERVIEW OF THE KEY REMUNERATION METHODS page 4). The terms used can vary in meaning and care should be exercised to ensure that everyone is actually talking the same language.

**10. Specified tracking and review dates**
Work being done, and expected to be done, should periodically be compared with the original scope of work and service requirements. This needs to be done as part of a formal review and evaluation at least annually. It is recommended that these evaluations are done six monthly, and always on a 360° basis.

# WHAT'S ON THE MENU AT PRESENT?
## OVERVIEW OF THE KEY REMUNERATION METHODS

## 1 COMMISSION

**How it works**
This system of basing the agency's remuneration, for advertising, on the commission earned from the media owner is still the basis of most media agreements, and about a quarter of agreements for creative agencies. Historically, in the UK, 15% commission on gross media cost was considered the norm for a 'full service' arrangement – when creative and media were provided by the same agency. The 15% agency commission on gross media cost actually amounts to the net cost plus 17.65%, hence the mark-up on non-media costs such as production, so that the commission equals 15% of the gross billed to client. After the emergence of media independents, the agencies responsible for developing the creative work bought less and less media. Today ('Paying for Advertising' (PFA) 2003 figures) only 6% of media is bought by the agency producing creative. This split between creative and media agencies allowed clients the flexibility of negotiating on commission level, if they had economies of scale, or less than full-service requirements. Commission is still the sole basis of 22% of agreements, and used in conjunction with a fee element in a further 14% of cases. Most companies still paying commission use some form of stepped arrangement or sliding scale, and the amount of media commission retained by the agency or rebated to the client is by negotiation.

**Advantages**

- Simplicity in the case of mainstream advertising. Commission rate can be negotiated according to the level of service to be provided.
- Easy to calculate and administer – especially in certain cases, such as global multibrand accounts.
- Both parties are focused on the quality rather than the price of the service.
- Commission functions as a crude form of Payment by Results. The higher the media spend, the more the agency earns. If the client does not run any advertising, the agency receives no income.

**Disadvantages**

- Based on volume of media spend, not scope of work. There is no reflection of agency income or output, which presents a potential problem for both sides.
- Equally, because it is volume-based, the system is inappropriate for digital agencies and others whose activities do not relate to media.
- Because the commission is paid by the media owner, agencies might be seen to be promoting media expenditure in their own interest, and not being media neutral, as opposed to creating a 'communication solution', which might only have a small media expenditure component.
- Cancellations of spending (often at the last minute) can have a severe effect on agency income with little or no opportunity to reduce costs.

## 2 RESOURCE PACKAGE FEES

**How it works**

Resource Package Fees (RPF's) – sometimes known as Retainer Fees – were developed as an appropriate way to remunerate creative agencies in the period following the splitting out of media planning and buying from creative. RPF's now account for around two thirds of all agency agreements and in nearly all cases, the 15% media commission is all rebated to the client. Fees are agreed in advance to cover a period of activity (normally one year), and are paid monthly. Typically a RPF arrangement is based on an agreed detailed scope of work and resource plan for a defined period, seeking to reflect the likely workload requirement of the agency. RPF's are usually based on staff costs (i.e. so many people at X% of their total working year), an allowance for overheads, and an appropriate allocation for profit.

The scope of work and agency resource plan should be set out in detail, with the various phases of activities separated out in terms of the input required from people with the required skill sets and seniority to produce deliverables. This will produce a schedule of people's hours and charge-out rates which can in turn be translated into a total cost to client, billable on a monthly basis. Ideally a RPF agreement should make provision for a longer period so that the base formula does not need to be negotiated every year. But in practice the detailed scope of work changes every year, thus necessitating an adjustment in fee level.

**Advantages**

- The agency knows what its income will be for the year and can plan staffing and other service costs accordingly. This helps agency cash flow forecasts.
- The same is true for the client. Agency costs can be budgeted precisely.
- Can encourage more holistic and media neutral communications thinking as it is not tied to specific media expenditure or commissions.

**Disadvantages**

- RPF schemes, however sophisticated, cannot work satisfactorily unless the scope of the assignment has been accurately defined.
- RPF's (or Retainer Fees) are an input-based remuneration system, and therefore less accountable than systems based on outputs, deliverables and volume. Not directly linked to agency performance. No direct encouragement to the agency to be proactive.
- Often time consuming to negotiate and administer.

## 3 VARIABLE FEE BASED ON ACTUAL HOURS

### How it works

This system is less common in creative agency agreements, but more widely found in other marketing service agreements, e.g. direct marketing, sales promotion and public relations. Fees are based on **actual** time spent using hourly charge-out rates for individual staff. The charge-out rate will be calculated to cover the employee's salary, a percentage of overheads and an allowance for profit. Although this is a similar approach to the RPF model, there is one essential difference: the fee paid is calculated after the event (based on hours worked) rather than in advance (on a pre-negotiated calculation.

### Advantages

- Relatively easy to administer, provided the agency maintains accurate records and ensures timesheets are completed on a regular basis.
- Reflects client needs and agency activity; allows some flexibility should the budget or scope of work change.
- Allows an agency to get a return based on a clearly defined process and actual deliverables.

### Disadvantages

- In the critical stages of an agreement neither the client nor the agency know in advance what they are letting themselves in for. The client cannot budget with a firm figure and the agency cannot staff with the same confidence. (It is of course possible for the client to negotiate a ceiling and the agency a floor.)
- There is a perceived accountability problem in that the system does not provide a direct incentive for efficiency. The more time the agency spends on a given task, the greater its income will be, unless the agreement is closely linked to scope of work, with an appropriate cap set.

## IN REAL LIFE WITH STEVE WARING

*Too often client–agency relationships are strained due to a lack of clarity over issues related to remuneration. Often the root cause of this tension is the lack of an up-to-date, clear agreement detailing how and for what the agency will be remunerated.*

*In our experience the best agreements are simple to understand, comprehensive in nature and transparent in their operation. It's also important that once agreed they don't lie in a dusty desk drawer but instead are revisited at least twice a year as part of an ongoing commitment to work at the client–agency relationship which is integral to producing great advertising.*

STEVE WARING
Fallon London - Finance Director

## 4 SCALE FEE + WIN BONUS

**How it works**

Client pays its agency a 'salary', which is a fixed percentage of either sales or of the annual marketing budget. In the case of a Scale Fee based on sales, the Win Bonus is built-in; i.e. if sales increase by 8% so does the agency's fee. If the Scale Fee is pegged on the marketing budget, the Win Bonus becomes more of a conventional Payment by Results – and can be calculated on a mix of subjective and objective elements.

**Advantages**

- Best for FMCG companies.
- This model is based on the premise that if agency remuneration is linked to client success, rather than the number of man-hours deployed on their behalf, both agency and client will benefit.
- The agency is remunerated on the basis of what its marketing communications achieve. If sales increase, so does the agency's remuneration.
- If the Scale Fee is based on marketing budget, the agency benefits according to increase in the volume of activity – and unlike commission, in a media-neutral way.

**Disadvantages**

- More difficult outside FMCG – and especially in a service industry where sales may not be the chief determinant of success.
- Less directly accountable than Resource Package Fees and commission, because remuneration is determined regardless of the scope of work and spend level.
- Basing agency compensation entirely on the client's results can be unfair to the agency. Marketing communications are only one part of the mix affecting client sales and profitability, and there are many factors that are beyond the agency's control, such as competitive action, economic change, distribution, intervention of regulators etc.
- Some marketing communications services are not directly sales related.

## IN REAL LIFE WITH DAVID WETHEY

*When AAI started in 1988 we were heavily involved in the big switch from commission to fee. The industry has been transformed by concentrating on scope of work rather than media spend. Clients as well as agencies now understand what a resource package is – and why meticulous costing is essential. But clients are now ready to move on from simply paying for agency hours. They are demanding accountability for results as well as inputs. Happily clients and agencies alike are ready to link a significant proportion of remuneration to how well the brand is doing, and how much the agency's deliverables and performance have contributed to that. In this new world of total communications it is time for everyone to commit also to the search for new and inventive solutions. But while we are waiting, the 10-step process described in this guide is an excellent place to start.*

DAVID WETHEY

Agency Assessments International - Chairman

# 5 PROJECT FEES

### How it works

Project Fees are an alternative to fixed annual fees, with fees being determined on an individual project basis. This system is usually not suited to longer-term arrangements, although they are becoming more common in roster agreements as a mechanism for specifying non-repeating tasks. Project Fees are widely used in the provision of ad hoc or supplementary services, and in specialist fields such as direct marketing, public relations and sales promotion. They are highly suitable for clients who are keen to work with agencies on projects or ideas which are additional to their main advertising requirements. This method should normally attract a higher level of charge than a RPF, as it does not give the agency the security of a notice period or a specific initial tenure. Usually the fee covers the planning and creative process with production or implementation being charged additionally as part of a total project budget.

### Advantages

- Ideal as a top-up.
- Easy to control expenditure provided estimates are given.
- Reflects specific client needs.
- Suits integrated or niche services approach.

### Disadvantages

- Too short-term a focus tends not to encourage partnership relationship and longer-term brand building.
- Agency cannot staff with the same confidence as in annual agreements, unless the detailed annual scope of work is clearly set out at the beginning of the year.
- Difficult to build continuity of relationship or any performance incentive for the agency.

# 6 CONCEPT FEE

### How it works

The Concept Fee is a one-off fee agreed to cover the cost of developing the creative concept of a campaign. It is based on the estimated value of an idea to the client's business and its anticipated use in an agreed context over an agreed period of time. Concept Fees are best suited when the client has a requirement for a specific piece of work that does not fit within its existing client–agency agreement. Concept Fees, like Project Fees, generally attract a premium rate due to the short-term tenure of the assignment. Usage of the concept outside of the agreed parameters will attract a further fee. An important factor is the overall understanding of the issue of Intellectual Property Rights (IPRs) which legally reside with the creator of the concept, unless otherwise assigned. The agency holds the IPRs and the Concept Fee means that the agency is paid in a similar fashion to musicians and artists for usage of these materials. Payment can be for outright ownership or on a licence basis to the client. The purchase or licensing of the concept should be enshrined in a contractual agreement that specifies when, where and how the concept can be used.

**Advantages**

- This can be an attractive option to a client wanting to buy or license rights to a first class concept that is going to enhance brand value. The Concept Fee is an appropriate acknowledgement of the value of the idea.

**Disadvantages**

- Clients should understand that the creation of quality concepts does not necessarily relate to time. It is usually impossible to use both the people hours and concept calculations at the same time. For a Concept Fee the value of the idea has to be the only determinant.
- Use of the creative concept for the client's communications strategies outside the agreement can be a major bone of contention.

## 7 LICENSING FEE – PAYING FOR COPYRIGHT AND INTELLECTUAL PROPERTY RIGHTS

**How it works**

This differs from the Concept Fee in one important regard. Under a Licensing Agreement the client may choose to pay the agency for concept development at a reduced rate than that paid under the Concept Fee basis and then agrees to pay a Licence Fee for the finished concept once it has been approved.

Conventional contractual arrangements provide for a client to own IPRs in material it has paid for. The agency retains IPRs until it has been paid for the relevant materials. But this approach assumes a commission or RPF scenario where these rights are bought by the client as part of the overall agreement. Licensing Fees highlight the importance of big ideas and concepts by making provision for them to be paid for and used under licence. Under such an agreement there will normally be a reduced level of Retainer/Service fee. Licensing Fees are a common feature of client agreements with digital agencies.

**Advantages**

- Incentivises agencies to produce big, campaignable, flexible, long-term ideas to build the brand.
- Licensing Fees are best suited when clients wish to minimise their up-front cost.
- This type of agreement is attractive to agencies when they see the potential for use of concepts in content or programmes, movies etc, and wish to retain all or part of the rights associated with concepts they have developed.
- Licensing can work well for multinational clients and their agencies, when concepts developed in the UK may be ultimately used in multiple markets. This system allows usage in each market to be negotiated as and when required, so avoiding either heavy upfront costs or disputes later about client's rights for extended use.

**Disadvantages**

- There are certain things that are beyond the scope of copyright. There is no copyright on an idea – only in the visualisation of the expression of the idea in hard copy.
- Straplines cannot be protected by copyright and must be registered as a trademark.

## HYBRID METHODS

***The client and agency may often find the fairest remuneration will be a mixture of remuneration types. Thus, while there are seven main methods of remuneration, there are other elements that are quite often employed. For example, production mark-ups and Payment by Results can be used in combination with one or more of the primary methods. However, hybrid methods still need to be guided by the principles of being simple to understand and administer, and flexible enough to accommodate change.***

## 8 PRODUCTION MARK-UP

**How it works**

Often erroneously termed production commission, production mark-up was historically one of the fundamental elements of agency revenue (and is still a feature of the sales promotion world). In its capacity as the client's agent the agency buys a substantial volume of products and services on the client's behalf. Production mark-up represents payment by the client to the agency for supervising and controlling quality. In the media commission era it was customary for the agency to mark up all third party purchases – originally by 17.65% on the net invoice to produce a mark-up. (See also COMMISSION How it works page 4). As the industry moved to a fee remuneration norm, production mark-up was reduced, and in many cases it has disappeared completely – with agencies deriving their supervisory and quality control income from the main fee. In PFA 2003 average production mark-up paid was 12.8%, but only 26% of the sample still reward their agency on this basis. In other marketing services production mark-up is still prevalent.

**Advantages**

- The agency takes responsibility for ensuring the overall quality, efficiency and effectiveness of production.
- The agency is rewarded for the work involved in managing third party suppliers.

**Disadvantages**

- If the agency is adding a mark-up, it can look as if they have a vested interest in not securing the very best price.
- Agencies might be seen to be promoting third party expenditure in their own interest.
- Where a significant amount of agency revenue comes from mark-ups, cancellation of spending (often at the last minute) can have a severe effect on agency income with little or no opportunity to reduce costs.

## 9 PAYMENT BY RESULTS SCHEMES

**How it works**

Payment by Results (PBR) schemes are incorporated in an increasing number of client–agency contracts (44% of creative agency agreements according to PFA 2003), with an incentive based on achieving mutually agreed Key Performance Indicators (KPI's) and goals. The intention is to devise a win/win situation with better, more measurable outcomes for the client and the potential for a significantly higher return for the agency. PBR schemes work best over a number of years as this timeline allows for better measurement of results.

The agreed goals and KPI's may be qualitative, quantitative, or a mix of both. They must be meaningful, achievable, and measurable. The goals should be considered very carefully to ensure that any focus on short-term objectives is not at the expense of long-term brand building. The suitability of this form of incentive will depend on the availability of meaningful data and the flexibility of the marketing budget. It is important that agreed PBR payments are allowed for in the budget. And within the client's financial systems.

**Criteria for rewarding agencies under a PBR scheme**

The criteria fall into two distinct areas, best described as 'objective' and 'subjective'.

**Objective:** Achievement of profit and other targets, such as sales or increases in market share or brand value. Also achievement of specific communications targets (as measured by impact scores; awareness and attitude tracking data; advertising test scores; creative awards and IPA Effectiveness Awards), corporate or brand performance.

## IN REAL LIFE

### PETER BUCHANAN

*We find a detailed contract (in our case in the form of a framework agreement) signed by both parties prior to any work being commissioned saves embarrassment, nasty surprises and most disagreements later on.*

*Our contracts are very precise and include details of everything we are prepared to pay for, at what rate and what lies within and without the contract.*

*I worry that some agencies sign the contract without reading it properly and whether everyone working on our business has been given a copy.*

*A best practice guide can only help matters!*

PETER BUCHANAN
COI - Deputy Chief Executive

**Subjective:** Vital for client and agency to agree upon a regular evaluation system for the client–agency relationship. This system must measure service and relationship attributes, as well as specific areas of performance. The process should allow for a full 360° evaluation of the contribution of both client and agency to the relationship. Normally this will incorporate client-on-client and agency-on-agency evaluation, as well as the conventional assessment of the agency by the client and vice versa.

**Advantages**

- The increasing focus on accountability makes it highly desirable that agencies are rewarded – at least in part – on the basis of performance and deliverables.
- It is very helpful, in new relationships especially, and after a precise scope of work has been agreed, for 'success' to be defined – and some part of the agency's reward to be related to it.
- In a relentlessly competitive market for agency services PBR schemes give incumbent agencies the opportunity to demonstrate on an ongoing basis the contribution they make – and to benefit from their efforts.

**Disadvantages**

- It is often difficult to isolate the effect of marketing communications on sales and commercial goals. This can lead to protracted negotiations on the exact mechanics of PBR arrangements.
- PBR schemes can sometimes be constructed in too complicated a way, leading to an extended "How much is the agency entitled to?" debate. (A good rule of thumb is that if it is not immediately obvious at the end of the year how much the agency has earned, the scheme is flawed.)
- Clients do need to provide for at least the possibility of the agency winning the full incentive. Failure to do so can lead to damage to the relationship. Careful budgeting and internal discussions with client finance departments are necessary to ensure that the scheme is set up properly.
- PBR, which is meant to be motivating for agencies, can work the other way, if the agency consistently fails to earn the level of incentive it feels it deserves. PFA 2003 showed that only around 50% of the agencies on PBR schemes earned even 50% of their maximum potential entitlement.

## OTHER EXAMPLES OF HYBRID METHODS INCLUDE:

***Resource Package Fee with Project Fee, e.g. for a major new launch***

An agency with a long-term client agrees to an annual RPF (based on fees charged over prior years) that excludes a major new product launch. This product launch is quoted on a Project Fee basis once the scope of the project is fully defined.

***Variable Fee based on actual hours with licensing element***

An agency agrees to develop a range of concepts at a fee less than the normal RPF level, on the basis that they will be paid a Licence Fee on the concepts used.

# SCOPE OF WORK AND INTERNAL AGENCY COSTING

## SCOPE OF WORK

Definitions within the marketing communications business are often imprecise or blurred. Agencies are increasingly expanding the services they offer to clients, from design to sales promotion and direct marketing, online advertising as well as brand consultancy projects or event management. Add to this a volatile business climate where budgets can shift dramatically – up as well as down. Ironically even a budget cut can lead to more work for an agency, if say a campaign that had been fully developed for TV now has to be reworked for print.

**It is essential that a clear scope of work is agreed before remuneration is set or work commences. It is also important to agree a defined process for any adjustments should that plan change.** These safeguards also protect the client by providing clarity on the relationship and its terms.

**Emphasis on fair remuneration will ensure that the scope of work and the agency resource plan match the objectives of both the client and the agency.**

## INTERNAL AGENCY COSTING

People/hours calculations have become an essential ingredient in negotiation, precisely because it is the agency's internal costing mechanism. The agency needs to know how many hours from how many people with what skills it believes it will take to deliver against a defined scope of work. The client also needs to know this. The salary plus overhead cost is the internal baseline. The agency has to achieve revenue at that level to break even. The agency must target an external baseline that includes their profit element. The client knows that the agency will not deliver below that level (or if they are obliged to do so, they will be well down the agency's list of favourite clients). But there is also a client external baseline: the allowance the client has made in the marketing budget for agency cost. The agency's RPF calculation may possibly exceed this external baseline, in which case there will need to be negotiation about scope of work and the composition of the people package.

It is important to note that it is inappropriate for clients to ask the agency for confidential information of a corporate or personal nature in this era of heightened corporate governance, and in particular details about individual salary package may not be disclosed as this would contravene the 1998 Data Protection Act.

It may be that client and agency agree to use Resource Package Fees as the basis of the client–agency remuneration system. But there are other options which take into account the value of the agency's outputs and their impact on the market (see OVERVIEW OF THE KEY REMUNERATION METHODS page 4).

# IS THERE A DIFFERENCE BETWEEN SETTING AGENCY REMUNERATION IN A NEW RELATIONSHIP AND IN AN EXISTING ONE?

In both cases clients will be concerned with transparency, quality and continuity of supply as well as the cost/value equation. The way a remuneration negotiation is conducted will vary appreciably between new relationships and existing ones. The process may have a substantial involvement from the client procurement function.

**NEW RELATIONSHIPS**

- Client will set out precise scope of work, and has the opportunity of comparing tenders from pitching agencies. (See *Finding an Agency*.)
- New agency has the benefit of a newly defined scope of work (see *The Client Brief*), and can calculate workload, resource required and desired pricing. Agency will also assess the scope of work against possible time frames: one year or two years?
- Client will be able to benchmark proposed agency cost against what the previous agency charged, and other agency relationships.
- Agency understands revenue/cost equation from its relationships with other clients.
- Client will have a target agency cost in mind – probably scaled on allocation from the total marketing budget.
- Agency will be balancing its desired revenue (probably based on a Resource Package Fee calculation) against what it anticipates the client will be prepared to pay.

**EXISTING RELATIONSHIPS** (ANNUAL REVIEW)

- Client must redefine exact scope of work for the coming year.
- Client and agency must analyse qualifying performance for PBR (if payable) before moving on to negotiate the next year's remuneration.
- Agency knows what it took last year to fulfil the scope of work set for them, and can thus make necessary adjustments in keeping with any revisions to scope of work.
- Client's hoped-for outcome: maximum value. Client will be concerned to conduct the negotiations without diminishing the agency's contribution to goals and KPI's, (see *Evaluation*) and without demotivating them.
- Agency's hoped for outcome: increased account profitability – even if that can only be achieved by reducing resource cost more than revenue reduction. Concern: to reduce resource cost, if necessary, without any measurable effect on service levels, client satisfaction, and most importantly contribution to goals and KPI's.

# AGENCY REMUNERATION
# IN TEN STEPS

Before looking at best practice and optimum process there are some fundamental questions to be answered. How great a contribution can the agency make to the fulfilment of corporate objectives? How flexible is the marketing budget?

Clients will approach investment in the agency on a risk/reward basis. The agency must have confidence in their own ability to make a difference, as well as their skill in managing their resource better and more effectively. Both are looking to sustainable growth and profit.

1

**First step is going to be negotiation on the scope of work. Client defines. Agency interrogates. It is the joint responsibility of each side to sign off scope of work.**

2

**Agreement on tenure: how long a period is the agency to be appointed for? Agencies are always keen on a longer tenure than the conventional one year – and the length of appointment is a genuine negotiating point. A premium may therefore exist for Project Fee relationships.**

3

**Similarly it is vital to establish the territory covering the appointment: which countries, regions, territories?**

**4**

Agency costs scope and prepares work plan based on people hours, and shares with client.

**5**

Client refers back to marketing budget and relates people hours cost to agency cost provision in the budget. If there is insufficient provision in the budget, the scope will be redefined and in turn the agency's price estimate will have to be adjusted.

**6**

Both sides agree level of agency remuneration (including the profit margin) at the point where cost provision and the cost of people hours intersect.

**7**

Client and agency agree goals/KPI's as the basis for Payment by Results terms.

**8**

At this point client and agency have come to terms on how much client is going to pay the agency.

**9**

And also how performance is going to be evaluated and remuneration reviewed in a year's time.

**10**

As a final step: definitive discussions on the form of contract to be used.

# FOR MORE INFORMATION

These guidelines could be a helpful tool for any company wishing to incorporate the principles of agency remuneration into in-house training modules. This document is available free as a downloadable PDF from the websites of all the signatories.

This guide has been developed by the four signatories: the IPA, ISBA, MCCA and PRCA.

All parties have given it their agreement and support, and urge its full adoption by both clients and agencies.

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# GUIDES IN DEVELOPMENT


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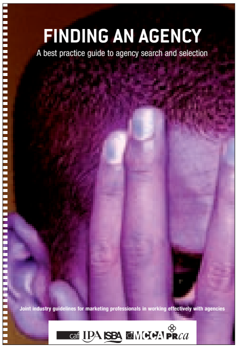


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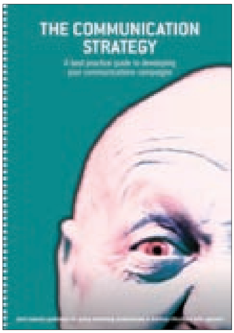
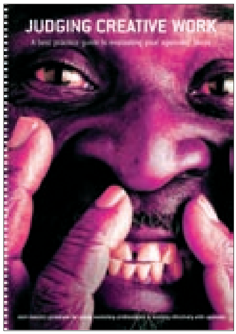
There are two more joint industry guides 'under construction', all designed to help you get more from your communications agencies.

Please contact the IPA, ISBA, MCCA or PRCA if you want to get more details.




**IPA**

44 Belgrave Square
London SW1X 8QS
United Kingdom

Tel: +44 (0)20 7235 7020
Fax: +44 (0)20 7245 9904
E-mail: info@ipa.co.uk

www.ipa.co.uk

**ISBA**

Langham House, 1b Portland Place, London W1B 1PN
United Kingdom

Tel: +44 (0)20 7291 9020
Fax: +44 (0)20 7291 9030
E-mail: info@isba.org.uk

www.isba.org.uk

**MCCA**

3-4 Bentinck Street
London W1U 2EH
United Kingdom

Tel: +44 (0)20 7935 3434
Fax: +44 (0)20 7935 6464
E-mail: info@mcca.org.uk

www.mcca.org.uk

**PRCA**

Willow House, Willow Place
London SW1P 1JH
United Kingdom

Tel : +44 (0)20 7233 6026
Fax : +44 (0)20 7828 4797
E-mail: info@prca.org.uk

www.prca.org.uk

Design and production by Su Johnstone. For further information e-mail info@sujohnstone.com or telephone +44 (0)7976 793368