05.04.2021 Agencies, Agency

Agency Remuneration Models Explained part I

Flexibility: the selling point every ***digital marketing agency*** needs to meet neverending demands in a highly competitive field. The head of a digital marketing course provider (The Left Bank), Ronan Mason, says that *every* business needs to have a digital marketing capacity. And he isn't wrong-nearly 70% of businesses in a survey planned to ***hire an agency*** for their business' marketing strategy.

In 2021, anyone from an 8-figure CEO to a teenager with a phone can start and successfully market a business. That is why agencies have to adjust their billing practices to suit the budgets and plans of many different types of businesses.

A report of thousands of agencies internationally found that 43% of those agencies used a mixed pricing model that they tweaked based on who their client was. The most common models in this combination are monthly retainers, fixed bids, and time and material contracts. Each of these models has pros and cons for both the business and the agency. It isn't as straightforward as paying an employee for their time and appointing a manager to make sure those hours are productive. This part I will cover the first two most common models in-depth to give you clarity on how each model works and which types of projects they benefit from.

Retainer

A retainer fee is a fixed payment, usually monthly, that a client pays to reserve an agency. Depending on the terms, the retainer grants the clients for a minimum amount of work the agency should complete monthly. Mostly determined in billable hours of the agency employee it can also be defined with point systems (also known as Value-Based Pricing). It takes great confidence on both sides to agree on a retainer: the client has to trust the ***agency's expertise*** enough to pay to retain them. The agency has to be sure that they can provide the value and the services that the client will demand at the price they paid.

This type of fee words best for long-term, complex projects in which each hour can't be billed at the same value, and the range of services provided are too broad to put a fixed bid on. The retainer fee is an umbrella underneath which any and every service of the agency is available for the client. This is why retainer fees tend to be quite high. Clients would only be willing to pay this if the agency has a good reputation and a history of work with the client.

How retainers benefit agencies

Retainer payments and ***long-term client/agency relationships*** go hand in hand. The agency, therefore, enjoys another benefit: a long-standing partnership with a paying client. Studies on customer retention found that businesses spend 16 times more on acquiring new customers than retaining existing ones. We can conclude that it definitely requires more investment and time for agencies to get new clients than to retain an existing one.

The agency receives a steady flow of cash and workload to keep them stable. Retainer charges are a low-risk option so even if an agency is going through a drought or loses clients, they can remain secure in the regular cash flow of clients who have retained them. They don't have the pressure of scrambling to find new clients. There is also less administration work that goes into billing and calculating costs to charge the client. That is probably why a survey by Entrepreneur found that agencies preferred retainer payments whether they were in the US, the UK or in Europe.

The stability of workflow also brings opportunities for more work. If you are a video-creating agency and see that the client wants to create Youtube ads, you can leverage your trust and loyalty with the client to offer these services too. The more comfortable the client is with an agency, the more likely they are to stay, pay the retainers and let the agency handle more channels. Another excellent benefit of a long-term relationship with a client is more work from *other* businesses through referrals. High-earning agencies rely the most on referrals for new business, which they are most likely to get when they have loyal, happy clients (source).

How retainers benefit clients

When a client has reserved the marketing agency, they gain the perk of contacting the agency whenever they need. They can ask for revisions, extra work and unexpected requests freely without worrying about extra costs or negotiating for each and every service. This gives clients plenty of security. No matter what goes wrong, the agency is fully present to resolve issues and regroup to keep the project going smoothly.

When an agency works with a client for a long time, the agency becomes familiar with the business' long-term goals, visions, branding and needs. Instead of just offering a service, the agency has enough knowledge of the business to provide real, long-lasting value as their visions align. Businesses save time that would otherwise be spent on briefs and lengthy meetings just describing their goals and other metrics for agencies to work with.

Challenges of Retainer models

The greatest challenge of fixed monthly payments is that there is no way to calculate if the payment made matches the work done. This is a risk for both sides of the deal.

For the agency, they might be overworked and may not receive sufficient compensation. In these cases an hourly rate would bring in more money than the retainer. As for the client, if they don't have enough workload, they may end up overcompensating the agency. Retainers are contracts, meaning that if these shortcomings arise, they both have to deal with it or try to resolve it-there is no option to leave before the contract expires (unless either side is willing to face the consequences of violating the contract).

According to an article by analytical scientist and agency founder Darren Woolley, retainers do not incentivize agencies to improve performance and deliver quality output. The retainer recovers hourly work and the cost of resources. So whether the agency puts great attention to detail or half-heartedly goes through the motions, they will be paid the same.

How can both sides of the agreement overcome these challenges?

1. Retainer models should never be used if the parties are working for the first time together. The ad agency won't know what the clients' goals are and how to deliver a satisfactory performance. The client doesn't know if the agency can give them what they need and expect. If there is an existing work relationship that is mutually beneficial already in place, then retainers are a good idea.
2. The agency should give a 1-2 month trial, fully compensated, to test this relationship. If there are problems that can't be resolved, there is no obligation to stay. If both parties are satisfied, they can commit for longer.
3. Agencies should set boundaries to present working more than they are being compensated, and these boundaries should be clearly communicated to the client. The client should have the opportunity to set their standards and clear expectations before agreeing on the retainer.

Fixed Bids

A fixed bid is a hard price set on one specific project. For example, a web design agency may set a fixed price of $5500 to build a business website from scratch. The client usually sets a deadline and may request samples or take up time discussing the project before agreeing to the bid.

The agency needs to ensure that the service is something they have a lot of experience in so they know how much time and effort it will take. A client should only pay fixed bids for agencies that can demonstrate past experience in

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similar projects because this means the agency is fairly compensated. For the client to make sure they aren't being overcharged, they should also be familiar with what goes into the work they are requesting. For example, a client cannot expect the website to be built in a week if they themselves have no experience doing so. On the other hand, if the client has had websites built before, they can easily set their expectations.

How can an agency propose a fixed bid?

The agency needs to ensure that the service is something they have a lot of experience in so they know how much time and effort it will take. Propose it for straightforward, one-time projects. If the project is something that may need revisions, like web development or copywriting, either include the revisions in your bid or charge extra for them.

The greatest benefit of fixed bids for agencies is that there is no income cap. If an agency is retained by 3 clients, and each client pays $6000, their income is capped at $18,000. On the other hand, fixing bids for projects with several clients has the potential to get a lot more in one month because the income depends on how quickly the agency completes the project.

How clients benefit from a fixed bid

The client has great budget control and a deadline to look forward to. They don't have to worry about the client procrastinating on their work or overcharging. Whether the agency spends 10 hours or 50 hours on the project, whether they divide it over the course of one week or one month, it makes little difference just as long as the agency meets the deadline and delivers on the client's expectations.

Fixed bids have an incentive by default for the agency to perform better. They will get more monthly income by completing projects on time. Another incentive is to anticipate further work from the client by performing well in the project.

Challenges of Fixed Bids

Clients are limited by fixed bids. They cannot request further revisions or extra work without paying more. While a project started on a fixed bid presents the promise of a defined budget even if a client carefully studies previous works from the agency and has received satisfactory results, there is no guarantee that the project will fulfill all of its goals.

Agencies who set fixed bids run the risk of miscalculating how long a project will take. If the deadline is extended for any reason, they'll get their payments late. This disrupts an agency's monthly cash flow required to pay overheads. If the project takes a lot more effort than anticipated, the agency ends up being underpaid and losing money on their client.

Fixed bids are most beneficial if the agency is able to complete them on time and to the standard of the client while also being suitably compensated by the bid for their time and effort. An agency should only accept this if they have enough prior experience to be confident that they will fulfill these criteria.

Conclusion

Between the two main remuneration models that agencies use, fixed bids have the potential to scale more whereas retainers are more secure. It's important for an agency to forecast its cash flow and be clear about its future plans before choosing a model. Some agencies may find that what works best for them is a combination of both, depending on which client they're working with.

The most important indicator of how successful any model will be is to assess how open the communication is and how transparent agencies are with their pricing. If expectations, goals and challenges are clearly addressed from both sides, they will be able to make the most of their work together regardless of the remuneration model.

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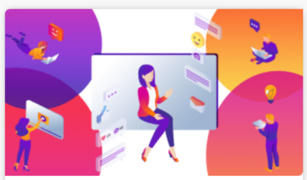

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