Thought Leaders

"Am I Paying My Agency Too Much?"

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Jeremy Taylor, managing director UK at TrinityP3, on the fear of overpaying

This is a question that we hear a lot. Funnily enough, we hardly ever hear the opposite question, "Am I paying my agency too little?", although it's an equally good one. But the best question on the subject is "Am I paying my agency the right amount?

The "Too much?" question is an expression of a fear of overpaying. The desire to save money drives an approach to buying advertising services at the lowest possible cost. And there is a problem with this: the potential cost of underpaying your agency for their services is the waste of your total advertising spend. Why? Because the agency will cut costs and service quality to maintain a margin. Worse still, the agency might also implement unreasonable demands on its staff, leading to stress and negative impact on mental and physical well-being.

The problem is not just in the procurement process. Often, the way agencies structure their fees also leads to the cost reduction focus. Let's look at the four main ways the agency fees are structured:

1. Percentage of spend (AKA Commission)
2. Resource costs (Hourly rates)
3. Output value (Value pricing)
4. Outcome deliverables (Performance fees)

The traditional commission is based on an agreed percentage of the spend. This might be expressed as a media commission or a production mark up. There are issues with this approach for the client. Once put in place, commission-based fees can act as an incentive to recommend the more expensive options, or at the very least discourage looking for more cost-effective solutions. But it's a simple methodology, and if implemented with complete transparency commissions can still have a role to play as part of a fee arrangement - as a very cost-focused approach which will encourage an agency cost-reduction approach.

The most common approach is to use hourly rate or day rates to calculate retainers and project fees. This is 100% about cost. Cost of labour, cost of overhead, cost of profit margin, and the cost recovery

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for the agency in maximising billable hours per person to maintain overhead and profit margins. Day rates remain particularly popular because they are a common approach to buying professional services (e.g. accounting and law) and for the agency finance team the cost recovery approach is easier to manage to maintain profitability. But the downside is that the cost focus is inclined to commoditise the whole offering and encourage the downward pressure on fees.

Rising in popularity is the value pricing model, or output pricing. The mistake people make is thinking that this is simply an hourly rate model locked into a fixed project fee. In fact, there is much more to it. Properly implemented, there should be an acknowledgement of several realities: not all projects have equal value to the client; creating strategies and ideas is not something that can be charged by the hour; and finally, there is intrinsic value in the productivity of the agency in producing the outputs - both tangibles such as advertising and marketing content, and intangibles such as strategies and creative ideas and platforms. For the agency, while setting the value pricing will clearly have a cost component at its base, the buying decision is made by the buyer on recognising the value represented by the price.

The final approach, outcome or performance fees, is the nirvana for any marketer and their agencies. This links the fee paid to the financial value delivered. In a world where data and AI are driving predictive analytics to close the loop on success attribution in marketing and advertising, there is an expanded opportunity to consider the performance fee approach. This is where buyer and seller and perfectly aligned and as close as possible to a partnership, where both benefit from success. Rather than the agency simply being a cost to be reduced, they are part of the marketing investment with the focus on delivering results.

Two decades ago, when first confronted with the question 'am I paying too much to my agency?' TrinityP3 set out to conclusively answer it for our clients. Commissions were relatively easy if transparent. Media commissions and production fees can be compared to market practices, but also to the underlying cost structures of providing a comparable service. Hourly rates gave rise to benchmarking. But the big mistake many made was to apply average benchmarks and expect above average quality.

Our focus has been on productivity and performance (Two of the three Ps in our name). Being able to accurately calculate what it should cost is the basis of assessing true value. This goes beyond rate cost to understanding the marketers' needs, the market category and its complexity so that the underlying cost and value of the work required can be calculated.

Of course, for us, the nirvana is performance fees. And the challenge here is the need for a marketing function that is acknowledged as an investment for growth and not as a cost of business. Encouragingly, we see this increasing globally - but it is still not common. Until it is, the pursuit of advertising value will continue.

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