OPINION

Value-based models and how to evaluate them in a pitch process explained

Value-based, cost-based, pricing-based, and performance-based agency fees - "bring it on" says Darren Woolley, CEO of TrinityP3.

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Last Thursday at Mumbrella360: Reconnected, I was moderating a session by Kathryn Williams, managing director at KMint, titled "Why 'Value', not 'Time', should be the New Agency Currency".

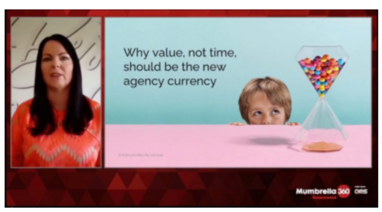
During the session, the following question arrived anonymously: "What's TrinityP3's view on value-based models and how they would evaluate them in a pitch process? How does it work when 'benchmarking' the agencies pitching?"

We did not get to the question during the session, and so I would like to address it now.

It is a terrific question, as it is a great opportunity to explain and perhaps address some of the misconceptions related to benchmarking agency fees. This is also good because there are actually three questions in one and I would like to answer all of these in this order:

1. What is our (TrinityP3's) view on value-based models?
2. How do we evaluate value-based models in the pitch process?
3. How does it work when 'benchmarking' the agency proposals in the pitch?

Firstly, we are all for value-based models. We have implemented value-based models for advertisers in Australia and across the globe. These have been output-based models linked to the value of the brands, pricing models linked to the work, performance models linked directly to sales and more. We have negotiated buying IP from agencies and have valued work as expert witnesses and advisors in legal disputes.



Kathryn Williams, at Mumbrella360:Reconnected

We have been a strong proponent of value-based fee models for agencies for more than a decade. As a copywriter and creative director, I could never understand why agencies were charging by the hour to come up with ideas. This was one of my frustrations with the advertising industry that motivated me to set up TrinityP3.

Unfortunately, the biggest obstacles to embracing value-based fees are, as Kathryn said, advertising agencies who are fearful of the new and unknown and advertisers not wanting to upset their agencies.

Next is how we evaluate value-based fee models. This will depend on the type of model proposed. As Kathryn's presentation demonstrated, there are a large number of different value models. A good starting point is to determine a 'reasonable' or 'expected' fee for the work based on the volume and complexity of the scope of work and the pricing levels of the agencies involved. This creates a baseline against which a value model can be compared.

You see, there is no point in evaluating agency rates. Especially not in isolation. It is interesting to see how agencies price by the hour, as it is indicative of how they perceive their value, and the value of the client. Higher hourly rates should indicate greater experience, expertise or scarcity of supply. We know there are many agencies that benchmark in the upper quartile for hourly rates, and they have a reputation and track record to support this price position.

If the value model is one linking fees to performance, we then need to consider a range of factors such as the achievability of the performance metrics, the risks for the agency and the advertiser, and the upside rewards for both too. Another consideration is the advertiser's ability actually to pay the fee if the agency is hugely successful. In many cases, the limitation of the marketing budget makes this performance-based fee model unsustainable. But as a general principle the greater the risk taken, the greater the reward.

Finally, the way we benchmark agency proposals in a pitch is we ask the agencies to respond to a proposed resource plan. This resource plan has been calculated from the advertiser's proposed scope of work. The agencies are asked not only to complete this, but also to propose a different resource mix or even to propose a totally different model. But rarely is this taken up as an option. Most agencies appear to prefer the cost-based model.

This scope and resource approach is designed to set a baseline that can be always shaped upward for a high-risk, high-reward fee model. The biggest issue is that regularly this baseline calculated fee, or benchmark, is discounted by many agencies. In some cases, by up to 50% or more. Agencies will propose free resources for 12 months, or heavily discounted overheads. It erodes not only the benchmarks but also the ability of the industry to maintain value.

So, to answer the question, TrinityP3 is a fan and supporter of value-based fee models for agencies. Yes, it is difficult to get these across the line in a pitch, when so many agencies are willing to discount heavily to win the business. A better approach is to transition from a cost-based model to a value-based model with existing clients. This is done in a spirit of trust, rather than bloody competition. Always a better way to navigate change.

Darren Woolley is the CEO of TrinityP3.