OPINION

Woolley Marketing: Is your agency a cost or value to the business?

In his regular column for Mumbrella, Trinity P3 founder and global CEO Darren Woolley crunches the numbers.

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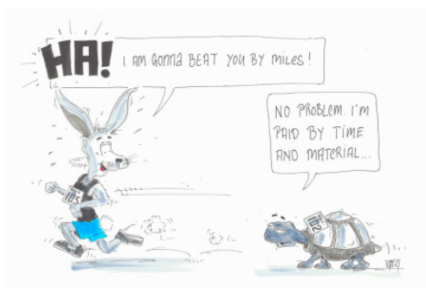
by DARREN WOOLLEY

For an industry segment responsible for creating demand and preference and for maintaining margin while driving sales, we seem obsessed with cost.

Sure, many marketers value their agencies. They value the agency team. They value their commitment and hard work. They value their long hours – right up to the point where they come to pay for them. Then they pay them as a cost. Not just in the language of 'agency costs' but in the fundamental way most advertisers have paid their agencies for the past two decades.

Hourly rates, retainers, and project fees: the dominant remuneration model in the market is based on the service being a cost. Take the individual's salary, divide it by the number of billable hours for the year, multiply it by the overhead cost and then multiply the sum by the profit factor and that is the hourly rate. Even the agencies refer to it as a cost recovery approach. It ensures their largest cost – their payroll – is recovered by the advertiser fees they are collecting along the way.



Cartoon by Dennis Flad, with permission (2021)

So, what is the alternative? No, I am not suggesting we go back to the old media commission and service fee (Although, I know plenty of more mature agency finance directors who dream that will happen). But there are legitimate alternatives that place value at the centre of the agency fee conversation. They include performance-based remuneration (PBR) and value-based pricing (VBP), to name just two.

Currently, you are probably paying your agency their costs and a profit margin for the agency to supply a team of people to work on your business. The more hours they spend, the more it costs. This is considered paying for inputs. You pay for the time spent. The alternatives switch from input cost to either output value or outcome value (hence, value-based fees).

The question for some advertisers is which one to choose. Well, that depends on your current needs and circumstances. But even better, you do not need to choose just one, because you can pay for your agency both ways. Or, if you cannot let go of the cost-based model, all three ways. Let me explain.

Let's say you are currently paying your agency for having ten people (a nice round number) working on your business. Each year you pay their agreed salary, overhead cost, and a profit margin to the agency. That is the cost of the agency services. But the value of those agency people is not their time you are paying for, but it is in the work they produce for your business, and in the results that work contributes to delivering.

Right?

VBP means instead of paying by the hour, you pay based on the agreed value of the outputs of the work. While PBR is paying for the agency for the results their work delivers or contributes to delivering.

If there is a component of your marketing requirements that is performance marketing and where leads and sales can be directly attributed to the agency work, then this is ideal for PBR. If there is a component of the agency work that is based on delivering project outputs, then VBP allows you to pay the agency for the agreed value of that work. And, of course, if there is a component that is neither about output nor outcome, then you can still stick with the cost-based input model for this component of agency services.

Both the PBR and VBP concepts may be confusing for some as we have become so used to paying for the cost of the agency. But 20 years of personal experience tells me that the current cost model is unsustainable. Why?

A model based on cost can only go one way – down. We have seen downward pressure on agency fees since the GFC in 2007. The result is stagnant salaries for agency talent, juniorisation of agency staff and loss of expertise through the redundancy of the more experienced. But it also continues to support long working hours for agency employees, with unpaid overtime charged to the advertiser going straight to agency profit.

This trend makes sense. After all, businesses thrive by reducing operating cost to maximise profit. But when that cost is one of the major growth drivers for marketing, reducing the cost has come at a price. Complaints about quality of strategic thinking, creativity and performance abound as the major reason for pitching business. With agency tenure with clients continuing to fall, perhaps it is time to think of agency fees as something more than a cost of business to be reduced at any and every opportunity.

Moving away from such a heavy reliance on an agency cost recovery model, and embracing a value-based model that rewards productivity and performance – could it not help?

Darren Woolley is the founder and global CEO at Trinity P3. Woolley Marketing is a regular Mumbrella column.

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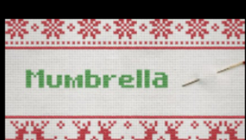

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