A NEW VALUE FOR AGENCY COMPENSATION

The world's most iconic brand, Coca-Cola, caused some waves at the recent American National Advertiser's (ANA) Financial Conference last month, by unveiling a new scheme for their agencies called "Value Based Compensation". The approach is the first real "public" sign of paying the agency not based on time or cost, but based on value.

In the communications area, this value approach is not new. Photographers, actors, directors and other creative specialists all charge for their services based on perceived value. Use Jackie Chan in one market, pay him a (healthy) fee. Take that work to another market, pay another (healthy) fee. The basic concept is simple – but instead, marketers and agencies have relied on the commission system for 100 years ("the more you spend, the more you pay") – which is a fine system if you're selling real estate. In the last ten years, most top marketers have moved away to the fee system ("the more you need done, the more you pay") – which is a fine system if you can work slowly and get paid for it.

So is value based compensation the next big thing?
Yes and No.

Coke are fortunate – they have many years and many markets on the fee system, so that have built up a lot of learning of what agency services cost. As part of this new structure, they are now taking the lead on setting the initial value for agency work. According to the ANA, one of the five value pieces they identified is what is the strategic challenge of the work – is it a strategy priority for the company or something they need to do that is not a priority? Another is industry dynamics: is this agency uniquely qualified to do this work or are their four other agencies that could do it thus level setting what the market will demand. The three other pieces to the equation are Budget Reality; Share of Work Management; and Talent. From there, a baseline cost for each project is set, and then the kicker – a 30% variable incentive based on the performance of the advertising, the advertiser and the agency.

Does this seem like hard work?
Well, it is for small fee agreements, but obviously when there are millions of

dollars on the table, the process is critical to greater transparency. This approach won't work for every company, and certainly not for those with no benchmarks on what agency services cost.

Is there another way?

P&G have just completed five years of paying their agencies on commission – but in this case, commissions based on sales. The actual amounts are confidential, but the process is simple – as a marketer's business grows, so can the agency's. P&G's the only company we know of using this model – it's worked well for them in some markets, and proved tougher in others – but it's a fresh take on agencies getting some skin in the game

What are the barriers?

The key barriers to the success of value based compensation are not the various methodologies but rather the internal and external stakeholders.

Internally, is your procurement head or financial head now prepared to pay 2x for something the company once got for 1x? (even if it is a so called 'better' idea, the labor costs may have been 1x). Does your marketing team have the skill and time to strike a value based deal that is fair and best practice? Does your CEO believe that the communication work has such a direct correlation to your business success? If you can answer yes to all of these, you're half way there.

Next – externally, is your agency so entrepreneurial to take these risks? Will their holding company be prepared for less than 15% profit – or even a loss? As one former BBDO finance director said - "Marketers accept extraordinary financial risk every day. If any of their product or service offerings fail, they shoulder the financial burden themselves. Many agencies with labor-based-plus arrangements are generally guaranteed not to lose money. I do not see any compelling reason for them to want to fix that"

Compensation for marketing services has to continue to evolve with new ideas and practices along the way. The critical thing from both sides is making sure the right motivations are in place to drive the right outcomes.

ABOUT R3

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Our clients include Coca-Cola, Samsung, VISA, Johnson & Johnson, GSK and Singapore Airlines.

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