

Why you should tailor the payment to the agency

With an ever-growing range of payment option for marketing agencies, purchasers must remember that one size does not fit all

What sort of contract should you have with your marketing agency? It used to be a straightforward decision for the buyer and the provider: payment was directly linked to the amount spent on the campaign. As one changed, so did the other.

But such "commission" payments are being replaced by more sophisticated and, for both agencies and purchasers, more complex "fee" arrangements. Under these, the payment criteria - which may focus on hours worked, project costs or even results - are fixed at the start and reviewed regularly.

So before you start to negotiate with your agency, it's useful to know about the common remuneration methods to see which is most suitable for you.

1. Commission

This sets the agency's payment on a commission, or a percentage of the gross cost of buying media space. Commission deals account for most contracts with media agencies (which buy media space) and about a quarter of agreements for creative agencies (which develop the creative content).

The average commission paid to creative agencies today is 9.6 per cent. However, the commission to a media agency is negotiated according to how much is spent on the media space and whether there are economies of scale.

Commission payments have become less common within advertising. However, they are still the sole basis of 22 per cent of agreements, and used in conjunction with a fee element in a further 14 per cent of cases.

2. Resource package fees

A typical RPF arrangement is based on an agreed, detailed scope of work and resource plan for a defined period to reflect the agency's likely workload. RPFs are usually based on staff costs, an allowance for overheads, and an appropriate allocation for profit. Fees are agreed in advance to cover a period of activity (normally one year), and are paid monthly.

3. Variable fee based on actual hours worked

Although this is a similar approach to the RPF model, there is one essential difference: the fee paid is calculated after the event - based on hours worked - rather than before.

Fees are based on the actual time spent using hourly charge-out rates for individual staff. This rate will cover the employee's salary, a percentage of overheads and a profit margin.

Variable fees are less common in creative agency contracts than in other marketing services agreements, such as direct marketing.

4. Project fees

This alternative to fixed annual fees is widely used for ad hoc or supplementary services, as well as in specialist fields such as direct marketing, public relations and sales promotion. The fees are suitable for clients who are keen to work with agencies on projects or ideas that are additional to their main advertising requirements.

This method is usually more expensive than an RPF, as it does not give the agency the security of a notice period or a

specific contract period. It normally covers the planning and creative process, with production or implementation charged as extra to a total project budget.

5. Scale fee with win bonus

The client pays its agency a "salary": a fixed percentage of either target sales or of its annual marketing budget.

In the case of a scale fee based on sales, the "win bonus" is built in: if sales increase, so does the agency's fee. If the scale fee is pegged to the marketing budget itself, the win bonus moves closer to payment by results and can be calculated on a mix of objective and subjective elements.

Objective success criteria may include achievement of sales targets; increase in market share; achievement of specific communications targets (measured by, for example, impact scores, or awareness and attitude tracking data); or corporate or brand performance.

If the criteria for rewarding agencies are subjective, it is vital for client and agency to agree a regular evaluation system for the service and performance.

6. Production mark-up

A largely disused method often (erroneously) termed production commission, this represents payment to the agency for supervising the quality of the products and services it bought on the client's behalf. As the industry moved to using fees instead of commissions, production mark-up was reduced. In many cases it has disappeared completely. Agencies now derive their supervisory and quality control income from the main fee.

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7. Payment by results (PBR)

PBR schemes based on key performance indicators and goals are incorporated in an increasing number of client-agency contracts. They work best over a number of years, because a long time period enables both sides to evaluate performance better.

The KPIs and goals may be qualitative, quantitative, or a mix, but must be meaningful, achievable and measurable. The success criteria can be objective or subjective.

8. Concept fee

Concept fees are most suitable when the client needs a specific piece of work that does not fit within its existing agency relationship. They cover the cost of developing the creative concept of a campaign. Such fees are based on the estimated value of an idea to the client's business and its anticipated use in an agreed context over a period of time.

The intellectual property rights reside with the concept's creator, unless otherwise assigned and they are paid for use of these materials. Using them in a different context will add to the fee.

9. Licensing fee

Licensing fee (paying for copyright and intellectual property rights) arrangements differ from the concept fee in one important respect: under a licensing agreement, the client pays the agency at a reduced rate to develop the concept, and then pays a licence fee once the idea has been approved.

This assumes a commission or resource package fee-type deal, in which ideas and concepts are automatically bought by the client as part of the overall agreement. Licensing fees are a common feature of agreements with digital agencies.

10. Hybrid methods

The fairest payment will often be a mixture of remuneration types. A common mix is a resource package fee with a PBR element; a resource package fee with project fee, for example for a major new launch; or a variable fee based on actual hours with licensing element.

However, hybrid methods still need to be simple to understand and administer, while flexible enough to accommodate change.

Whatever payment method is used, it's worth remembering that only a tenth of any marketing communications budget relates to agency fees - the rest goes on production and buying advertising space. As agencies are crucial to creativity and nurturing clients' brands, purchasers should beware of cutting the agencies' fees any further.

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