ADVERTISING AGENCY REMUNERATION

Global best practices in Fair remuneration

ASSOCIATION OF ACCREDITED ADVERTISING AGENTS MALAYSIA

This document has been prepared as a tool for members of The Association of Accredited Advertising Agents, Malaysia (4A's) and their clients with the hope that it will help in the fair management of an agency remuneration system. It does not pretend to have any magic solutions for making the planning, negotiating and maintenance of a client compensation program easy. Instead, it attempts to stress the importance of planning and monitoring a program that features clear logic, consistency and understandability by both agencies and clients. To fulfill this objective, it strives to define as simply as possible the different terms and systems that are being used and debated in the marketplace by offering a presentation of the facts, especially as it relates to fee-based compensation.

The ultimate objective of this document is the development of a win/win, agency/client business relationship. Until both agencies and their clients reach a comfort level with a compensation system that simultaneously satisfies the needs of both organisations, the subject of compensation will occupy a disproportionate amount of time and emotions.

To achieve this comfort level, it is critical that both clients and agencies recognize that compensation agreements are merely a means to an end. The challenge comes in thinking about what the Ringgit allows both sides to do; both client and agency. Hopefully this document will help you to think about these issues.

The Malaysian 4As firmly believes that advertising agencies should be compensated fairly for the work that they provide to their clients. When establishing any remuneration method, all agencies should follow the same objectives including:

(a) Recovery of all of the costs associated with the services being provided.
(b) Return of a fair and reasonable profit.
(c) Recognition of the creative nature of the business.

An agency should never commit itself to a precise compensation plan until it has first examined its needs. The agency needs to pay a return on owners' capital. It must pay taxes. It needs to grow, if only to keep pace with inflation. It needs to attract talented people and provide a stimulating environment in which to work, as well as to retain and reward those people. It must establish a respected identity for itself in the marketplace. All of these are management goals that can be attained only by recovering costs and earning an adequate profit.

Therefore, the agency needs answers to three questions:

(a) What is the true cost of the service the agency is offering?
(b) How much profit is needed?
(c) Adding cost and profit, what compensation is required?

How much the agency needs to be paid should precede the question of how it will be paid. The method of compensation will follow.

Clearly all remuneration methods must be negotiated and agreed between clients and agencies. By taking into consideration these factors and other details discussed in this document, we hope that we can facilitate this process better.

The most productive and successful client/agency relationships are based upon a mutually rewarding marketing partnership concept. With inadequate 'reward', agencies are often forced to cut corners and reduce their service to clients. This eventually impacts the quality of creative and, inevitably the relationship between the agency and the client.

The 4A's wishes to thank in particular the Association of Accredited Advertising Agents of Hong Kong and the Advertising Federation of Australia, for allowing us to adapt their document entitled "Agency Compensation Guidelines" and "Agency Remuneration' respectively.

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Principles for Negotiating Remuneration

1. Defining the task

The starting point is understanding the advertiser's communications objectives and the tasks to be accomplished. This will determine the nature of the services to be provided.

The agency and advertiser need to reach agreement on the implications these have for agency resources. The needs will be a combination of the following:

- the service areas required;
- the anticipated levels of activity in each;
- the way in which the advertiser expects the agency to relate to their organisation.

The last point will have a profound effect on the profitability of the agency. A brand manager's real versus their assumed authority to take decisions is at the heart of it. Any organisation with layers who can say 'no' but who do not have the authority to give approval, will be expensive for a service business to deal with.

Senior clients will need to be brutally honest with themselves about the workings of their own organisation. Will their staff have the same awareness of the need to manage the agency's resources without waste? And in their understandable desire to drive their brand, respect the spirit as well as the letter of any future contract with the agency?

This stage should end with the client putting their needs into writing and a provisional definition by the agency of the general structure required to provide the service.

2. Know your client to know your costs

- Consider your experience of this particular client, or of other advertisers with similar characteristics.
- The potential for the greatest error lies with those clients where the apparent volume of activity is low, that is clients with big brands, big campaigns and no apparent requirement for rapidly changing materials. Or to clients running centralised campaigns on a multi-country basis.
- How often does the client require new creative work? Clients requiring new creative every year or so will have totally different expectations in terms of the gestation period for an advertisement to those clients who need a new advertisement to run every week.

3. Building a cost structure

- Have a full understanding of your internal cost structure (which you may or may not choose to share with your clients).
- Build a picture of the likely costs from the 'bottom up'.
- Start with the necessary account handling and strategic planning resource in numbers and levels of experience. This will be the firmest number.
- Estimate the creative resource (which probably will be subject to considerable error).
- Production staff and time will be closely related to the volume of creative work.
- Media costs can be estimated by analogy with other clients of similar size and similar patterns of media use.
- Check all of the numbers mentioned above against the actual numbers existing for similar clients, as well as against agency norms (using the account handling figure as the basis).
- Make final adjustments taking into consideration the individual client's idiosyncrasies.

Having done all of the above plus reading Section 2 of this document you should be in a position to make a firm recommendation on the method of remuneration most suitable for a particular client.

4. Adjusting the proposal

No matter how good the proposal is, the client may raise objections based on any of the following:

- the services proposed have been interpreted incorrectly;
- the proposal implies unacceptable judgements about how the relationship will work;
- the costs of agency personnel are considered too high;
- the absolute cost of the agency is more than the client can afford to pay.

Incorrect interpretation of services

Now is the time to adjust the interpretation (and probably the remuneration proposal) so the agency and client set out with the same understanding.

How the process will work

If disagreement persists after further discussion, define a period of observation with a provisional remuneration agreement. At the end of the period, reassess in the light of actual experience.

Agency personnel costs too high

Check whether this is due to:

- a misunderstanding as to how the loading on direct client costs is calculated;
- a lack of agreement about the levels of skill required for certain functions;
- a lack of knowledge of what goes on behind the scenes in an agency;
- the salary costs of individuals being deemed too high.

In each of these cases, the agency can explain either its assumptions or the method applied, or the need for those 'hidden' support people.

Creative salaries can be of particular concern as creative talent is not related to age, university degrees or other qualifications. It is the scarcity of talent that determines its value, with market forces determining the rewards for the individual.

Client finds absolute sum too much

Re-examine the number of services to be provided and agree to eliminate those that are the least important. The proposal can then be adjusted to come closer to, or hopefully match, the acceptable figure.

5. The remuneration negotiation

Points 1- 4 cover the process. However, there are a few more points you should consider before proceeding.

(1) Do not rush the process. Agree a timetable and adhere to it.

(2) The people negotiating should be the same throughout and should be authorised by their respective organisations to make commitments.

(3) Clients tend to be more practised than agencies at negotiating. Agencies would be well advised to identify the individual best equipped for the task, give him/her additional training and have them lead all major remuneration negotiations for the agency. The role of the senior account person of a particular piece of business would be to support him/her with detailed

understanding of the client. *It is sensible to recognise that the person who has to lead the agency's relationship day to day with the client is best kept out of a front line role in what can become a confrontation, even if the guidelines are respected.*

Guide to Alternative Forms of Agency Remuneration

1. Standard Commission

This system of obtaining commission from the media still remains one of the most popular, both in Europe and the USA.

Historically, media owners and advertising agencies have operated a "commission" system. A 15% commission means that for every RM100 of media space/time purchased, the media will actually charge the advertising agency RM85. By charging the client RM100 the Agency therefore receives a commission of 15% of the gross cost of the media or 17.65% of the net cost to the Agency. For production, the Agency will charge client 17.65% on the net supplier cost to the agency. This was considered the norm for a 'full service' arrangement. This allowed flexibility for advertisers to negotiate on the 2 components if they had economies of scale or less than full service requirements.

It is important to recognise that for most clients, including those who have moved to a different percentage or system, this 'standard' commission remains the reference point.

Advantages

- Simplicity - even to the point that no negotiation is required other than to define which services are included.
- Sales growth can lead to expanded billings and the hope of increased agency profit. Linking the agency's income to the client's fortunes via their advertising expenditure reinforces the notion of partnership.
- The agency's reward is directly linked to the extent to which their ideas are used.
- Both parties are focused on the quality rather than the price of the service - it inspires the agency to experiment on the client's behalf.

Disadvantages

- The agency appears to be encouraged to promote media expenditure in its own interest, rather than create a 'communications solution', which may only have a small media expenditure component.
- Cancellations of spending (often at the last minute) have a severe effect on agency income with little or no opportunity to reduce costs.

What to watch out for

- This system is best suited to those clients who require extensive practical services.
- Clients may think that paying full commission is an automatic guarantee of unlimited service, especially the medium-sized or smaller ones.
- Make sure that the extent of non-billable services is clearly defined.
- Make proper provision for remunerating non-media activities so that appearance of bias is not allowed to colour the client's view of the agency's recommendations.
- You may wish to design a contract that has a minimum expenditure clause in case media spend is cancelled after creative is developed.

Client suitability

- Clients with consistent and regular media expenditures who focus on value rather than on price and who have the will to involve their agency in-depth with their brands.
- Medium size clients with consistent and regular media expenditures and moderate service requirements.

2. Reduced Commission

In no market is there an accepted definition of what constitutes an 'average' advertising budget in terms of size. And when it comes to looking at the service components desired then it is generally assumed by advertisers that the standard commission covers everything imaginable. Therefore any curtailment of their individual requirements can only bring them below the norm.

The process is one of subtraction. The reference point is the 'standard' commission and then percentage points are deducted on the basis that this or that service is not required. Or percentage points are subtracted on the assumption that the billing levels in question justify, by their size, a lower rate than that available to other clients.

Advantages

- Those advantages which are generic to any form of commission.
- Allows advertisers with limited, but definably different service requirements to only pay for specific services they need.

Disadvantages

- While a lower remuneration level may be perfectly acceptable for a given client, this will not be achieved if the client does not understand exactly what services are included and what are not.
- It is hard to estimate the true cost of services top down as it is bottom up. If it is possible to do it by subtraction then why not do it by addition and cost the required package bottom up?
- The notion of reduced commission is psychologically negative, and can lead to the agency becoming known for its discounting rather than the quality of its work.

What to watch out for

- Insist that the assumptions made about the starting point are set out clearly. For the top down approach to have any chance of producing a fair result, one has to start from a reasonable view about what size of budget and what service package justifies the standard commission and service fee.
- Those service elements which are excluded must be both clearly definable and peripheral to the basic task of developing creative campaigns (unless the agency is only retained to adapt and place already existing work). Agencies would ordinarily need to retain the right to apply all relevant resources, including for example, research and strategic planning, to their central task.

Client suitability

Large and medium clients with limited as well as predictable requirements.

3. Sliding Scale Commission

The idea of the sliding scale method is that the level of the agency's remuneration should decline as a percentage of media expenditure as the latter increases. It is based on the assumption that certain costs arise independently of the volume of media activity and can therefore be covered by a given rate of commission on billings up to a certain level. When billings go beyond this the commission rate can be lowered, as only the variable costs associated with managing the marginal advertising volume have to be covered.

While this suggests a two-tiered remuneration arrangement, most advertisers operating a sliding scale have three or even more tiers.

They are more often a result of negotiations between the agency and client to provide adequate remuneration at an acceptable cost.

Sliding scales are usually related to the advertiser's total volume in a given market. They are only very rarely related to the accumulated expenditure of several countries. Nor are they frequently related to the expenditure of individual brands, though this would be one way of getting their impact to match more closely the variances in workload.

Finally, general practice is for declining percentages to be applied to successive tranches of expenditure and not for the overall percentage to be reduced when predetermined levels are reached.

Advantages

- When not pushed to extremes, logic makes this acceptable. A recent European Association of Advertising Agencies' (EAAA) Survey showed that large sliding scale clients are as profitable as fixed commission clients, if not more so.
- The agency is protected against the impact of extreme variations in expenditure. If billings decline then it is only the tranche of expenditure at the lowest commission level which is affected. Of course, if billings increase the same is true. But that happens more rarely and is a bonus.
- The system makes it easier for the agency to defend higher rates of income on small billings, to the extent of receiving more than the standard commission on the first tranche! This becomes especially relevant when billings are at very different levels between brands, if brands are the basis for the calculation.

Disadvantages

- The extent of marginally diminishing costs as billings increase is often overestimated. Advertisers tend to relate costs to finished items (a TV commercial, a media plan, etc) and therefore underestimate the cost of the day to day administrative service, e.g. preparing and attending meetings, communicating within the agency or between members of an agency network, etc.
- Sliding scale remuneration is mainly practised by large clients who can argue that their volume is sufficient to justify significant reductions in commission at the margin. This means that any error in achieving a reasonable income for the agency will have disproportionate impact on the results of the agency as a whole.

- These clients also tend to have large brands. When the pressure is on, the client tends to forget the premise on which the agency's remuneration is based and expects instant and unrestricted service.

What to watch out for

- That the scale starts with a sufficiently high percentage and expenditure level. This is more important than the percentage on the higher volume levels.
- Do not underestimate the costs at the margin. They will be well in excess of just the costs of media handling.
- Go for a scale, wherever relevant, by brand rather than company volume. Logic is on the side of this position, this is how 90% of costs arise.
- Make sure that the scale is related to each tranche and is not to be applied cumulatively.

Client suitability

Large clients with predominantly large brands. Clients with requirements focused on media advertising.

4. Fixed Fees

Fixed fees are defined as fees which are agreed in advance to cover a period of activity, usually a year.

They are determined on the basis of the marketing plan for that same period, thus seeking to reflect the likely workload of the agency. They differ from commission in three fundamentals.

i. workload is not assumed to be in relationship to the volume of media activity.

ii. the fees do not vary according to whether a plan is implemented in full or not;

iii. they are cost-based (with an appropriate allocation for profit).

Advantages

- Agency knows exactly what its income will be and can plan its staffing and other service costs accordingly.
- Income flow is generally even throughout the period in question, which matches the pattern of the agency's salary costs.
- In theory, the agency has its costs fully covered and the opportunity of a fair profit built into its income.

- Detaching remuneration from media billings allows the agency to be seen as independent in its advice and motivated to provide any communications technique relevant to the advertiser.

Disadvantages

- The client's negotiating stance focuses on minimising the agency workload, which is often more affected by the client's working methods and structure than by the formal task to be done. Client managements are not generally aware of or prepared to admit to the inefficiencies in their own organisation.
- Because there is no direct link with media expenditure there is no direct reward for having generated big and durable ideas. Indeed the activity list for the agency will be longer if it has to redo the advertising each year or even more often. This is neither fair to the agency, nor in the client's own interest.
- A corollary of this is that development opportunities can only exist if the number of activities increases rather than their scope. Unless, of course, there are brands available to be taken from another agency.
- In the event of a fundamental change in the client's requirements, the agency may need to change its internal structure to streamline communication and job handling and/or re-negotiate the fee.

What to watch for

- Achieving a truly realistic assessment of the client's requirements and the agency's workload, especially if this method of remuneration is being applied for the first time.
- Opportunities for growth.

Client suitability

Clients with a heavy need for non-traditional media advertising. Small to medium clients with a clear view of their service requirements. Clients with low or non-spending development projects.

5. Project Fees

An alternative to fixed annual fees are fees determined on an individual project basis. It is mentioned here for completeness, but given the continuing and overlapping multi-faceted service requirements of most advertisers, this is not a realistic option. It is really only relevant for the provision of ad hoc supplementary services, or for specialist agencies in fields such as sales promotion.

This would be suitable for clients who are keen to work with the agency on projects or ideas which are additional to their main advertising requirements.

6. Fees Based On Actual Time Spent

Fees based on actual time spent with an allowance for profit built in, reflect the same basic approach to agency remuneration as fixed fees with, however, some important differences. The fact that there is no commitment in advance to a figure for the agency's income has two consequences.

Neither the client nor the agency know in advance what they are letting themselves in for. The client cannot budget with a firm figure and the agency cannot staff with the same confidence.

The agency has no direct financial incentive to run its business efficiently. Indeed, the more time it spends on a given task, the greater its income will be. While the impact of this may be short-lived, it is impossible to ignore this factor in the short term. Not surprisingly, this can lead to much discussion as to whether the agency's recorded costs were, in fact, true costs.

Advantages

- This method is potentially the fairest way of remunerating an agency. Client demands can evolve over the time period, as we know that they usually do, without either party being penalised.
- The client pays for exactly what they get.

Disadvantages

- The potential for endless wrangling over hours spent.
- No incentive for the agency to be efficient.
- An hourly rate is an adequate method of rewarding creative work; quality creative output is rarely related to time spent. Because there is no direct link with media expenditure, there is no direct reward for having generated big and durable ideas.

What to watch out for

- The attitude of the client to the agency; if it is not one of true partnership and confidence then the prospects are not good.
- The need to monitor the agency's efficiency and to be in a position to have unassailable records of time spent.

Client suitability

As for fixed fees, with the rider that their business culture must be one of trust in their business partners (to avoid the arguments over time spent).

7. Guaranteed Minimum Fees

This is a refinement usually applied in conjunction with remuneration by commission. That is, the client undertakes to guarantee a minimum income to the agency. When the figure is not achieved through media commission, a supplementary fee payment is then made.

Advantages

The agency knows on what financial basis it can plan its own business with certainty.

Disadvantages

If structured properly, in terms of the minimum fee covering agency costs and profit, there are no real disadvantages to this method of remuneration.

What to watch for

- The level at which the minimum is fixed. To serve any fair purpose, it should be high enough to cover costs plus a margin for profit.
- Make sure agency personnel understand the basis for remuneration and do not over service the account.

Client suitability

Clients with volatile and unpredictable spending patterns.

8. The Trend Towards 'Hybrids'

'Hybrids' are the name given to those contracts which draw on a combination of methods to determine agency remuneration. Either by using two of the options discussed above or by using one of them together with the possibility of an incentive payment.

9. Commission Plus Fees

This system is the most common in Malaysia. Commission and fee is generally the dominant component of the agency's remuneration. Fees are used as a supplement to cover specific identified areas of service e.g. strategic counsel, creative development, copywriting, art direction, translation, supervision of production, artwork production and graphic design. They may also be used to compensate agencies for their activities outside of mainstream advertising e.g. event handling, sales launches. This, of course, would be nothing new except that items previously included in the basic service package, funded by commission are being isolated and paid for separately in this way.

Advantages

- Hybrids of this type allow agencies and advertisers to use their discretion as to which services are best remunerated by each method. They can retain the simplicity and motivational benefits of commission, enabling the agency to be rewarded as a result of the growth of the client's business. At the same time, services with predeterminable costs can be isolated and rewarded with precise fairness.
- The agency can be clearly and directly motivated to cover as many of the advertiser's communications needs as they are able, without potential loss of income through the diversion of media funds.
- Activities with a predictable time-length component will lend themselves best to fee payments. The same may be true of an account group on a piece of retail business where the flow of small jobs is continuous. Access to specific strategic advisers can also be costed in advance.
- Commission and fee is best applied to those functions which are unpredictable. The prime example is the generation of creative ideas. It is also desirable to reward these according to their usage, and only commission and fee can do this simply.

Disadvantages

There are no fundamental disadvantages. That is, if the combination of systems is used in the spirit described.

What to watch for

- The addition of fees should not be a pretext for taking the level of commission down to the point that the combination provides an unacceptable total. Nor should the opportunity of speculative fees, which may or may not be earned, be accepted as a substitute for satisfactory commission levels.
- Use a sensible allocation between the two methods. The predictable will lend itself best to fees; the uncertain and imponderable, above all creativity, will lend itself best to commission.

Client suitability

In principle, all clients, but predominantly those with a substantial component of fixed costs e.g. multi-market or retail, generated by largely administrative functions.

10. Incentive Payments

The principal other combination is either commission plus fee or fees combined with an 'incentive'.

While this is a relatively recent practice, starting in the US and still in its infancy in Malaysia, it represents an important development. Incentives are the first real innovation in agency remuneration since cost-related systems were tried and even more significantly resurrect a fundamental concept: namely, that rewards should be linked to results.

One would expect both agencies and clients to applaud the idea that part of the payment for agency services should be linked to their effectiveness. For agencies it is a chance to put a price tag on an elusive part of the value that they add, namely their creative product. We should be happy to accept this challenge.

Accountability in advertising is, of course, as important psychologically to advertisers, and in absolute monetary terms much more so. Not only are they paying significant amounts to their agency, but they are spending seven to ten times as much with the media. Of all their company investments, it is the hardest to justify with hard facts or econometric projections.

Furthermore, for agencies this could be a way to break out of the vicious downward spiral in which their remuneration appears to be trapped. If clients have success beyond their expectations in the marketplace, they will be much ready to commit more money to their agency. Especially if the conditions are agreed in advance and before the fruits of that success have already been taken into the profit plan.

Advantages

- Incentives are an expression (albeit imperfect in their application) of the desire to reward performance.
- Agencies are staffed by human beings. The prospect of exceptional rewards will heighten their motivation.
- The sense of partnership is reinforced, especially when sales or general business criteria are used.

- Exceptional performance has a better chance of receiving an exceptional reward.
- An exceptional reward in turn encourages investment by the agency in people, equipment, thought and disciplines to improve performance still further.

Disadvantages

- It may encourage the illusion that truly objective criteria exist and that they can be applied with total objectivity.
- The difficulty of agreeing on the best criteria given that the direct relationship with sales is distorted as a host of factors play a role e.g. competitive activity, pricing, distribution, etc.
- It may encourage the agency only to commit resources on the basis of minimum expected income, i.e. discounting potential income from the incentive portion.

What to watch out for

- The package must allow the agency to exceed the income it could normally anticipate if it reaches the maximum incentive payment.
- The incentive component in the agency's remuneration should not exceed what it can afford to be without. This suggests that it should not exceed what it would expect to make in profit.
- Define the criteria carefully to minimise wrangling over whether or not a target has been reached.
- Avoid use of targets which can distort the agency's work away from its true objectives. (Advertising communication tests are one example. Using a specific test technique, an arbiter can encourage the creation of advertising to produce good test results and only that.) In general, measurements should be selected which do not privilege the short versus the long term in order not to endanger the vital process of adding durable values to the brand.
- Agree in advance how targets should be modified in the event of reductions in media spending. For instance, targets could be scaled down in proportion to cuts in advertising budgets.

11. Remunerating 'Integrated Brand Communications'

There has been more and more talk of the need to ensure that all the elements of a particular brand's communications mix are truly synergistic or 'integrated'. This concern applies as much to those advertisers who use companies from a variety of different sources as to those advertisers working primarily or exclusively with marketing communications companies belonging to a single group.

The client need can be broken down into two parts.

- **Strategic management** of the complete range of marketing communications activities for their brands.
- **Individual services** in the communication techniques selected as most appropriate.

Methods of remuneration for each marketing communication technique

The methods of remuneration are determined by the type of activity and should not be influenced by questions on the ownership of the companies selected. Each activity has developed a method of remuneration which is most appropriate to it. Thus:

- Corporate or other **design projects** will generally be remunerated on the basis of project fees agreed in advance. Mock-ups in excess of the number included in the initial quotation and requested by the client will be billed at cost plus a mark-up or again at a predetermined rate per item.
- **Sales promotion** is also generally billed on a project basis. Margins on anticipated costs will allow for the amount of speculative work which is required before an assignment is awarded. In cases where the relationship is more continuous, a retainer may be paid in return for work being done with a lower mark-up. Outside purchase of items generally carries a fixed percentage mark-up.
- **Direct marketing** companies do most of their business with clients who are committed to that particular communication technique. Given the need for continuing counsel, independently of particular programs, they charge an annual retainer plus a mark-up on each programme that they run.
- **Public relations** follows a similar pattern.
- **Event marketing and sponsorship** is charged on a project basis.

Remunerating strategic management

This leaves the issue of how to pay for the overall strategic management of the total communications programme. If this is managed by an outside resource, rather than by the client, it will most often be by the advertising resource. There are several reasons:

- The advertising agency often controls some or all of the other companies involved.
- The advertising agency deals in most cases with the lion's share of the client's brand communication expenditure and is thus the 'natural leader'.
- The advertising agency has the best contact with the higher echelons of the client's management (more specialised communications are often dealt with at a lower level in the client's organisation).
- Most importantly, the advertising agency generally has the deepest understanding of the brand and is therefore best equipped to ensure the cohesion of all activities around the brand's character and objectives.

Some agencies need to acknowledge this responsibility more positively and develop managers whose understanding of the strategic role of each discipline is more complete. A condition of leadership is that the other disciplines are considered as readily as media advertising even though their share of the total expenditure may be smaller.

Clients should acknowledge this in their approach to remunerating this critical service, one of the most important that their agency can provide. They are certainly not doing so if they simply roll this function into the general advertising service paid for with a commission on media and production billings. This can only perpetuate the tendency to view all the other disciplines as poor relations, which drain resources away from the real focus of interest.

The opposite extreme is to dispense with any form of commission on media on the basis that a fair hearing for the other techniques will only be available if the agency has no financial interest whatsoever in how the money is spent. While this position has an absolute logic to it, it does fall down in two ways:

- the agency may still be biased towards those disciplines which it can offer the most lucrative service (be it the advertising agency itself or its specialised companies);
- it means throwing out the commission system even for those services for which it is particularly well adapted.

The mutual interests of the agency and client will best be served by a more flexible solution. Namely isolating this particular service from the arrangements made for the individual disciplines and remunerating it with an annual fee. The fee should be directly related to the calibre of the people (or often the person) providing it and the time which it is anticipated that they will devote to it. This will provide the client with a guarantee of quality attention and advice.

APPENDIX 1

Recommended Method to Calculate Fixed Fees

- Prior to the commencement of each fee year, the client and the agency will determine the scope of work and consequently the man hour requirements for the upcoming 12 months. Where applicable, the year's projection will be by product, and will comprise of:
  - (a) Month-by-month analysis for the first quarter,
  - (b) Total for each of the last three quarters, (assuming history is available); and
  - (c) Total for the first 12 months

This is to be based upon the planning brief/marketing communication plan provided by the client.

- Client and agency should always review the total fee proposal with reference to the total communication budget, so that a reasonable relationship is established. Such relationship will obviously be dependent upon the nature of the communication budget, and the nature of the products assigned.
- The agency and client will agree to the mix of manpower, the functions of the billable people and their estimated time allocation. <u>Under no circumstances will actual salary for agency staff be shared with clients.</u>
- The fee will be calculated on an individual employee cost accounting basis using the follow formula:
  Direct Labour Costs plus
  Overhead (as a % of direct labour) plus
  Profit (as a % of both direct labour and overhead)

It should be noted that:

1. **Direct Labour Cost**
   - (a) Includes salary, benefits, Employee Provident Fund, Pension plan, bonus, and other benefits that can be considered a part of total compensation; e.g. company-paid automobile, travel, accommodation etc. (Note: only actual staff costs should be used, <u>not</u> industry averages since an agency must recover its true cost).
   - (b) Is calculated on the basis of a 1600 average working hours of an agency i.e.:-
     365 days in a year
     Less 104 days for Saturdays and Sundays
     Less 15 days for annual leave
     Less 15 days for public holidays
     Less 2 days for medical leave
     Total 229 days @ 7 hours per day = an average of 1600 working hours per annum.
   - (c) The client cannot be charged for more hours than an individual is paid. As a practical matter, therefore, no individual can be billed to the client more than 100% of that individual's compensation.
   - (d) The cost for each employee will only vary when actual salary increases are given, although during hyper-inflationary times this may be more than once per year.

2. Overhead

(a) Includes all indirect legitimate operating expenses such as senior management costs, accounting, administration, human resources, secretarial support, clerical staff, computer services, research data, rent and utilities, telephone and telecommunications, depreciation, insurance, equipment, furniture rental, repairs/maintenance, stationery, postage, messengers, indirect travel, training, audit, legal, professional fees, Head office charges and new business expense.*

(b) Excludes interest expense unless it can be specifically related to the client and outstation/overseas travel which is to be reimbursed directly by the client.

(c) Will be allocated as a percentage of direct labour cost. It is calculated with reference to the following 12 months and will normally remain constant during this period.

(d) Will not be the same for any two agencies because of the different cost structures represented by individual companies.

* New Business Expense

Some argue to exclude new business costs from agency overhead on the grounds that they do not benefit the current client. Not true. New business expense is a necessary operating expense that benefits all agency clients by:

- Bringing in additional business over which the agency can allocate its fixed cost commitments, e.g. lease for office space, investment in training and technology etc., thus keeping its ongoing overhead rate at a reasonable level.
- Replacing lost business to accomplish the same goal. It is a fact that client turnover is occurring at an increasingly rapid rate, frequently due to circumstances that they have little or nothing to do with the agency's performance.

Since agencies do not sell product off the shelf, or cannot represent competing products, they must constantly seek new clients. These expenses are the equivalent of the client's marketing expense. As such, they are a legitimate operating expense.

The expansion of the agency's operating base, and the prevention of its erosion, benefit both agency and client.

3. Profit

A fair industry norm in international markets and one that is also appropriate for Malaysia is that profit will represent a 25 per cent markup on the total of the direct labour and overhead as an industry standard. This 25 per cent markup on total costs represents a 20% profit margin on the total fee.

- Each month a fee will be billed in accordance with the above and the manpower plan will be reviewed at the end of each quarter or at such other regular intervals as is agreed between the client and agency. The exact methods for review will be agreed between the client and the agency up front.

- As the year goes by, if an adjustment in fee level is deemed necessary due to changes in the business plan and for unforeseen circumstances, the agency/client should open-mindedly renegotiate.
- Fee remuneration in its fullest implementation, removes the need to charge agency commission on media and supplier cost

Clearly in order to make such a fee structure work, accurate time sheets need to be maintained by the agency. The client should be given the right to audit time reports should they question the time allocated to their business. Under no circumstances may a client have access to individual salaries of staff within the agency.

These procedures are recommended as a standard within the industry and should be reviewed openly with each and every client. Whilst details of each component will vary by agency (except for profit), the methodology should remain the same.

Annual Advertising Fee

Staff Requirements
(Please complete and attach "Dept Detail" form with names and % of time spent)

DEPARTMENT	**RM** Direct Salary Costs
Account Management	0.00
Strategic Planning	0.00
Creative	0.00
Media	0.00
Production	0.00
Total Direct Salary Costs	0.00
Overhead %	0%
Total Direct Salary and Overhead Costs	0.00
Mark-up	25.0%
Total Annual Fee	0.00
Add Govt. service tax	5%
Grand Total	0.00

Note: A 25% mark-up on total direct salary and overhead cost represents a 20% profit margin on total fee.

Department Detail - Staff Requirements

(Department)

Name	Title	% of Time

Account Management

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Strategic Planning

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Creative

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Media

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Production

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Note: This staff requirement list must exclude all "indirect" staff in finance, admin, human resource, secretarial, clerical, computer and support services. The cost for these personnel are to be included in the agency overhead cost component calculation, together with rental, utilities, telephone etc. etc.

APPENDIX 2

Menu - Schedule of Agency Services

1. Overall Services

- A careful study of the business of the Client and the Brands.
- An analysis of present and potential markets.
- The identification of problems and solutions in relation to advertising, marketing and merchandising of the Brand.
- The formulation and submission to the Client for its approval of advertising ideas, plans, programmes and campaigns together with estimates of the cost of executing the recommendations.
- Proposing, arranging and interpreting market research activity which the Agency judges to be of use to the Client in promoting the Accounts.

2. Media

- The evaluation of all advertising media.
- The formulation and submission for the Client's approval of marketing and media plans and subsequent implementation.
- The development, formulation and submission of a detailed media schedule for the Client's approval.
- General media planning and buying.
- Campaign post-analysis inclusive of competitors.

3. Production Supervision

- Preparation and submission of production estimates for all print and audio visual communication materials.
- Supervision of production companies and other suppliers.
- Organising the despatch of artwork, prints and other necessary materials to the media.
- Making the necessary arrangements for the use of artists, models, music etc. including licences, buyouts and fees wherever practicable prior to commissioning.

4. Other Services

- Negotiating and agreeing sponsorship deals on behalf of the Client and the formulation of all appropriate sponsorship credits and idents.
- Formulation, development and submission to the Client of merchandising and other promotional schemes.
- Analysing the relevance and usefulness of new media as they become available and the formulation, submission and with the Client's approval, execution of new media projects.

Note: The above is not an exhaustive list. It is an indication of the type of services performed.

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