

# CLOSE-UP 1



## Why agencies should call time on selling time

Agencies need to be thinking up ways to get paid for their work that aren't tied to the hours they put in, Tim Williams writes

Despite some recent reports about the small percentage of marketers who currently have a value-based compensation arrangement with their agencies, the move to a value-based approach will very soon become an imperative for agencies rather than an option.

Paradigms always take time to shift (germ theory was developed by 1700, yet didn't take hold until the time of Joseph Lister in 1865) but when they do, entire industries shift with them. In the not-too-distant future, it will be as hard to imagine that agencies sold "time" as it is to imagine the pre-germ-theory world of medicine where surgeons didn't bother to wash their hands.

### WRONG PRICING PRACTICES

Billing by the hour is built on the wrong theory, and faulty theories are always exposed, refuted and ultimately overturned. The labour theory of value, postulated by thinkers such as Karl Marx, states that value is created by and correlates directly with labour; the more work that goes into something, the greater the value. While this might have been true for the assembly line workers of the industrial age, it is not true for today's knowledge workers who live in a society where more than 70 per cent of all wealth is created not by labour, but by intellectual capital.

Recently, a digital agency in the US was hired by an online retailer struggling to increase its sales. After conducting a few simple usability tests, the agency learned that most customers didn't want to be required to "register" on the site in order to make a purchase; they just wanted to give their credit card information and buy the product. So the agency took out the "Register"

button and put in its place a button that simply said "Continue". In the first year, this simple change resulted in an additional \$300 million in sales. The agency spent its intellectual capital, not its time, in solving the problem and in the process created tremendous value for its client. Time and value are not in any way related.

### BARRIERS TO SUCCESS

Still, the great majority of agency executives haven't yet come to terms with the fact that their compensation agreements with clients are built on the wrong theory of value. The notion of value-based compensation often hits a roadblock because it is equated directly with "performance-based" compensation. Paying the agency based on specific outcomes is a form of value-based compensation, but it is not the definition of value-based compensation. The fact is that there are innumerable ways for agencies to be compensated in ways that have nothing to do with hours or time. A fee doesn't have to be tied to a set of metrics to be "value-based" – it just has to be based on something other than timesheets.

For example, some direct marketing agencies get paid per qualified lead. Some digital agencies, instead of charging for the time they invest in developing branded apps, simply ask to be paid per download. An agency in the US that was a finalist in a luxury car brand review took "time" completely out of the equation and proposed to earn \$50 for every car sold.

Of course, the chief resistance to this kind of approach is that agencies don't have complete control over these things and would, therefore, never agree to tie their compensation to them. But they're

looking through the wrong end of the telescope. If agencies want more control, this is precisely how to get it. Moving away from time-based compensation fundamentally changes the dynamics of the agency-client relationship, because when the economic incentives of the client and agency are aligned, there is a much higher degree of trust and mutual respect than in the standard pay-by-the-hour-regardless-of-results mentality.

Value-based compensation can also mean that the client pays the agency to use its intellectual property. A healthcare agency in southern California develops branded content that it licenses to its clients. For a client that markets medical devices for diabetes, the agency developed a video game that teaches children how to use their insulin pump. The agency owns this IP and licenses it to their client.

In its most basic form, value-based compensation can mean simply quoting a fixed price that is based on the value to the client rather than the cost to the agency. This is how pricing works in virtually every other industry besides professional services.

When the world's best-known brand (Coca-Cola) and the world's largest marketer (Procter & Gamble) adopt a value-based approach

**"There's a pricing revolution and it's up to the agencies to innovate with new and different ways to get paid"**

to compensating their agencies, it certainly takes away one of the primary excuses used by agencies and marketers alike: "I'll do it when I see one of the major brands do it."

### BOLD MOVES FROM BIG BRANDS

Coca-Cola's new approach to agency compensation is an impressive effort to align the economic incentives of their agencies with those of The Coca-Cola Company. This approach is based on the realisation that Coca-Cola is buying talent and outcomes, not structure and activities. Rather than pricing an assignment based on costs, Coke establishes the value by looking at such questions as strategic importance, scope complexity, talent requirements and the uniqueness of the assignment.

P&G has been practicing value-based compensation for years by paying its lead agencies based on sales increases of their major brands. This past year, P&G took this a step further by tying agency compensation to a combination of three metrics: brand sales, market share, and agency performance. P&G further aligns economic incentives through the concept of the "Brand Agency Leader" – a lead agency charged with marketing leadership for a brand.

The BAL has the ability not only to hire but to pay other discipline-specific companies necessary to fulfil the brand's marketing objectives. P&G writes one cheque to the BAL, which then decides what to pay the other agencies based on their role and contributions.

Marketers such as Coke and P&G understand that there is no correlation between labour and value. They begin each major assignment with a discussion of "What does success look like?"

rather than "How many hours will it take?" They have decided to get out of the business of monitoring their agency's costs, which makes the concept of hourly rates and ratecards irrelevant. They have changed the dialogue away from billable time to instead talk about what really matters: outcomes that are created in the marketplace.

### APPOINT PROFESSIONAL BUYERS

There's another important dimension of the compensation discussion that agencies must address. Client organisations are populated with well-trained procurement professionals schooled in negotiating, pricing and pricing psychology. Most agencies then attempt to match these professional buyers with amateur sellers. It's time for agencies to make pricing a core competency.

There are some signs this is beginning to change. TBWA\Chiat\Day recently announced the appointment of a "chief compensation officer" whose job is to ensure that the agency prices its services based on the value provided, not the costs incurred. The San Francisco-based Venables Bell & Partners has a "chief value officer". And a number of midsized independent companies in the US now have a "value council", a small group of senior executives charged with moving the agency away from uninventive billing based on time toward more creative forms of pricing based on value.

There's a pricing revolution underway, and it's up to the agencies (the sellers), not clients (the buyers) to innovate with new and different ways to get paid.

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