

Catalyst Reports: A Prescription to Heal the Ad Agency Business



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INTRODUCTION

The diagnosis is terminal when it comes to the current Ad Agency model; that has been repeated time and time again. Many people have put in their two cents and diagnosed this problem, but few have offered a solution. Few have offered a Prescription for what ails this business and a way to fix it for the future. I say it is time to take an old Biblical proverb and put it into action; “Physicians Heal Thyselves!” Let’s address the solution for the ailing Agency business.

Forecast after forecast has been published over the last three months predicting how ad spending will continue to increase over the next five years. But how will these dollars be managed when the ad agencies that traditionally service this industry are faltering and facing challenges to their very own business models? I come from an Agency environment and have spent the last 13 years either building, fixing or scaling digital shops and I think if our industry is going to heal we need to do it from the inside; we can’t wait for someone to do it for us. I think we know what needs to be done, but we need to set the stage for the prescription to work. We need to observe the symptoms and understand the ailments affecting our industry before we agree on the solution and write the prescription.

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THE SYMPTOMS

In order for the Advertising Agency business to succeed in the coming years we need to make some changes. It’s no different than a Doctor telling a person with high blood pressure or a person with high cholesterol how to get healthy. We need to make some changes in their lifestyle! We need to find a way for agencies to flourish in a world where there are far too many choices for media consumption facing the consumer and far too many ways to spend dollars to reach those consumers with advertising. Conversely, with the increase in opportunities, there is fragmentation. There are fewer and fewer mass-media outlets and targeting your consumers has become hard so publishers have difficulty finding a way to make money and the business becomes slightly less stable.

OLD PERCEPTIONS, NEW REALITIES

There was a perception in the past that advertising agencies were composed of cubicles full of brilliant people, within creative departments and media departments, who possessed incredible insights into consumers. These people were like interns in a hospital; learning their craft and practicing it every day; capable of operating under duress to save Brands, create messages and campaigns which drove specific consumer actions and drive sales and market share for their clients’ products and services.

I’m sad to say those days are gone and there’s no more magic. Not only have we exposed the public to secrets to our services but we’ve gone and made our efforts more accountable through technology. Technology has exposed the “man behind the curtain” and made the general populace aware of the ways in which agencies serviced their clients in the past.

User Generated Content came along and made it so anyone could create highly effective messages for their favorite brands and distribute them over the Internet at little cost. Google came along and began the current shift

towards the advertising marketplace model with products such as AdSense, allowing anyone with a credit card to buy media and reach a targeted audience to sell their products. These and other factors have worked together to commoditize the areas where agencies traditionally make their money; media buying and creative development.

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The magic is gone; in reality the execution of these concepts were always a commodity but as a result of these strides in technology and the door being thrown open into the world of the Agency, the client's are now aware and they're no longer willing to pay for it! Additionally, our ideas are now more accountable than they used to be so not only are we exposed, our effectiveness is exposed as well. I like to refer to these phenomena as the "Kids in the Garage". When the Kids in the Garage can do what the big Madison Ave. shops can do, then the clients recognize the even playing field and are unwilling to pay for it.

These days, anyone can be creative and anyone can target an audience online. We've progressed so far to the future that we've come across our very own past. In the past the Idea was King, but now the Idea is King and its accountable! These days it is more important to be Strategic and for the Strategy to drive the execution, which anyone can do for a price. The differentiation lies in Strategy, no longer in how you execute.

HOW LONG HAS IT BEEN HURTING?

Every seven years (or thereabouts) the Agency business witnesses a cycle wherein the business moves from a strategy of Bundling Agencies towards the Unbundling of Agencies. Bundling is defined as using one Agency that handles all your marketing needs whereas Unbundling refers to using multiple resources, or what many refer to as the "best-of-breed model", where experts in each area work together under the direction of a single point of contact. At different stages of a business and at different periods in time either model will work, hence the cyclical nature of the process.

Each cycle of the decision making brings with it its own pain and this recurring pain all points to the issues facing the industry. The current cycle appears to be focusing its attention on consolidation as a direct result of having witnessed the issues operating with too many partners on too many disparate efforts and lacking a cohesive structure (such as when campaigns lack a singular message or a distinct look-and-feel across multiple media formats). When we're in the midst of an economic downturn,

Bundling agencies and consolidation of resources is a typical reaction (fewer agencies to manage translates to fewer costs for outsourcing and fewer resources internally to manage them). This shift makes sense, but due to the threats facing the Agency model the effect may be negative. The threats still lie in the fact that Strategy is what will drive the business, not execution. The Agencies still focus their business, their revenue generation opportunities, on execution. Most agencies recommend what is in their best interests to recommend because these are the areas where they make the most money.

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In a Bundling or even in an Unbundling landscape, most agencies are focused on what they do best, not what is best for the client. Strategy contradicts this. Strategy means saying what the client needs, not what you want them to hear! Strategy is accountable as well, yet it is not a revenue source for most agencies. When a client looks to save money, the first thing to get cut is typically the Account Mgmt people or the Project Management people because these people are not responsible for execution, but I think the issue facing the agencies lies in this exact decision; do we retain the executional elements or do we retain the strategic elements?

DIAGNOSIS: BAD LIFESTYLE

Fundamentally there are three primary afflictions facing the Agency business; three primary lifestyle issues that need to be addressed before our prescription will take effect.

The first lifestyle issue facing the Agency business is they've de-emphasized Account Management and Strategy and focused on execution. If you ask an Agency if they are strategic, they will always respond, "Yes", but I'm afraid that it's just not true. If you ask an Account person for their insights into a client's business they will not always be able to deliver one in an efficient and effective manner because they have not been tasked to do so very often. And may not have been trained to do it either.

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Account Managers and Strategic Planners are supposed to be the thought leads for any business, but they have become glorified Project Managers with a little bit of Sales Rep wrapped in. An Account Director these days is encouraged to think about execution and what's best for the Agency before they think about what is best for the client. That is the model under which they are paid. More media dollars being spent means more commission for media. More creative units being developed means higher margins on banners, commercials and print ads

Their salary, specifically their bonus structure, is the direct result of billings for the Agency. So when the client and the Agency disagree, the Account team is not incentivized to put Client needs first. For the model to become effective we need to have Strategists' time paid for directly by the clients and incentivized with bonus structures based on their client's needs rather than the needs of the Agency. Since the client is fundamentally where the money comes from, why can't they be incentivized in that manner?

Another lifestyle issue facing the agencies is the fact that digital media requires more work per revenue dollar than non-digital media does, and not all agencies are adept at the intricate details of operating in this medium. The medium is work intensive because of its profession of accountability but Account Management and Strategists are rarely billed at accurate rates while executional teams, such as Media Planners and Designers/Developers are many times unfamiliar with the technology they're working in.

When a traditional Agency does an interactive campaign, they often take longer to put it together than a digital shop because they have to learn as they go. The Interactive agencies, on the other hand, do not bill accurately because they are trying to keep pace with the pricing offered by the traditional shops who profess to be able to work in this environment just as well as the digital shops. The Traditional shops try to work under the margin of profitability they make from traditional media, but even this margin is no longer what it once was and dollars are

lost on execution because agencies are either attempting to handle a medium they are unfamiliar with or they are spending too much time executing on these projects.

There is more data on how consumers interact with media as well as with each other. There is more data on the performance of the advertising units being integrated into the platforms. There is more data that outlines that the consumer is in control of when and where and how they will interact with the media, and there are more ways than ever for a consumer to choose to interact with media. All this explosion of opportunity and choice has created a system whereby planning, analyzing, and trafficking advertising units is more complex and management of campaigns is more difficult because they can be changed out in a close-to-real-time manner. With accountability and this resultant flexibility, managing a digital effort is much more intensive than managing a traditional media campaign.

Another lifestyle observation is that the Ad Agency business is threatened by digital media because margins for operating a digital Agency are lower and are continually being pushed even lower. With more accountability in the media and with a better window into the process for managing this media, clients are requesting fees be cut lower and that their Agency partners find more efficient ways of working, which is hard when we know that the work required to manage these efforts is higher than it ever was before and the costs to build a team which is knowledgeable in these fields is becoming exponentially higher than they were before. These two forces are at odds with one another and they are making it increasingly difficult to be an Agency in this environment!

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Decreasing margins and higher volumes of work required to execute and manage a campaign are diametrically opposed forces and squeezing the business dry. I routinely read through the headlines to see which agencies are pitching what businesses and I know that in many of these pitches there are procurement departments managing pitches and judging against hard numbers such as retainers and monthly fees and media commissions. In creative reviews there are examples of reverse auctions where creative shops bid against each other for the right to work on the business, thereby devaluing the creative element they bring to the table. These processes are cruel and unusual and are forcing the agencies into an uncomfortable position, but I also argue that a portion of the blame lies on the side of the agencies themselves!

The agencies are also partly to blame because they've created the system in which they are being evaluated and they refuse to accept the possibility of change and the chance they have to revise their models to react accordingly. For many years we've seen the growth of the holding company model without any new revision to the ways in which they run their individual businesses and that resistance to change and to flexible business practices has created an immovable object; a situation where the change that will be necessary is more radical and probably more painful than it would have been five years ago.

The change will now be on a revolutionary scale rather than an evolutionary scale, with people's positions and jobs in the current model being put in jeopardy.

So rather than continue to talk about the problems, I want to talk about the solution. I've read article after article, and I've written a fair number myself, on the problems facing the advertising Agency business but here I propose a solution. If I were a doctor this would be my prescription for how to fix the Agency business.

THE PRESCRIPTION

The prescription is simple in message but very difficult in implementation. The prescription has three components:

- A. **“Lose The Fat”**
- B. **Outsource Execution**
- C. **Base Your Business On Strategy**

PRESCRIPTION A: LOSE THE FAT

Let's face facts. There are too many people offering too little or redundant value inside the Ad Agency business. There are too many Account Executives unwilling to learn the new tricks of the trade and there are too many “specialists” walking the hallowed halls of Madison Avenue. We have too many people and therefore we have high overhead and we demand large retainers to service client businesses without concern for the flexibility and the accountability of that business. Clients are pushing for incentivized packages with potential upside for both parties but the current Agency model is unable to manage that type of a relationship because they have financial staff and human resource staff to pay for.

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Additionally I see that too often we promote people in the ad agencies up to senior or executive levels and we take them away from doing what they were really good at; advertising strategy! We remove people from utilizing the skills that got them where they are and we focus them on overhead functions which do not use their skills and talents correctly. When you take a brilliant Strategist and you make them Managing Director of an Agency, you focus more of their attention on profit and loss tables rather than on strategy, taking them away from what they were great at! We don't need all the overhead and we don't need to run our business this way.

We can all benefit from consolidating back-office functions under one roof within each of the holding companies. We can consolidate Human Resources and we can certainly consolidate Strategic Planning and Account Management under one team. I used to pitch against larger agencies and use the line, “We won't cost you as much because you don't have to pay a large overhead. You don't need to pay for ‘offices in Helsinki’. You pay only for what you need; the team on your business”.

Then I became part of a large company with an overhead that covered multiple offices and a management team with too many people who were un-billable. My biggest complaint was that we took the most senior people, the people who had worked their ways up in the advertising world because they were really good at what they did, and we'd put them in positions where they never practiced their crafts and they never spoke to clients. Where does the idea come from that if someone is really good at something, you reward them by putting them in a position to never do that which they are good at?

Many of the operations of management can be either automated or consolidated and the holding companies are in the best position to do so. Let finance people do the books and let MBA's run the business aspects, but let the Presidents and the Managing Directors be Advertising people. That's what they do best!

When I refer to Losing the Fat I am referring to the redundancy. I am referring to the fact that there is software which can handle 75% of what needs to be done and can create efficiencies where there currently are none. The Holding Companies do not need finance departments for every individual Agency when they can manage the finances from a centralized point! By Losing the Fat, I am not implying these people are ineffective, but they are not cost efficient.

The holding companies could consolidate these functions over a period of the next 5-7 years, but this will result in cutting redundant positions and broadcasting their problem to Wall Street. Wall Street would likely punish the stock price during these restructuring efforts, but the outcome would be a more cost effective solution for the Agency model. The agencies would then focus on Strategy and Consumer Behavior and the things that actually make them great! The power struggle inside these holding companies would be catastrophic, but after the dust settles you would see that the agencies are leading by doing what they should be doing best; directing Strategy.

PRESCRIPTION B: OUTSOURCE EXECUTION

The second element of the prescription is to Outsource the Execution. The world has plenty of media buying shops and creative execution shops...so why are we continuously building new ones? The Holding Companies can consolidate planning and buying in a finite number of groups and for those of you who are independent, you can focus your attention on a partner who has already built out these services. Why try to build an online media team and hire over-priced talent and manage the business in such a way when you can work with someone who already invests in the research and the tools and had already hired the team and amassed the intelligence to make these buys a reality? Professing to do it all in-house is hubris and will only serve to cause more trouble than it's worth. Plus, these media buying shops already have recognized the efficiencies in their teams and this, couple with a leveraged buying position, can ensure they get the best rates which are probably better than you would've gotten on your own!

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The same goes for creative! Creative design is where the money and the interest for your people lies, it doesn't lie in tactical build out of banners and skyscrapers! Even video is an area where costs are being reduced and anyone can create content on the cheap, so while your margins are being pushed close to 0%, why not focus your efforts on the part where you can make money; creating design strategies and theme ideas?

For this part of the prescription to work, there need to be some admissions:

1. **Admit that your margins are too high on creative and start to cut back.** Let's face it, you are overstaffed in your creative departments and media can no longer cover the costs in their commissions. I would also argue that you are fat in the account departments, so you might need to move people from there as well unless they are billable. Your job should be to direct creative messaging and design an overarching campaign, but you can work less expensive outsourced partners for the tactical execution of creative in Flash and in Video Production and these partners will already have benefitted from scalability and planning and can likely create your content for a fraction of what you would charge.
2. **Admit that you cannot be an expert in the tactical execution of every media format and work with the partners to execute the ideas that you plan strategically!** It's ok to say that you don't know how to implement outdoor AND mobile campaigns, but someone else does and they have already made the

mistakes and invested in the tools to make this a reality. Work from where they have left off rather than trying to rebuild the wheel!

3. **Focus on strategy and the understanding of consumer behavior, but work with best-of-breed partners for tactical execution.** These partners can happily remain behind the scenes and they should never present much of a mark-up, if at all. There are best-of-breed services for buying Television and for buying Radio and for buying Online. Use their expertise, but understand the ways that these media formats will work between one another and understand how the audience will see the message across these multiple formats.

The landscape after administering this prescription is simple. You would have Holding Companies where the back-office functions are consolidated which frees up the individual shops to do their business of driving strategy, planning and design. The individual shops would be leaner, which is a downside of course, with some people whose roles are redundant being forced to move on. The agencies would compete on the grounds of thinking rather than price and the only competitive advantages would be in terms of intelligent applications of ideas!

Media buying would be standardized in this model with rates being standard across the board. Ad exchanges would likely flourish in this environment and automated marketplaces would become the standard tools of the trade. Creative execution and build-out would be standardized as well, just as it is in traditional media, with costs being fixed or within a defined margin and the effectiveness of these efforts being based on the thinking and the understanding of consumer behavior that went into their design! With focused variables such as price and format taken care of, our learning would be focused on behaviors, interaction and reaction of the consumers.

PRESCRIPTION C: BASE YOUR BUSINESS ON STRATEGY

The third part of the prescription is the hardest; you need to stand your ground. In the old model for advertising, back when Agency's were built, the motto was to earn the respect of your peers and your clients, and demand it second. When you were working on a business you were paid to be the experts on how to market that business, but you earned this reputation by actually performing. If you are focused on Strategy and you can prove results by sticking to that Strategy, you have earned their respect.

Nowadays I rarely see or hear of this. And when I do I hear the Agency proclaiming this motto to be arrogant. Arrogance is a fine line to walk but is the evil sibling of Confidence. Confidence is a good thing and if you are confident in your Strategy, then stand your ground and tell the client what they NEED to hear, not what they WANT to hear. Too many people will back down and too many agencies will default back to the executional elements and know that they make their money on media buying or creative development rather than the Strategy behind them, so rather than risk the execution they fall back into agreement so that they campaign will move forward.

I think this is even more of an issue now that the curtain is open and the room has been exposed; not everyone is Strategic and that is ok, but not everyone can implement flawlessly either, so outsourcing the execution to pure professionals can make a lot of sense in this situation.

TAKE THESE EASY STEPS

In order to summarize what I am talking about, let me run through the steps:

STEP 1: OBSERVE THE SYMPTOMS

The symptoms we see are a decrease in fees associated with advertising, decreasing length of relationships between agencies and clients, a high level of churn and a continued splintering of services as business moves from Bundling to Unbundling and back again.

STEP 2: DETERMINE HOW LONG IT'S BEEN HURTING

How long have these issues been a problem in your shop? Are there clear points in time where you can point to where the pain was worse than it is now or has it been a gradual decline? If the symptoms are new, you may be able to ride it out, but if they are long-term you might need to seek help.

STEP 3: MAKE LIFESTYLE CHANGES

In order to get started, you need to change some lifestyle elements. You need to focus on what you are good at and have that become your area of expertise. Ideally this is Strategic, but if you are purely an executional player, then embrace that and be that!

Stand your ground and defend your ideas; don't be afraid to tell your clients what they need to hear, not what they want to hear. That's what you are being paid to do, so don't lose sight of that.

STEP 4: FILL THE FINAL PRESCRIPTION

Reduce the overhead of your business by factoring in redundancy within your agency or holding company and start to reduce your dependency on the historical margins you were making. Focus your staff and attention on the business that got you here, not the business of running the business. Be strategic, but not if you aren't trained to be.

THE FOLLOW-UP VISIT: TAKE TWO AND CALL ME IN THE MORNING

If the agency model is to succeed, and believe it or not I still believe that it can, change has to happen. Like that patient with the high blood pressure and the high cholesterol, lifestyle changes need to be made, even if they also have some medication to take. If you follow this course of treatment and aren't afraid to make these changes, then the business will succeed. It won't be easy, but it really never is. You've been eating your cheeseburgers and getting fat off the grilled onions, but your heart can't take it and you need to make some changes! I look forward to these changes! A few years down the line everything will be great again and we'll have even more time to work together and play together.

Take it from me; I may not be a doctor but I know how to heal myself!

Share your thoughts: cory@catalystsf.com