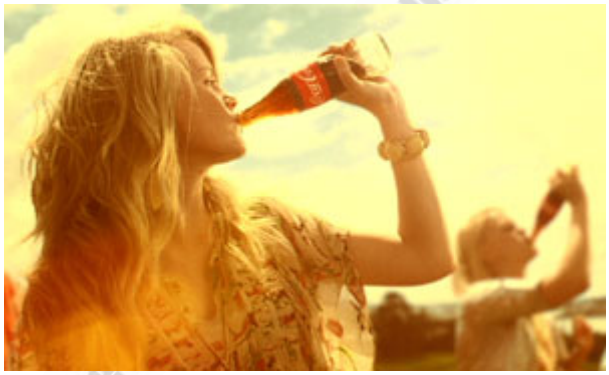
Clock-watchers no more

A movement to pay advertising agencies for value, not hours, takes off.

Emma Cookson, the boss of BBH, a global advertising firm, says her industry has been “approaching and avoiding” a change in how it is paid for many years. Avoidance, however, may no longer be an option. On April 20th Coca-Cola said it would adopt a “value-based” compensation system for the advertisers that do work for its 400 brands. Rather than paying advertising agencies for hours worked, Coke will pay for results achieved.

The industry, already sick because of the recession, turned a bit bluer in the face at the news. Global ad spending is expected to decline by nearly 7% in 2009, according to ZenithOptimedia, and by around 9% in America. Carmakers and other faltering firms have cut marketing budgets, and work is harder to come by. There have been lay-offs. It is hardly an opportune time to discuss a change in compensation models. Billable hours have been the standard way of doing things since the 1970s. Assessing a campaign’s value is much harder.

Coke, however, thinks it can do just that. Its new model guarantees to cover advertising agencies’ costs, plus a bonus of up to 30%. The bonus depends on a number of metrics, including the agency’s overall performance, and the sales and market share of the products being advertised. Coke insists that its aim is not to cut costs but to inspire creativity and efficiency. Procter & Gamble, a consumer-goods giant which has also ditched hourly fees in favour of performance-related fees for 12 of its brands, says the same thing.



Coca-Cola - What is it worth?

Although the recession may give companies an immediate reason to reassess how they pay their advertising agencies, it is not the sole impetus for the switch. Discussions about finding better ways to reward agencies for their creativity have been going on for years. The American Association of Advertising Agencies estimates that about 10% of compensation agreements are value-based. Coke’s announcement of its new approach will probably spur other firms to follow suit, and Coke has said that it wants its model to become the standard for the industry.

The shift away from the billable hour, however, may take a while. Some agency executives are sceptical about being paid for value, because it is so subjective. They interpret talk about value as code for cost-cutting. Jeff Goodby, co-founder of Goodby, Silverstein & Partners, an advertising agency, dislikes the fact that Coke’s new policy guarantees only recouped costs. If he is going to take on a project in which he assumes risk by not knowing his profit margin in advance, “There has to be a big pot at the end of that rainbow,” he says.

But some advertising agencies have voluntarily moved away from billing by the hour and towards contracts that reward value. Jeff Hicks, chief executive of Crispin Porter + Bogusky, says this approach has helped his agency work more closely with clients by aligning the agency’s compensation and the advertiser’s profitability. Others, sensing the limitation of being

paid by the hour, are trying to develop new ways to capture the value their work can create. For example, BBH recently launched a unit, called Zag, which designs and markets its own products, such as ready-made foods.

Advertising is not the only industry where there is discussion about whether to pay for time or results. Some accounting, consulting and law firms are also scrapping the billable hour, often at the request of their clients. Ron Baker, author of “Pricing on Purpose”, a book on pricing strategies, thinks service agencies need to grasp that they sell ideas, not time, and that ideas should be generously compensated. Imagine, he says, if J.K. Rowling had been paid by the hour to write about Harry Potter.

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