



PUBLIC RELATIONS AGENCY COMPENSATION: ENHANCING VALUE THROUGH BEST PRACTICES

BY J. FRANCISCO ESCOBAR

In this paper, J. Francisco Escobar, former marketing services and procurement manager for Texas Instruments Incorporated, presents his approach to the procurement/agency partnership. He interviewed agency executives and procurement clients, and filtered the input through his own 25 years of experience as both a client and industry consultant. This paper was developed for use by public relations firms, but is equally appropriate for other key stakeholders in the partnership.

INTRODUCTION

The discipline of public relations continues to gain importance to public and private sector organizations and is forecast for continued growth into the next decade.* According to a 2006 study by the Association of National Advertisers (ANA), the marketers surveyed rank public relations as number one in terms of overall value to the enterprise.

The Council believes that the client/agency relationship should produce a successful financial arrangement that:

- Encourages agency involvement
- Rewards success with growth
- Supports long-term relationships
- Lets the agency run its own business

To accomplish this, agency executives and their clients are encouraged to build and sustain productive working relationships with all those involved in compensation discussions. This paper offers insights toward that goal. We invite you to share your best procurement practices with the Council of Public Relations Firms. Kathy Cripps, President (kcripps@prfirms.org).

*Veronis Shuler Stevenson (VSS Communications Industry Forecast 2007-2011)



THE CHANGING BUSINESS LANDSCAPE

WHY PROCUREMENT ...

In this time of ever-increasing technological advances and growing globalization, a significant evolution has taken place throughout the corporate world with respect to its organizational structures, operational priorities, and business practices. Public relations firms, whose growth has been largely fueled by the expansion of its corporate counterparts, have survived by adapting, and thrived by embracing the significant changes to its core customer base.

Specifically in the area of managing a company's expenditures with third parties, this evolution has been significant and impactful. Purchasing departments maintained arms-length relationships with internal customers and adversarial practices with external vendors which were almost solely dictated by price. By virtue of the quality revolution initiated in the early 1980's, the strategic role of purchasing was established as companies drastically increased outsourcing activities and their approach to supplier relationships. With the availability of electronic data and the focus on improving business processes, alignment and teamwork across corporate disciplines and its key stakeholders became a priority. Consolidating a larger amount of expenditures with fewer sources yielded pricing leverage and an emphasis on supplier delivery and performance.

Fast-forwarding to the internet era, in many major corporations third-party expenditures exceed expenses related to its employees, thus becoming the largest overall cost component. Procurement, strategic sourcing, and supply chain management departments are firmly entrenched within multifunctional global teams to optimize the value of all categories of spend. In developing long term supplier-partner alliances, these professionals have placed emphasis on simplifying processes, measuring continuous improvement, and generating quantifiable cost savings.

Procurement's coming of age has included an irreversible entry into the marketing services category, where relationships have historically been handled directly between marketing/communications stakeholders and their agency counterparts. In the words of major client procurement executives interviewed for this paper, internal practitioners still have the "authority to commit" but no longer have the "authority to spend" without procurement's blessing; and the rationale of "exercising our corporate fiduciary responsibility" and "ensuring fairness in all business transactions" has created a compelling argument for their involvement.

Public Relations Today

The landscape in the public relations industry has been far from static during the evolution of its corporate clientele. The discipline has grown exponentially in importance and has attained a significant role in the marketing communications mix as a driver of awareness, influence and purchase consideration, while increasing its impact at the highest levels through crisis communications and reputation management. With the multitude of mediums of communications offered by the internet and virtual communities, public relations has assumed ownership of managing many of these newer channels of "free" dialogue, through



diligent monitoring as well as more precise delivery to extremely targeted and increasingly diverse audiences. The balance between frequency of communications and appropriate, relevant information has never been more critical in an overly cluttered and message-saturated marketplace.

Client Care-about

What do procurement, strategic sourcing and supply chain management professionals really care about? Many of the same things which clients would deem important:

- Strategic partners who are aligned with business objectives
- Quality conscious professionals that execute flawlessly
- Brainpower delivered on time and timely project completion
- Customer-focused service providers that really listen
- Excellence in all areas, including administrative functions
- Reasonable supplier contractual terms and conditions
- Fair compensation that is managed within overall budget
- Sufficient financial transparency to ensure supplier viability
- Profitability which allows service providers to hire the best talent and utilize state-of-the art tools and resources
- Productivity – Eliminating waste by streamlining processes on client side and in coordination with service providers

With respect to public relations agency compensation, there is now a different dialogue taking place on both sides of the agency/client relationship. On the agency side, compensation negotiation has increasingly become the purview of executive management, predominantly the CFO, the COO, and to a lesser extent the CEO. The key is a much higher and diverse level of preparedness on either side of the negotiating table which was previously not expected or required.

The intended outcome is the ongoing elimination of costly and wasteful steps in the course of achieving mutually desired results. As it continues its involvement, procurement must concern

itself with productivity, whether the process is with its internal communications and PR stakeholders and/or with its external public relations partners. Quite simply, procurement needs to ensure that there are no mysteries in the way services get delivered, valued or charged to their corporations.

CURRENT PRIMARY BILLING MODEL

According to the Council's 2007 business benchmarking survey nearly 45% of its member firms are engaged in time-based contracts with their clients; another 34% use a fixed fee or retainer basis for billing clients. Public relations firms, like law firms and management consultants, primarily provide strategic counsel (for example on reputation management, public affairs and other stakeholder communications that may protect as well as sell a brand); this differs from advertising which primarily provides a product – an advertisement. This difference has a direct impact on the compensation expectation of a public relations firm. Public relations firms have traditionally used a revenue-based model which considers direct and indirect costs, and reasonable profit, to determine billing rates. Comprehensive employee compensation is the largest direct cost; indirect costs reflect the size and location of the business. While few firms currently are using value-based or incentive billing, less than 1% according to the above mentioned benchmarking survey, it is a trend that may gain momentum in the next few years.



VALUE-BASED RELATIONSHIP MODEL

Fundamentally, there is a clear distinction between what corporations buy through “General Procurement” to make their core products and services available (i.e. component parts and materials), and what they expend to generate positive brand awareness and sales in the marketplace (i.e. marketing communication and creative services). Alternatively, this “Value for Money” procurement resides on the revenue end, opposite of the cost end, in the expenditure continuum of all corporations’ financials. In this situation, the point is not merely to continually reduce an expense figure that impacts the bottom line, but rather to grow the top line by obtaining tangible value for the marketing services investment. Additionally, by considering the inherent goodwill and learnings that accrue over the life of a sustained agency/client relationship, procurement validates that significant “switching costs” are incurred in failed relationships.

Where Procurement Can Be Most Effective: Best Practices

The best practices in public relations procurement are centered on early involvement, fact-based analyses, process improvements, and an ongoing assessment of value for the goods/services rendered. Best practices in this type of “Consultative” or true “Value for Money” procurement must consist of the following:

- Alignment with internal PR client stakeholders
- Linking capabilities across client brands/departments
- Sufficient transparency to engender confidence and trust that compensation is reasonable and within overall budget
- Process Guardians: ensuring good inputs, enabling smooth approvals, and encouraging performance evaluations
- Serving as “marriage counselors” when billing-related problems are brewing or to handle unreasonable client PR practitioners
- As advocates of fair-play and ongoing stewardship, being perceived as an indispensable part of the team
- Whether it relates to the contract or invoicing, the ability to get things “pushed through the client’s system”
- Providing value-add reporting to top management
- Constructive coaching and manipulation of all parties
- Insisting on fairness and equity – “QUID PRO QUO.”
- Acting as stewards of ethical behavior and builders of trust

As compensation models in marketing communications have evolved from spend-based (commissions and mark-ups) to labor-based arrangements (cost-plus), the public relations industry has resisted the trend. The “rate card” methodology has typically yielded higher profit margins, especially at the junior and mid-level staff functions. The rationale is that this revenue is intended to cover the more expensive senior strategic staff the client desires but is unwilling to pay. From procurement’s practical perspective, the existing methodology is flawed.

Inherently “cost-plus” is not an unattractive compensation mechanism for the public relations industry. A complete recovery of an agency’s reasonable cost, along with a fair profit, provides management with a reduction in the risk of its people assets and inventory. The key then is consistency of client activity and budgets that maximize personnel utilization, as well as consensus on an appropriate agency staffing plan,

reasonable cost recovery metrics, and a fair profit margin. Add to this an incentive compensation mechanism or “success” fees, and a labor-based methodology can be mutually beneficial to both parties. In order to move the dialogue to a value-based compensation and relationship model, there needs to be agreement as to what “value” is being bought when it comes to public relations services. Agencies should ask their clients, “how can I achieve incentive compensation on the work we are doing with you?”



Be Wary of “Worst Practices”

If a firm’s creativity or intellectual property, the value and tenure of the relationship, and the specific talent assigned to an account by its PR partners is not genuinely part of the mix, it is inevitable that some of the following worst practices may surface during the life of the engagement:

- Price is the predominant driver from the outset
- Sourcing to multiple candidates when clear winner is already known by client
- Unaligned budgets, expectations and strategic programs
- RFPs with artificially high budgetary levels and protracted contractual and compensation negotiations
- Using inappropriate benchmarking data from other marketing or professional services categories
- Inequitable contractual terms and conditions (not bilateral)
- Treating public relations like an undifferentiated commodity with tools such as reverse auctions or dynamic bidding
- Asking for needless information or expecting complete accounting transparency (individual salary data)
- Expecting services for free, firms to act like a bank, or perform with unrealistic or non-existent profit margins
- Unprofessional and unethical behavior

(And as an aside, procurement have been scrutinizing their spend with accounting, law and management consulting firms in much the same way as they have marketing services.) But in reality, public relations is about communications programs that are linked to overall messaging, be it for a specific brand, product, service or a corporate initiative. It’s about selling a business process that involves human capital, expertise and talent, whether in support of product promotions, investor relations or crisis communications. Incentive compensation arrangements for public relations services can be as creative and customized as the two collaborative parties in the partnership are willing to be. The key is that the criteria for measuring success, particularly the quantitative portion, align with the business objectives and reward system of the client and its communications stakeholders. In most cases, incentives have utilized a risk/reward

paradigm, based on either levels of agency profitability or a percentage of fees, which assures that both parties have some “skin in the game.” In a discipline where relationships are tantamount and the link between programs and business results can be difficult to correlate and quantify, it is logical that a significant portion of success measurements be qualitative in nature and relate to agency service level performance. Quantitative metrics may include such public relations objectives as the attainment of specific communications goals (e.g. particular media effort in a certain number of markets), measurement of communications outputs such as share of voice or event attendance, or determination of identifiable communication outcomes (e.g. awareness, website visits, etc.)

WHO DETERMINES THE PRICE?

What is a fair total “price” for the value of these programs? The onus for “pricing” a product or service has always been on the seller and NOT the buyer. Therefore, it is incumbent on public relations firms to take the lead and responsibility for determining the value of its services. Clients need to be educated that, when it comes to “good-quick-cheap” or “faster-cheaper-better,” you can only ever get just two of the three at any given time. There must be a balance, and the quality and performance of the “outputs” needs to be in line with the most appropriate price in the marketplace. Firms should expect clients to compare this price, and so



long as it is done with internal benchmarks of comparable firms in the market, historical data from the existing relationship, or external benchmarks from sources which either side is willing to disclose, the dialogue will remain productive.

Ultimately, a value pricing model is a joint effort between the provider and the consumer of services. Collectively, they must find a way to define the elements of value by agreeing what, how and when the “outputs” will be delivered and measured. Return on investment must be a shared responsibility in identifying reliable, reproducible metrics. Quantification in this discipline IS a challenge, but it CAN be done so long as a legitimately collaborative conclusion is reached that includes qualitative customer satisfaction as part of the equation.

Public relations firms want consistency from their clients, challenging work they can be proud of, to grow profitably, and to gain respect by adding value to the marketing mix. Such a value-based relationship model can enable this preferred end state while moving clients to more holistic brand building. Client procurement must be willing to be open to any alternative compensation discussion whose outcome can be measured and validated, and that both sides can feel good about.

Public Relations Firms would be well served when dealing with procurement to get answers to the following questions to determine priorities:

- What is your top concern: driving down costs, improving working processes or building/sustaining a vibrant business relationship?
- Is there alignment between your business objectives and those of your communications stakeholders (our direct customer interface)?
- What is your level and type of experience with the public relations discipline, your client practitioners and other firms in the category?
- If the choice is between faster, cheaper and better, which two of these three is the most important?
- How much – time & money – are you willing to spend or expecting us to expend to achieve identifiable levels of productivity?
- Where does your organization report to internally and how are you or the involvement of your organization measured?
- Who will be responsible for determining the value of our services and how can we be more involved in this process?



Getting to More Effective Compensation Negotiations

If the firm is aware of the clients key “care abouts” and fully informed of its own value and pricing requirements, successful discussions come down to negotiating skills.

Consider:

- 1. In business, as in life, people who EXPECT more, ASK or DEMAND more, will GET more.** If people will always give you less than what you want or ask for, it stands to reason that those who somewhat exaggerate their expectations and requests will inevitably end up with more than those who don't.
- 2. Negotiate in person, face-to-face.** Negotiations conducted via e-mail, over the phone, and through video-teleconferencing are ineffective and only serve to drag out the negotiations, until a live meeting can be consummated.
- 3. Make the best use of body language.** Positive body language reflected by good posture, leaning forward and getting closer to the other party, firm handshakes, steady eye contact, engaged listening, and a big smile are all reflective of self-confidence and a winning attitude.
- 4. Elevate the other party's ego and be careful NOT to lower their ego.** Finding ways to convey “I like you” will always result in getting what you want from the other party. Conversely, hurtful personal comments – even if only perceived as such by the other party – will NEVER result in a favorable agreement.
- 5. Talk about money last.** Initiating the discussions on a mutual item of interest that has nothing to do with the negotiations at hand will put the other party at ease and more open to your position. Foregoing immediate reference to compensation and pricing then serves to elevate the dialogue toward value, partnership and the meeting of mutual expectations.
- 6. Be stingy with any concessions.** Don't give up too much or too easily, because large, fast jumps in position erode your credibility. Give in slowly and a little at a time.
- 7. SHUT-UP.** Don't give away too much information. The more the other party knows about your pressure points and weaknesses, the better off they are, as these invariably become sources of negotiating power for them.
- 8. Negotiate with confidence.** By representing your party's interests with conviction, you demonstrate how much you believe in yourself, your company, and your position.
- 9. Say “NO” one more time.** Just when you are ready to concede a major negotiating point, throw it back to the other party one last time. You may be surprised to find out that the other party still has some room for concessions that may even result in greater satisfaction for both parties.
- 10. Walking away can sometimes be the best course of action.** If the other party's culture does not mix well with your own, or if they overextend your range of fairness, you may be better off to turn down the opportunity to do business. It's amazing how the other party's tune changes when you are willing to “walk away.”



FINDING COMMON GROUND

Irrespective of the compensation model being applied, procurement and public relations firms need to build a relationship around pertinent measurements that are equally important to both parties. The Association of National Advertisers most recent *Trends in Agency Compensation Study*, reporting results in 2007, revealed a continuing increase in major corporations' propensity to utilize incentive compensation arrangements with their principal agencies of record – currently in use by 47% of respondents and 89% of the largest marketers. In essence, these “pay for performance” plans establish a risk/reward methodology, whereby an incremental amount of compensation is contingent upon the achievement of mutually agreed-upon goals and objectives, in consideration of the value derived from the agency's service and performance. With the study clearly indicating that value-based compensation is still in its early stages, the road to maturity is most likely paved through the use of performance incentives. The public relations industry has an opportunity to enhance labor-based fee models with a value-based fee incentive.

State-of-the-art incentive compensation arrangements typically exhibit the following similar characteristics – simply put, the 3 T's:

1. Trust that the client allows the incentive to be meaningful, engages in the process as objectively as possible, and budgets for the maximum incentive payout.

This level of trust builds over time and is normally lacking in a new relationship. It is recommended that these arrangements not be initiated in the first year of compensation negotiations.

2. Tool in place that enables the parties to agree on all measurement objectives/specifics, capture quantifiable metrics, and properly evaluate qualitative criteria.

The key is that the process for developing and deploying the tool be collaborative, simple to administer, and subject to modification. Most importantly, the tool must reflect an alignment with business objectives.

3. Teamwork that ensures input from all relevant and engaged client stakeholders, promotes bilateral communication, and provides for joint involvement to continually improve the process.

There must be commitment to the process from the standpoint of participation, candor and professionalism. Clients are responsible for being fair in their assessments and firms have the obligation to address areas of improvement with prompt, deliberate action plans.

The ANA's study also showed a decline in corporations' appetite for requesting specific cost information from agencies servicing their account, as well as a narrowing of the gap regarding clients and agencies' expectations of what constitutes a reasonable agency profit. In 2004, the study indicated clients' reported level of agency profit to be an average of 12%, whereas marketers indicated that their agencies were requesting an average of 18%. In 2007, clients' reported average increased to 14% while they considered their agencies' expectations to have decreased to 16%. Both of these trends are positive indicators that reflect greater trust and alignment in major agency/client relationships.



The study also revealed that client procurement and sourcing departments/personnel have become the single largest client group reviewing and negotiating agency compensation – a doubling from 34% reported in 2004 to 70% of marketers in 2007. Finally, as far as a future outlook is concerned, 46% of respondents indicated that they were likely to make a change in compensation agreements in the next 12 months. The primary rationale given was fairly evenly divided between improving agency performance, reducing costs, and simplifying administration.

Notwithstanding these results, client procurement and strategic sourcing continue to be measured based on their cost initiatives, be they savings, avoidance, containment, or cost improvement. All of this terminology is synonymous with the “added value” that is the primary justification for the involvement of these organizations. By spearheading joint process improvements which help both parties become more efficient, resources can be freed up on either side and reduce unnecessary cost.

It is a firm’s responsibility to:

- Be proactive and routinely bring alternative approaches for cost reduction to their clients.
- Examine all aspects of service delivery for any inefficiencies.
- Continuously demonstrate that you are spending a client’s money as if it was your own.
- Find innovative and cost-effective ways to deliver content.
- Employ the latest available technology and project/financial management tools.

It’s no longer about over-servicing and over-delivery but about doing the right thing better, at the right price, and on time.

Process Matters

As data-driven organizations with transparent measurement criteria, procurement expects its agency partners to be prepared to be open and honest about their needs, and then work toward a fair compromise. There is a definite client perception (validated by those interviewed for this paper) that a true project management culture is lacking at some firms. At the same time, they realize that firms are not sufficiently integrated in clients’ approval and decision-making process. There is a pervasive need for both parties to trust, open-up the dialogue, and embrace difficult matters together.

Clarity of communications by way of a defined and disciplined scope of work is an essential first step in the journey. A critical part of the ongoing dialogue is an educational process that enables learning about each other and looking for solutions on both sides. And finally, a semi-annual relationship review, whether through a formal evaluation process or an informal gathering of key stakeholders, provides the necessary 360° feedback to engender a continuous improvement mindset. Public relations firms have a vested interest to insist that formal performance evaluations be routinely conducted, as they provide the quantitative and qualitative historical data to support keeping a vibrant relationship alive.



Where Procurement Can Add Value to the Agency

The author has specific experience in structuring and implementing incentive compensation arrangements within the public relations industry. In one case the work was clearly responsible for providing the necessary dialogue and management feedback to the public relations firm to not only avert a failed marriage but rather move the relationship to a consistent “best in class” status. Proper stewardship of agency-client relationships may best reside with a company’s enlightened procurement, strategic sourcing and supply chain management departments. With the ability to quickly access all relevant client departments, including accounts payable, they are ideally positioned to call upon finance, human resources, and legal, to validate that the client is securing the best value from its supplier-partners while mitigating any perceived risk. Additionally, procurement is in a much better position to consolidate requirements of diverse, and often competing, businesses or brands within their client company, thereby appearing as one face to the firm, whether in agency selection, compensation negotiations or supplier relationship management practices. If they are truly speaking with a voice of fairness and reason, as is their charter, they are the only central group that can create a “Win-Win” by constantly projecting an even view.

AUTHOR’S CONCLUSIONS

This white paper represents a sustained effort by the Council of Public Relations Firms to build bridges of understanding between public relations firms, client practitioners and procurement departments. It may seem far-fetched, but the industry has a unique opportunity analogous to China’s leap into wireless technology – and consequent bypassing of burying of miles upon miles of cable. By welcoming procurement’s participation and clearly moving toward value-based compensation, firms may be able to avoid the painful scrutiny of their costs (direct labor, overhead and profit). Additionally, demonstrating and quantifying cost savings from joint process improvements can only result in positive steps toward increased business with those firms most willing to engage in these partnering and value added activities.

ABOUT THE AUTHOR:

J. Francisco Escobar serves as a business management advisor to clients and service providers in the marketing communications industry. In 2003, he founded JFE International Consultants, Inc. as a Minority Business Enterprise. Consulting to marketing communications service providers includes crafting of client contracts, negotiation of financial agreements, streamlining of individual agency and network processes, assistance with new business development initiatives, and specialized training of personnel interacting with client Procurement. The company is engaged in assisting agencies around the world to enhance their overall performance and to improve budget and client relationship management.

Mr. Escobar has been an active participant in numerous venues with the ANA, an expert panelist for the AAAA, and an advisor/consultant to the Council of Public Relations Firms. He authored the ANA’s publication entitled *Marketing Communications Procurement: Building Value Through Best Practices* and is regularly quoted in *PR Week* as a category expert.

The Council of Public Relations Firms’ mission is to advance the business of public relations firms by building the market and firms’ value as strategic business partners. Contact the Council of Public Relations Firms at 1-877-773-4767 or at www.prfirms.org.