Why Retainers May Be Best For You

RE: Your Advertising Agency's Compensation

By Gregory I. Gaul

Openness and clarity are the bedrock of most agreements and relationships. It is common and expected that most clients are skeptical of the agency's profitability and sometimes their motivation. Smart clients and agencies take the time necessary to discuss and understand each others concerns. Clients who do this will immediately earn the respect of the agency.

Lots of clients view retainers as monthly give-aways to the agency. Others think of it as some sort of "tip" or payment that they must tolerate in order to keep their agency.

It's unfortunate when this occurs because it belies a basic misunderstanding or mistrust between the agency and client. And both are at fault, or at least have responsibility in this matter. After all, the essentials in hiring an agency are very similar to hiring an employee of any kind. The details and motivations for compensation must be discussed and clearly understood on both sides or the relationship won't last very long.

If the client starts off with the drive only to cut costs, there will soon be friction. On the other hand, if the agency is going to try and sneak extra profits in here and there, past the client's watchful eye, then they're heading for trouble. Profitability should be discussed openly. There have been numerous cases where clients have a prearranged agreement to review the agency's profits; go into their books.

This is a counter check to assure that a fair profit on the account is being paid and earned. It all starts with the contract and the type of agency compensation that is selected.

There are several ways to compensate: commissions, hourly, project fee, performance to sales, and retainer. Each has its own pluses and minuses. It is the agency's responsibility to advise the client as to which method is best for the situation. As to what the client should do, I think Mr. David Ogilvy (long-time agency head and leader in the advertising industry) summed it all up well: "Ask what the agency charges. If it is 15 per cent, insist on paying 16 per cent. The extra one per cent won't kill you, but it would double the agency's normal profit, and you will get better service. Whatever you do, don't haggle over the agency's compensation. I know a big corporation that insists that its agencies negotiate terms of business with it's Purchasing Department, as though they were selling office furniture. Would they do this with lawyers and accountants? Insist on a five-year contract. This will delight the agency — and protect you from being resigned if one of your competitors ever tries to seduce them with a bigger budget.”

Retainers have been used for a long time in the agency business but are pre-dated by a commission structure as a means of compensation. Retainers are used by lawyers and consultants and are often referred to as fees in those practices. In setting a retainer there is usually some compromise or guesswork involved on the agency’s part. It is something more than a “what will the market bear” strategy however. Usually, the client will request a rationale for the retainer. And on occasion, a client will actually request retainers as a way of controlling and leveling costs (or payments) to the agency throughout the year. Some businesses have big shifts in cash flow on a seasonal basis and in order to keep operations running smoothly throughout the year, a level of payment, or retainer is best.

In giving the client a rationale for the retainer, the agency will usually refer to the hours required to service the client’s business on a monthly basis. Some clients are unaware that most agency people log hours daily just as lawyers and accountants do. Most agencies count to the quarter hour, while law firms (the big ones) go to every 6 minutes. This covers all the phone time and back office work required to make the account run smoothly. Yes, it may cover some questionable time for internal agency meetings, chats and morale boosting on the client’s behalf — all conducted to keep the agency cadre motivated.

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of one very modestly paid employee, the client has the loyalty and partnership of an entire organization that provides objectivity, creativity, planning and management skills, and fresh insights that can help build the business — none of which can be done internally in most companies for anything close to that low cost.

Some clients balk at this time and dismiss it as wasteful, but they would be foolish to do so; an agency is not a mechanical machine. Far from it, often the best ideas come from out of the box thinkers — the unruly — the crazies that agencies coddle and keep on staff.

Here’s another way for clients to think about a retainer fee that might be appropriate. Assume a retainer fee of $2500 per month, $30,000 per year. This is the equivalent of the cost of one additional employee with a salary of approximately $21,500 understanding that employee cost is usually calculated at SALARY x 1.4 to cover costs such as employer portions of taxes, workers compensation, vacation, and other hidden costs.

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Consultants use the rule of thumb that for every hour in front of the client there are two hours of office or prep time required. This ratio is true for the contact people and account people at the agency. It consumes a lot of man-hours and someone must pay for it. The client does. The smart client knows this; the experienced client expects this. Nonetheless, the client has the right to keep those billable hours under control. And it’s true that not all agencies have their overhead accounted for properly. These things should be detailed in the agreement and discussed openly.

From both the client and agency perspective it is often simpler to bundle these items all in one monthly figure; sort of a monthly salary. Otherwise, there is a month-to-month accountability, finger pointing, if taken to extreme, encumbers good overall relations. Simply, you don’t want to be quibbling over money every month while you’re trying to grow the business together. One of the most disruptive things a client can do to an agency is to bounce an invoice. Agencies are notoriously slow to pay their own suppliers and generally are pretty weak at the back end of the business. So when an invoice bounces it sends ripples throughout the agency. Account people cringe at having the agency accounting person (usually the most beleaguered and unhappy person of the lot) standing in their doorway brandishing a fist full of invoices.

So, when calculating the monthly retainer, the agency people have all these items in the back of their minds with one notable addition. The traditional start up curve for learning accounts is much higher than the ongoing level of work. Generally, it lasts three or four months before leveling out. Thus, time and money — for studying the markets, attending sales meetings, tradeshows at the start, customer research is viewed as non-recoverable by most agencies. So, it never gets counted in the monthly fee. Clients usually view this as the price of doing business and often are irritated at even the thought of paying someone to learn their business.

When an agency develops a retainer fee for a client based on no particular precedent, this is how they would proceed. The account service team would estimate the number of hours required monthly to service the client's business. Then, they would apply hourly rates (billing rates — i.e. $150/hr. for account service personnel), multiply it out and usually round off downward to arrive at a monthly total. Sometimes when commissions are involved, provided the commissions projected for the year are substantial enough, the commissions are credited against the hours spent as they are earned for each month. The difference is either captured by the agency as profit, accrued to the next month or, (if it is over the fee for the month), billed as excess fee that month to the client. These conditions are determined by how the contract is set up.

What it all boils down to in the end,

is hourly rates. No client will continue retainers without getting service. Agencies who labor under unfairly low retainers are long suffering and usually crack under the pressure. So, there is often a provision to adjust the retainer if it becomes inequitable to either party during the term of the contract. This is often a topic in agency annual reviews.

Often overlooked, the ability of the agency to network and create "freelance" thinking on the client's behalf is a great asset of the retainer system. If the agency is on a project basis, while they peruse the Journal on any given morning they may not take the time to read the article that addresses the same issue that their client has been struggling with for over a year. It's that constant awareness of the client's needs that creates opportunities for the agency to be innovative in building or discovering new strategies.

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Both the client and the agency should assess the profit to the agency from all sources and see if it makes sense based on their assessment of each other. As a rule of thumb, agency gross profit should fall somewhere between 15 to 25 percent of the gross billings. Too far either way for a mature account would require a special rationale.

Start up clients and chaotic clients usually do require more nurturing and sometimes teaching. On the other hand, clients who constantly lead their agencies deserve a price break.

The forgotten element in all this is an essential one. Who pays for the breakthrough ideas? As you well know, one great concept may change the course of a business. So how does the agency ever really collect for this very essential service that they provide? The answer is usually in the hands of the client and in their mindset of how the agency should be compensated. After a great year, the client may suggest a substantial retainer increase as a generalized reward to the agency.

The converse may also be true. It's the agency's role to always keep the retainer trim and be able to defend it with a fairly concise rationale.

When any of these elements start to drift too far apart it is usually a sign that the relationship is faltering. At that point, it is appropriate to rekindle the relationship through open discussions.

The big benefit (for both agency and client) in the retainer strategy is stability. Clients can budget and move smoothly through the year with few surprises. The agency can feel secure that they have a committed client and constant revenue stream for the term of the agreement.

Everybody is happy because each gets what they want. And that should be no surprise to any of us. What is true in life is usually true in business.

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