AlixPartners

MAY 2020

# MAKING THE ADS ADD UP

## Why ad agencies must take back control of cost – and core proposition

Even before the COVID-19 pandemic ripped through the global economy, there were proclamations that times were changing for advertising agency giants, beset from all sides by a rise in creative and media in-housing, consultancies encroaching on their field of play, and smaller, nimbler independents gaining market traction.

The current crisis should not be viewed as the final nail in the coffin of the old guard of agencies, but as a catalyst for them to make the changes many already knew were needed. There are many opportunities for agencies to harness, through a process of reassessment, refocusing and rediscovering control of cost.

Fundamental change is no longer an option. How can ad agencies get their houses in order to minimise the impact of significant revenue drops forecast for 2020, and return to profitability?

---

The largest agency groups such as Publicis, WPP and Omnicom have long ruled the playground of creative content and media, owning the right to imagine and develop advertising concepts, and distribute these across ever-expanding global media channels. But for the last five years, winds of change have been blowing across their client bases, sending worrying signs for investors.

Many big brands are experimenting with bringing creative – and particularly media buying and analytics activity – in-house, while the safety net of long-term client retainers is being unhitched, rolled up and replaced by short-term contracts, project-based commitments and aggressive payment terms. Add to this the huge financial blows struck by COVID-19, and its impact on agency client bases across every industry, and change is inescapable.

It is vital that agencies act quickly and decisively to fix the basic economics. A review of service offerings, business models, organisational structures and flexibility is key to survival, and it is through greater efficiency and effectiveness that agencies will be able to create opportunities for future growth from a lower cost structure.

> "It is through greater efficiency and effectiveness that agencies will be able to create opportunities for future growth from a lower cost structure."


## Stay home and get your house in order – the need for cost management

COVID-19 may well change the behaviour of agency clients forever, depending on their own restart and recovery activity. Not only will a global recession hit them hard, but end consumers will likely have very different expectations and buying behaviour.

There will be opportunities for agencies, but first they will have to focus on their core business – preserving cash in the short-term. Some agencies have already announced plans to reduce costs before the full impact of the pandemic can be understood: WPP aims to slash costs by £2bn, while Publicis has announced plans to take out €500m of spend.

Agencies will also need to consider reassessing and restructuring their businesses, and long-term implications to their business model, in the world after COVID-19.

Put simply, agencies need to control costs better, and be prepared to break their own model in order to rebuild it, concentrating on their core capabilities. And that requires strong leadership buy-in and recognition of what it is they do best.

**AGENCIES NEED TO FOCUS ON THREE KEY AREAS, IN ORDER TO RETURN TO A HEALTHY COST POSITION:**

1. Develop cost transparency
   - Drive clarity of understanding on current productivity/utilisation across brands
   - Enable more transparency and rigour around ROI – structure measurement models more effectively
   - Offer more flexible staffing models/pricing solutions to better meet client needs

2. Ensure organisational control
   - Rigorously reduce organisational complexity resulting from past acquisitions and poor integration
   - Remove organisational silos to establish common capabilities across brands/teams
   - Review corporate overheads and ensure an effective balance between business management and creative

3. Drive accelerated transformation
   - Embed newly acquired capabilities across the business/global network to fuel organic growth
   - Tightly manage integration at an accelerated pace to unlock synergies, especially in middle and back office functions
   - Enable more dynamic teaming across brands/capabilities

## Competition in a dynamic and uncertain market

Macro-economic conditions prior to the outbreak of COVID-19 hinted that pressure could be applied to 2020 forecasts – and we will see spend cut significantly in its wake. Growth in global advertising is fuelled by digital, with an estimated 80% of digital marketing spend consolidated with internet giants such as Google and Facebook. Despite long-standing portents of doom, traditional media channels of television, outdoor and radio remain robust and closely aligned to the core offerings of many agencies. But assorted groups of potential rival players in the advertising ecosystem – not all of whom should be regarded with suspicion – are keeping a close eye on the field of play. And transformation is needed if agencies are to remain best-placed to nurture creative talent and manage global advertising messaging.

### INTERNET GIANTS – DATA RICH, BUT CREATIVE INTEREST POOR

Google, Facebook, Apple and Amazon are in an unchallenged position when it comes to big data, but show no desire to take on traditional agencies head-to-head and play in their people-heavy, low margin, creative space. In return, agencies know that accessing the dominant ad-serving platforms of the internet giants through collaboration is a way to grow their own digital revenues.

Direct competition from Google and Facebook has been expected to pose a greater risk to the market, but a combination of cost and authenticity are keeping them in the agency friend rather than foe category. Growth in companies who produce and monitor big data is already very strong, and there is currently no need to consider broad service diversification. Furthermore, it is of no interest to Google and Facebook to price traditional creative agencies out of the market, as they rely heavily on these agencies for revenue in the form of media spend on their platforms.

### CONSULTING FIRMS – A NEW NEMESIS?

Other players are staking a claim to available industry value pools, bringing significant expertise in data management and customer profiling – two services highly valued by clients – in pursuit of the highest performing campaigns and long-tail CRM opportunities. Consulting firms are actively looking to grow their presence in the advertising and marketing arenas, and to play in this space primarily through aggressive digital marketing acquisitions.

But further pushing the boundaries with extensions into branding and traditional creative campaign work is likely to be relatively limited. Internal creative leadership is limited within consultancies, and realistically they are not able to compete for and retain the highest quality talent, nor pose a significant threat to traditional agencies at their creative core. Equally, price is an issue, with creative work either dilutive to their existing pricing models, or the price point being misaligned with client expectations.

### IN-HOUSING – KEEPING CREATIVE IN THE FAMILY

The rise of hyper-targeted marketing, only possible through the analysis of proprietary customer data, has given rise to brands bringing creative back home, not only catering to their Below the Line CRM needs, but also the bigger Above the Line campaigns.

Procurement departments are taking their red pens to preferred supplier rosters in order to drive cost effectiveness and reduce overall agency spend. In June 2019, P&G cut global advertising spend by $350m due to 'reductions in agency compensation'.

The creative results of in-housing have been somewhat mixed, with broad recognition that brands struggle to bring in and retain leading creative talent. Agencies' exposure to a wider set of client demands, a broader understanding of measures of success, and a greater array of creative talent, should enable them to assert their value better.

### SMALLER AGENCIES – WHEN IT'S NICE TO BE NIMBLE

How much could large agency groups learn from smaller, more specialist agencies? They are often nimbler, with niche, clearly defined service offerings, and are increasingly attractive to clients employing single point solution buying behaviour.

Lower headcount, smaller back-office overheads and less duplication of middle management tick all the commercial boxes, while the creative talent in these organisations proves itself to be more than capable of capturing big brand campaigns.

While historically the agency approach to new talent – and competition – was to hoover it up in never-ending M&A cycles, this focus has shifted to the data space, to take on the consultancies, potentially leaving big agencies more at risk to these agile and creatively capable smaller shops.

## When the time for growth returns, look to big data

While the urgency to reduce cost and optimise core services will remain an immediate priority for some time, agencies will look towards growth again to keep ahead of the curve and harness the evolutions in social platform-led advertising and OTT marketing.

Unfortunately, many agencies still significantly undervalue the importance of big data within their creative offerings. As creatives increasingly need to appeal to the holders of the purse strings, clients are changing how they allocate marketing budgets at an alarming pace and digital skills gaps need to be filled. But how can this be achieved effectively?

There is a fork in the road when it comes to how agencies choose to invest in data. One strategy employed by large agency groups is the acquisition route, bringing on board data companies/agencies or analytics platforms to quickly boost their own proprietary data set. Dentsu acquired Merkle for $1.5bn, while Publicis spent $4bn to acquire Epsilon.

On the other hand, agencies can 'pay as they play' – a potentially smart move in a marketplace where data can be outdated almost as soon as it is of the moment, and costs can be better controlled. Omnicom, for example, has stated a preference to rent data and technology at the right time to retain agility and avoid investment in platforms that may become obsolete soon afterwards. Agencies don't need to own their data, they just need access to the right data at the right time, and carefully considered partnerships could present a workable compromise.

However, neither of these options is as fundamental as the need for agencies to get the basics right, reduce costs and provide a strong platform from which to deliver a desired ROI on marketing spend. Achieving this will allow them to make positive moves in response to the increasing shift towards digital and data and avoid being left out in the cold.

# Moving forward – how agencies can survive and prosper

Creativity remains king and many clients still place huge value on third-party viewpoints of their brand, transformed into successful campaigns by creative agency talent that they would struggle to attract as in-house hires.

However, poor organic growth and pressures on margins have led to market cap decline among agency networks. In a market where transparency in relation to budget division is valued, the key markers for agencies lie in improved performance in organising and managing cost for client budgets.

**ONE SIZE DOES NOT FIT ALL – BUT BETTER COST MANAGEMENT IS UNIVERSAL**

The traditional retainer model may be all-but-dead, replaced by multiple individual KPI or ROI-led campaign engagements, and it is time to retune the agency mindset. Transparency of spend is valued more than ever, so projecting a tighter understanding of cost management must now be an agency baseline.

Relevant cost savings can be achieved partly through overhead and headcount reductions. As with smaller agency structures, working in a project-based landscape, compared to long-term retainers, means organisational silos must be removed in order to establish common capabilities across teams.

There is no longer a one-size-fits-all model for a creative studio, and a diverse team of flexible people and skills is paramount. But this comes at a cost, and exceptional creative talent knows its value in today's market. Agencies must exploit their draw for creative talent, while refining the ability to nurture and retain it.

Restructuring of organisational complexity resulting from poor integration must also be tightly managed at an accelerated pace, to unlock synergies and realise savings, especially in middle management and back-office functions.

## A LOOK IN THE MEDIA AGENCY MIRROR

Perhaps the biggest, and potentially most damaging, competition to a large agency group is the most familiar one: itself. Agency group management structures are unwieldy, and aggressive competition between networked agencies is not uncommon, externalising to clients as poor integration – the antithesis to the touted 'one-stop-shop'.

Agency groups that have grown largely through M&A can find themselves wrestling with a personality and proposition disorder, which presents a number of challenges when it comes to effective integration and organisational simplification.

Too many service offerings spread across a wider group of agencies reduces clarity and focus on the core competencies that a network should be striving to be famous for. Brand conflicts present a challenge to delivering on transformation through integration, as major advertisers are used to insisting on dedicated teams which, by its nature, encourages the duplication of roles and functions as agency brands are instructed to operate independently.

The broader structural complexities from an organisational and legal standpoint will add to a lack of cost transparency at an overall group or network level too, while earn-out structures for acquired businesses foster dis-synergies, and fiefdoms can persist long after earn-outs have finished.

Culturally, for businesses that focus so heavily on creativity over financials or cost management, these issues will be difficult and uncomfortable for management teams to untangle. Challenging the cost of top creatives and senior relationship managers, for example, is not easy. But it is crucial to resolve this for both immediate consolidation and future growth.

## SIX CHALLENGES TO AGENCY TRANSFORMATION

Delivering on transformation, particularly integration, is not easy in complex agency environments formed from a long history of M&A activity:

**1. Lack of cost transparency:** Poor integration from past acquisitions and multi-brand organisation structures within agency networks restrict cost and resource visibility.

**2. Brand conflicts:** Major advertisers often insist on no brand conflicts and dedicated teams, resulting in duplication of roles and functions across agency brands.

**3. Changing business models:** Clients are moving away from retainer models, previously relied upon by agencies, towards project-based engagements.

**4. Legal entities:** Multiple legal entities in the same jurisdiction reduce cost transparency and complicate legal and financial structures.

**5. Earn-outs:** Earn-out structures for acquired businesses encourage dis-synergies and fiefdoms to persist, often long after the earn-outs have finished.

**6. Culture:** Creativity, rather than financials or cost management, tends to drive culture in agencies and challenging costs is not easy for senior leadership teams.


## Winner takes all?

Even the most significant transformation and restructuring efforts undertaken by major agency players in recent years have failed to fully deliver and keep pace with market expectations.

Building digital dexterity remains a priority for the future, but it is the re-rationalisation of core purpose, and a move towards tighter cost control and streamlined network nimbleness, that will give large agencies the best chance to survive and remain relevant and competitive. Change of this magnitude will require a new guard of strong yet empathetic, top-down leadership and associated buy-in throughout an organisation.

The fallout from COVID-19 will affect agencies for some time to come, but clients will still reach out to them for the creative talent and advertising expertise that they market themselves on. As with any campaign though, success from that point on will mean delivering their product or service at a level of quality – and price – that meets and then exceeds expectations. This will be achievable only when agencies have once again established firm foundations to build on.

AlixPartners

## AUTHORS:

**John Miles**
Director, London
jmiles@alixpartners.com

**Jasdeep Batra**
Vice President, London
jbatra@alixpartners.com

## FOR MORE INFORMATION, CONTACT:

**Francesco Barosi**
Managing Director, Global Coordinator, TMT
fbarosi@alixpartners.com

**Giacomo Cantu**
Managing Director, Regional Coordinator, TMT
gcantu@alixpartners.com

**Klaus Hoelbling**
Managing Director, Regional Coordinator, TMT
khoelbling@alixpartners.com

**Markus Mantwill**
Managing Director, Regional Coordinator, TMT
mmantwill@alixpartners.com

## WHEN IT REALLY MATTERS℠

The time for agencies to act is now, addressing their cost bases no longer suitable for the market. AlixPartners has strong experience in supporting agencies to manage these challenges, with specific expertise in the areas of:

- Operating model redesign
- Customer and service line profitability assessment
- Portfolio and service offering review
- Business simplification and cost reduction
- Post-merger integration and synergy realisation
- Organisational simplification, re-design and governance improvement
- Digital capability roadmap development

## ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.