

# Is there really true value in value-based pricing?

In the last six years, we've witnessed a sea change in the compensation of agencies. Once in a volume business, based on commission, most multinational agencies are now paid a labour-based fee for their services. But research done by our US partner in conjunction with the ANA shows there is a groundswell of debate about fees and 'value pricing'.

The concept of 'value pricing' is best summed up by a US author and consultant on the topic Ron Baker's statement that "the firm of the future will price its services based upon external value provided, not internal efforts generated". It's a very logical argument — "I create an idea of value for you; I should be paid appropriately for it." Independent agencies all around the world are leaping at the thought of it, yet the jury is still out on exactly how to implement it. In addition, the holding company people we've spoken to are rather nervous, because this, more than anything else, brings to play one of the most dangerous ideas of all — risk.

In value pricing, payment is linked to the quality of the idea — a bad idea could well see an agency losing money.

While we are strong believers that clients and agencies need to spend more time on appropriate compensa-

tion, we still think there are some myths around the current labour-based model that should be reviewed.

One myth is that fees are entirely based on input and effort, not outcome. Well, this is the case where there is no sensible incentive programme in place, something we strongly recommend. Another myth is that fees encourage a 'production line' approach, versus creativity and ideas. We think agencies are not stifled by the method of compensation, only by the amount of compensation. Certainly, leading companies such as Coca-Cola or Johnson & Johnson know they need to pay their agencies for strategic counsel, not just project management.

This said, the concept of value-based fees is not a new one in the industry — talent such as actors and photographers already enjoy these benefits. Shoot an ad for Jackie Chan for China, pay one fee. Extend the spot to Japan, pay an additional fee. This model is well-entrenched, and marketers are ready to accept it.

The leap then, to take this to agency compensation is the mutual client-agency agreement on the value of the marketing communications provided by the agency. How many clients have internally reached a common defini-



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tion? One that their CEO buys and supports? And then, can the client and agency agree on the specific role and value the agency will provide? Finally, can the value be measured? And will the agency accept no payment for total failure? One big issue in this scenario right now is inertia — will clients want to pay more? And as one former BBDO finance director said, "Marketers accept extraordinary financial risk every day. If any of their product or service offerings fail, they shoulder the financial burden themselves. Many agencies with labour-based-plus arrangements are generally guaranteed not to lose money. I do not see any compelling reason for them to want to fix that."

Interestingly in Asia, a lot of local agencies are already using the project fee method as one way to get to value based compensation. In China, a campaign might come for a rack rate of Rmb 2 million (US\$272,000) with a Rmb 1 million bonus if it is successful. Will other agencies consider this model? Putting an accurate value on commercial art has never been more of a challenge.

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