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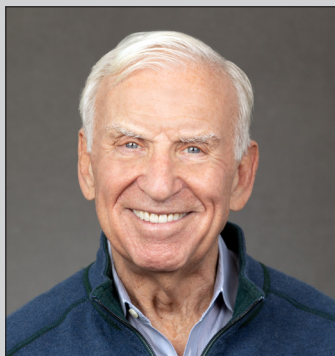


Rethinking the Agency Model:

An Interview with Michael Farmer, Chairman and CEO, Farmer & Company

Michael Farmer:

Michael Farmer is the CEO of the strategic consultancy Farmer & Company and the author of "Madison Avenue Revisited".



These days it's not much fun to work in the agency business. Agency staff are overworked and under duress to work faster and smarter. There is the constant worry about layoffs. And now as AI looms over them like storm clouds, they wonder about their career prospects.

It wasn't always like that. Back in the 1960s, 70s and 80s, life in an agency was fun, invigorating, glamorous even, a beehive of creativity, where clients treated you as a thought partner, someone to make them look brilliant, come up with "Big Ideas", help grow their business. Agency profit margins were healthy enough to pay everyone really well. Agency founders were revered as demi-gods – creative geniuses – marketing oracles of their time. And when neighbours asked what you did for a living, you were always proud to say you were in the "ad business".

That world no longer exists. Agencies have become sweatshops. A business where too often lowest price wins. Where clients have become incessantly demanding – intolerant of pushback – under

immense pressure themselves to deliver "stretch" results. Scopes of work keep expanding, which agencies are obliged to execute at increasingly thinner margins, imposed by procurement officers who urge them to just do more with less. Agencies are now thought of as just another substitutable cost in the supply chain.

There is almost no such thing as an "agency of record" anymore. The rug can be pulled out from under an agency every few years or so at the whim of the client, when contracts get bid out at renewal time. Agencies find themselves in continuous pitch mode, either trying to hang on to a client in an agency review, or expand their client roster, notwithstanding the out-of-pocket expense, which can take years to fully recoup. When a major client is lost, layoffs are always quick to follow, with the most senior staff the first to go. In today's agency business, there is no such thing as a retirement party anymore. As a result, agencies have been hollowed out, populated by junior staff, with few mentors to coach or inspire them.

The decline and fall of agencies can be traced back directly to the rise of the financial holding companies in the mid-1980s and 90s, beginning with Martin Sorrel's WPP in 1985, when he went on an acquisition spree, acquiring Ogilvy and JWT. Sorrel insisted on fatter profit margins in order to drive up share value and sought to cut the surplus capacity out of his agencies by reducing the head count. But he also hived off the media divisions into separate profit centres to compete against the independent media companies. By depriving the creative agencies of the 15% commission they normally made placing media, they were forced to earn revenue solely through time on page. And that eventually led to procurement being brought in by clients to negotiate the service level agreements, even though they knew nothing about how work gets done in an agency (and could care less).

That's why Michael Farmer, author of three books on the plight of agencies, the latest being "Madison Avenue Revisited", accuses the holding companies of "murdering the ad business", largely by bleeding the agencies dry over time with their singular focus on maximizing profits. Farmer points to other villains as well – not just procurement, but corporate CEOs for their "short-termism"; marketers for their abuse of agency time, and for callously playing off agencies against each other; and agency leaders who consistently underestimate the scopes of work, meaning agencies get underpaid for their time.

That's where Michael's strategic consultancy comes to the rescue, helping agency leaders manage their businesses more profitably, mainly by aligning the contractual agreements with the scopes of work. His ScopeMetric methodology enables an agency to calculate and assign an expected cost (what he calls a SMU) to any creative deliverable within a scope of work. Add up the SMUs and you can properly estimate the workload.

Michael started his strategy consultancy almost four decades ago in 1990 after serving stints with both Boston Consulting Group and Bain where he successfully expanded their European footprint. He first got drawn into agency consulting in 1992 when he was tasked by Ogilvy's London office to help them comply with Martin Sorrel's draconian marching orders.

SS

Stephen Shaw (SS): What made you leave Bain and strike out on your own in 1990?

MF

Michael Farmer (MF): They promoted me to be the head of the UK, which by that time had 350 people. And let me tell you, I'm not an administrator. I hated the job. I didn't get to work with any clients. I lasted two years and I quit. I wanted to get back to consulting and took four guys with me. And then out of the blue I got a call from Ogilvy in '92 to say we need a strategy consultant, not an industry expert, because we were bought by WPP and we're not making our numbers and we can't figure out what to do.

SS

I presume at that point you had no idea how the ad business worked.

MF

No idea. In fact, the other client that I had at the time was Lucas Industries and they made injectors for diesel engines, lighting systems and brakes for cars. They had a big aerospace business with Airbus, they made missiles, they did all this other stuff. And so we were bouncing back and forth between Birmingham and Canary Wharf.

But we knew an agency produces stuff and that we're just going to have to figure out what its products are for each of its clients. We needed to figure out the relationship between the work they do for clients and the number of people they had, because that is a thing you would do in a factory. We didn't have any records about what work they were doing and so we had to spend two months reconstructing it. And here I am, 35 years later, still reconstructing scopes of work for agencies that don't have records on the work they've done, and yet the volume of work is a hundredfold times greater today.

SS

The surprising part of your story is the amount of rework that was going on, the number of creative teams being assigned to briefs, and Ogilvy really had no line of sight on any of it.

MF

When we asked the creatives, "How do you define work?", they would say, there are different kinds of ads in different media, TV, radio, print, for the most part. And they said, there are "originations" and "adaptations", and they're not the same. And even within those categories, if you were doing a TV commercial for a new brand, that's not like cranking out a regular TV commercial. So we learned there were three levels of creative complexity: high, average, and low, based on whether the work had ever been done before. And then they said, sometimes we put two creative teams on it. And then it all depends how much rework there is from the client. Because sometimes we get briefed very badly and we do 16 reworks. So we had to develop a model that said, okay, what media is it? What's the media detail? Is it origination or adaptation? How many creative teams are on it? How much rework is it? And what is the creative complexity?

Now, at that time, there were only 360 ads with 50 creatives doing the work. But it still took us two months to gather that data. And what we were trying to do was develop time standards, like if there was a TV 30 commercial origination of average creative complexity, we wanted to know how much time it would take one team if there was no rework, and then if there were two teams. So we were putting together all these time standards according to the type of brief which told us how long it would take one team. But then how many

teams did they have? And what was the real rework? And by the time we had put all that in a giant Excel model, we could say, here's what you've got on every one of your 360 briefs. And when we run that model, it tells us you need 52 creatives, 75 account people, and 40 production people. So I could go to Mike Walsh¹ and say, okay, we now know why you aren't making the margin you want.

SS

The shocking part was they were often assigning multiple teams to the same brief in a creative shootout.

MF

I have to look back and laugh. I was so proud of this model, so absolutely proud of this model, that we had actually figured out how a creative agency worked. So I went in to see Walsh with my spreadsheets: "Okay, Mike, we figured it out. Here's the way it works." And I thought he would say, bravo, great job. But he just got red in the face. He was so mad. He said, "Those fuckers!". Here he's trying to make a 10% margin and he's got two rogue executive creative directors assigning 2, 3, 4, 5 and 6 creative teams to every brief in order to upgrade the quality of the creative work and to create this competitive atmosphere! And he said, these guys, they keep asking for more resources because everybody's "so busy" in the creative department. And that's why we're only making a 5% margin. So then he said to me, I want you to run your model and tell me how many people we actually need if we have only one team and one rework on everything. And I did that and I said, you don't need 52 creatives, you need 35, you don't need 75 account people, you need 50 etc, because you have less rework, less back and forth.

SS

So what happened then?

MF

He called them in and told them we've got to do this, we've got to run this a different way, because we're not making our margins and we're owned by WPP now. And they said we can't work that way. We're trying to get creative quality up. And Mike said, you don't have a choice about it. This is how we have to run the business. They said, well, we can't do that. And he fired them right in front of me.

SS

Really? In front of you?

MF

He then brought in a guy named Tom Berry, and said, Tom, take over the creative department and implement what he called the "Farmer Rule". I said, wait a minute, this isn't my rule, this is my scenario. So he blamed it all on me: "Farmer came in and said there's a new 'Farmer Rule' for running the creative department". We were then invited to do the same type of diagnostic in every European office.

SS

In the book you accuse the holding companies of "murdering the agency business". Is the guy holding the smoking gun Martin Sorrell?

MF

Well, in a way, but it wasn't an immediate murder because not everyone shifted away from commissions to man hour based billing. And the other thing is, agencies during that period had a lot of surplus resources. In fact, in my consulting over a 12 year period, I was helping agencies downsize because they were all overstaffed, just like Ogilvy was overstaffed relative to the amount of work. So Martin, between 1986 and 2004, was squeezing out surplus resources.

I've told Martin this personally, so I'm not telling secrets here, by the time we got to 2004, agencies had no more surplus resources. By then I was back in the States and I had Hershey, Ford, Toyota, Mazda, Volvo, Kraft, and American Express as clients. I had done all of their scopes of work with their agencies which included Saatchi and Ogilvy and a bunch of others. And in every case the agency resources and fees were exactly right for the scope of work. But by then procurement had come in because man hour billing was complicated and they started to slash fees.

SS

But wasn't it Sorrell who got the ball rolling on the shift to man hours by splitting off the media services from the creative agency?

MF

Sorrell split media out with much lower commissions because they were losing clients. Up to about 2001 or 2002 or so, these big agencies - Ogilvy, JWT, Y&R, BBDO, TBWA, et al - all had media operations and made their money by getting a 15% commission on media spend and a 17 ½% percent commission on production. That covered media planning and buying and creative operations. It was one commission - a big pile

of money. It covered all the resources that they needed. Now at the same time, there were media independents - media companies that didn't offer creative services and were stealing media business from the holding companies by saying, hey, forget about working with WPP, we'll do all of your media planning and buying for 4% or 5%. Now here's the client thinking, I'm paying a 15% commission now, that means creative is making what, 10 or 11%? These guys are making a ton of money. So they weren't going to pay commissions anymore to cover the creative work. But they did agree to pay for the head counts.

SS

Did Sorrell not realize it might lead to the squeeze put on fees?

MF

Well, listen, billing for time had actually been going on for decades, even as far back as the 60s. So it wasn't really a new thing, it just wasn't industry wide. It seemed to be okay because don't forget, from the 80s until 2004, there were surplus resources. So the fact that they were going to be paid based on man hour billing was fine. They were paid very handsomely. The problem was when digital and social came in. In fact, Toyota had hired me in 2004 to work with Saatchi to help them become their digital and social agency. So here was the problem. The workloads were about to explode because the number of digital and social deliverables was beginning to skyrocket. That was work they weren't used to and it's work they didn't actually even want to do.

SS

I remember that era very well - the traditional creative agencies were very reluctant to fully embrace digital. It was beneath them.

MF

You are so right. In fact, this was why Toyota hired me. Because they said to Saatchi, you know, we prefer to stick with our current suppliers, so we want you to be our digital and social agency. Saatchi said, oh, I don't know, that isn't what we do. And Toyota said, yes, you're going to do it, here's what we'll do: You will keep your fees as they are today. You'll work with Farmer. Farmer will help you figure out how to do that work more efficiently so that you generate bigger margins. And then you can afford to hire digital and social people. And it was Deborah Wahl² at Toyota who promoted this idea. And I

tell you, to this day, Saatchi should kiss her ring because they probably do hundreds of millions of dollars of digital and social today.

SS

In that earlier era the big agencies were seen as strategy advisors - the strategy work they did was a "gift with purchase", as I've heard it described - priced in to the full service package. But since then, all of those full service agencies have ceded the strategic high ground to the consultancies and in some cases to independent strategists. How did they lose their status as a thought partner?

MF

When agencies were the "gods", they had senior people who really knew the business, were very strategic. I think what happened is when digital and social came in, things became very confusing. Clients had to master the technology. And you had Accenture and the other consultants telling marketing departments, if you don't digitalise, you're dead. And so marketers took their eye off of the ball with respect to their brands. They lost the plot.

Go back to Martin Sorrell. He was so disappointed that his agencies weren't fully embracing digital and social that he said, screw them. We're going to have holding company relationships now. I'm not going to rely on Ogilvy, JWT, Gray and Y&R to be carrying the torch for WPP. I'm going to have a WPP relationship and then we can offer the client a full suite of products, some from the creative agencies, some from our digital agencies, some from PR, some from media, et cetera. And all of a sudden the power shifted from the agencies to the holding company. And they lost control of pricing too, because the pricing was run by the holding company, which told them how they would divide the pie up. And then when manpower billing came in, it was too much for marketing to figure out how to do fees. So they brought the procurement folks in. And procurement had a very tough time dealing with agencies because the agencies treated them like spreadsheet idiots.

SS

Not far from the truth.

MF

So the procurement people developed an attitude. The agencies are a bunch of prima donnas, they believed. The only way to control them is just whack their fees every year. But they didn't take into consideration that the workload started to go through the roof. Nobody on the

agency side was thinking, hey, maybe this is a good time to know how much work we're doing.

SS

But aren't the agencies accountable for caving in to this demand by procurement to do more with less?

MF

Well, I think it's because they were held accountable by the holding company for making their budgets. And the budget was twofold. They had to grow their revenue and they had to deliver a margin. And so it might have been crappy revenue, but I heard two things: they needed the revenue to meet their holding company targets, otherwise they wouldn't get their bonuses and might lose their job; the second thing I often heard was, well, we don't make any money on this client, but it's great for winning awards. And award winning work was still very much high on the creative list. Meanwhile, procurement's cutting the fees the whole time because they think agencies are making tons of money.

SS

The other unintended consequence is the loss of agency of record status.

MF

Well, that's because of the holding company relationships. Because if an agency like an Ogilvy wasn't going to be doing every kind of deliverable for a client, then the client was going to divide things up. I'm going to have a creative agency for doing TV, radio, print. I'm going to have someone else do digital and social. And in many cases, procurement thought, you know something, we're not going to let Martin Sorrell and WPP dominate our relationship. We're going to bring in Omnicom, IPG, Dentsu, Publicis, just to keep everybody honest. And we'll get them competing with one another.

SS

Then there's the creative review where every few years the client stages an agency "Hunger Games".

MF

That's right. Because as procurement figured out, you don't want an AOR status, you don't want an agency hanging around for 20 years, you want to rewrite the contract so that there's a review every five years or so.

I remember I was brought in by an agency that had just been given an RFP from Radio Shack. And they said, Michael, could you analyze this scope of work? So we did. It was a 22 page Word document. We said this is a \$20 million scope of work. And they said, well that's interesting, because the people they just fired were being

paid \$8M. And I said, don't bid on it. Which they didn't. And then I know of the agency that took it for \$7M and they really took a bath in that first year. And then the second year Radio Shack went bankrupt for the 2nd time and stiffed them completely on the fee.

The reason I say the holding companies murdered the agency is that they were bad parents. They didn't help their agencies understand how to adapt to this new environment where they couldn't afford to guess at fees anymore. And therefore the strategy of downsizing to make margins, which has been the industry practice now for over 20 years, would go on to liquidate their senior talent, make them even less strategic than they had ever been, and reduce the quality of their work. So yeah, it's the greed of the holding companies to make their quarterly numbers for Wall Street that led them to force the agencies into a downsizing mode.

SS

Can you explain how your scope of work management platform works?

MF

Again, it all started 34 years ago when we tried to figure out the relationship between the amount of work an agency did and its available resources. That got to be impossible when we were into thousands of deliverables during the social and digital era. So what we had to do was gather the media type, the media detail, whether it's origination or adaptation, and model how many people were needed and what fees should be based on if done efficiently. And efficiently meant that an origination with high creative complexity had two teams and two reworks. An average complexity brief would have one team and one rework, et cetera. And an adaptation would have a half a team and a half per rework. And by the time we had done that, we could create a unit of work which we called the "scope metric unit" [SMU].

So what we do in our model is we gather the deliverables, we classify them, and then every deliverable in the database has a scope metric value. So all the model does is when it gets a long list of, say, 15,000 deliverables, the model looks up the SMU value of each of those deliverables, adds it up, and calculates that there are 365 scope metric units. Then you can figure out what the price per metric unit should be to cover resources, overhead and make a profit.

SS

It baffles me why more agencies have not adopted that as their way of estimating work.

MF

Here's the thing. They know that if they're being underpaid by 30%, they're going to have to have an adult discussion with their clients. And maybe they're going to have to say, the fee is fine, it's just that there's too much work. So we'd like to have a discussion about what we can cut out of it without changing the fee. But they don't want to have that discussion. They don't want to have any discussion with their client because they're so terrified that procurement is going to say, hey, you're not playing ball with us, I can replace you in a minute. Procurement has totally cowed them into thinking they have no leverage.

SS

The holding companies seem to be moving away from management of agencies as separate brands to functioning now as integrated service providers. Is this approach likely to succeed?

MF

Yeah, that's a really good question. And I think we have to differentiate among the holding companies. Publicis, for example, has fully integrated to become a single company operating out of Paris long ago. I ran Bain's office in Paris for five years. I got to know the French pretty well. They're very comfortable with the concept of centralization - goes back to Louis XIV, everything emanated from Paris. And all of my French clients were very top down driven strategy. That's just part of their culture. So Arthur Sadoun and Maurice Levy decided long ago that they didn't really want to be a holding company that had portfolios of brands like Leo Burnett and Saatchi and Saatchi and Publicis USA and the others. They knew that digital and social had changed the game. They knew that data was important and they made a decision: we're going to move power to the centre, we're going to do the right kinds of acquisitions, and we're going to present ourselves as a single company. That means we will have to downgrade the brands.

Now Saatchi was a client of mine at the time and, boy, I could see it from the inside that all of a sudden they weren't able to publicize themselves. They were not going out on pitches on their own. They were subordinate to the holding company. And it looked a

little unusual and a little frightening, even to me. I didn't really recognize what Maurice and Arthur were doing. But they really pulled this off. They have genuinely created a single company out of what was a portfolio of properties. And you never hear anything about Leo, you never hear anything about Saatchi anymore. You probably don't even know who the CEOs are. And now Publicis has grown faster than anybody else.

Omnicom has really let BBDO, TBWA, and DDB run their own shops. Interpublic, equally so. McCann, FCB, and all the other agencies, they had tough targets to meet, but they did not have a strong holding company. WPP, I'd have to say the same thing. Even though Martin wanted to move in that direction, he didn't move real fast taking control. He never wanted to add a lot of overhead at WPP. But Omnicom and IPG are now together. And in Omnicom, WPP has a new CEO and they're moving in that direction now, but without any of the cultural imperative. They're jealous of what Publicis has pulled together. I don't think they've put together the team at the top to pull this off. They're still operating really as if they are portfolios of agencies. And even in some of their big relationships, I discovered the holding company doesn't do any billing at all. It's the agencies that do the billing and the holding company taxes them. At companies like Nestle and elsewhere, it's Ogilvy that sends the invoices, not WPP.

So I would say Publicis is a decade ahead and they're growing faster than the others. And I just don't think that Omnicom and WPP really understand what it takes at the holding company level to run it from the centre. So they are much more vulnerable right now because the more desperate they try to compete with Publicis, the more they will cut their prices.

SS

One stop shopping appeals to marketers faced with omnichannel complexity. It certainly makes sense if there's more centralized orchestration.

MF

Except for one thing. None of the holding companies are saying to the client, we're in business to help you grow again. They say we're in the business to pull together creativity, technology and data, essentially for programmatic advertising.

SS They're an assembly line for content.

MF That's right.

SS AI, I'm sure you agree, is about to hollow out the industry because two thirds of the work is production related, which can be easily automated. Obviously, layoffs to come. Already 40% per cent of agencies have laid off people in the past year. Apart from the layoffs, what impact will AI have on agency operations?

MF Well, just so you know, my model recognizes that an SMU value today of an adaptation is cut by a factor of 5 if it's done with AI. The SMU value of an origination is cut in half at least. And those are very conservative estimates. So this amounts to big time cuts in man hours. What the agencies need to do is use AI to get rid of the juniors, okay? And then they need to staff up on seniors who use AI to be more strategic and reposition the services: we're going to help you grow again. Because if agencies could help their clients grow again, you wouldn't have an RFP every three years. You would not have procurement whacking the fees.

SS You argue that agencies have to be paid differently. You say they should be compensated on the basis of defined deliverables and outcomes. How would that work exactly?

MF If you were to price a deliverable so that agencies made a 10% margin, they would be marking up the time of their people by 2.2 times. Consultants get a five to six times multiple on the cost of their people. So I'm saying that the price of the deliverable is your achieved value. A TV 30 origination ad at today's average billing rate would be priced out at about \$160,000 for the output. But if that were part of a scope of work that was delivering double the growth rate for a company, there isn't any reason why the agency couldn't start charging \$250 thousand or \$300 thousand for the work because they're worth it.

SS Well, I think the secret sauce is measurement of contribution to incremental growth and revenue. That's been a forever challenge for marketers, right?

MF Yeah, it is. Well, marketing isn't as important as it was back in the 60s, 70s and 80s when it was TV advertising. It's a saturated market right now. So it's a little harder.

SS You're sitting across the desk from a newly appointed agency CEO. What's your advice to them today to future proof their business?

MF Well, the first thing I would ask them is, how are your clients doing in their marketplaces competitively? And I'm thinking this is one of the agencies in Worldwide Partners or Magnet Global or Tribal Global³, any of these associations of independent agencies. The independent agencies are entrepreneurial and they're flexible.

So I would say there's a wonderful opportunity for you to reposition yourself to help your clients think through how they can do better in their marketplace. In other words, you're going to help them grow, you're going to help them be more competitive, and you describe how you do that. The thing is, it will require some retraining of your people, the kind of training that consulting firms do. Consultants train tens of thousands of people out of college every year. And then we have to talk about what kinds of scopes of work are likely to do this and how you get paid for that. It's the necessary transformation for agencies to get out of this terrible situation they're in.

SS In other words, they should become change agents who will lead the charge on AI transformation.

MF I think there has been such abuse of agencies one way or another over the last 20 years that most of the people who are at a senior level are like spouses who have been beaten up and have a low self esteem and can't see a rosier future. They really need a cheerleader to say, this isn't that complicated, it's logical, you can do it. And the elements of change are within your grasp. It just requires a leader who's totally committed to it. But there's just a terrible morale problem and it's hard for them to see a different kind of future. So you want to find the optimistic entrepreneurial folks who are willing to take on the challenge.

- ¹ Mike Walsh was the CEO of Europe, Africa, and the Middle East for Ogilvy & Mather, and served as a chairman/director within the agency's UK leadership.
- ² Deborah Wahl was Toyota's corporate manager of marketing communications, and later served as the vice president of marketing for Lexus.
- ³ Instead of operating as traditional corporate holding companies these organizations allow independently owned agencies to remain completely self-governed while gaining shared resources of a multinational network.



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