Output-based fees getting uptake from indie agencies

By Jason Pollock | 30 July 2024 0 Comments

Photo by Campaign Creators on Unsplash.

The picture painted by Trinity P3's Darren Woolley of an industry where agencies are reluctant to move to an output-based fee structure from the traditional hourly-based fee model may be changing, with some independents embracing the idea of charging based on deliverables instead of time.

Media agencies in Australia typically operate a remuneration model based on the percentage of time committed per individual to deliver the agreed scope of work, calculated by base salaries, plus agency overhead multiple, plus a mutually agreed profit margin.

An output-based model, however, sees the agency remunerated solely based on the outcomes – for example, delivering sales or leads or ROI improvements.

Awaken CEO Chris Parker said that as an independent agency, its approach has traditionally been centred on output, as Awaken's clients generally operate with fixed project budgets.

"Dropping time-based fees makes an agency more competitive, as we prioritise high-quality outcomes over mere time tracking or, worse, time stacking to boost profitability," he said.

The Pistol CEO Jaime Nosworthy said her agency has never been in the game of selling 'head hours' and are aligned in the premise that this is a race to the bottom, but challenged the position of moving to selling 'outputs', instead preferring to focus on 'outcomes'.

"'Outcomes' get exclusively grouped with bottom of the funnel performance marketing metrics, but can be many things including not just creative but creative that works; collaboration, provocation, and education; margin gains through operational efficiency; and profitability improvements through the activation of owned channels," she told *AdNews*.

Nosworthy said that agencies need the space to ideate and create, and clients need to value not just the end-product but also the process.

"If AI can help us get there faster, great, but let's be open with clients and redistribute the efficiency gains to pushing boundaries of innovation and capability to raise the bar for the industry as a whole," she said.

Woolley told the audience at *AdNews' Sydney LIVE* event that AI will erode the current agency fee model based on payment for time as it reduces creative and production time to market.

As such, he said that the implementation of a pricing model based on outputs and deliverables means that agencies can be property paid to recoup their costs and provide a margin to reinvest back into the transition of the business in a changing world.

"In the last 10 years in Australia, I've not had one agency suggest an output-based price model in any pitch," he said.

The Media Federation of Australia (MFA) and Australian Association for National Advertisers (AANA)'s guidelines for successful agency pitching said that while the fixed nature of the current time-based model allows both the advertiser and the agency to manage their budgeting, as well as confidently resource a team, the potential risk is that fees are earned irrespective of the quality of the outputs or outcomes, which is why a pay-for-performance component may be recommended alongside a fixed-fee model.

Bench Media's VP of growth, Anthony Fargeot, said that although his agency doesn't generally use output-based fees with clients, he can see such a structure having merits, as it's more tangible for a client to sign on what they will be delivered with rather than how long an agency will theoretically spend on crafting such deliverables.

"Hours spent on a project or campaign are meaningless if the end result is not delivered - or worse, delivered to sub-standard levels," he said.

"[Output-based fees] may also allow agencies to manage expectations - how many creative variations are expected, what campaign results are we forecasting?"

Enigma's head of performance, Chris Stobbs, said that it's evident adopting an output-based

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approach will make the industry more reliable and trustworthy.

"Output-based pitching ensures that agencies are fully aligned with client goals, creating a partnership focused on delivering measurable results," he said.

"This model is straightforward: we agree on the objectives, and we commit to delivering them. By tying compensation directly to outcomes, agencies are motivated to innovate and perform at their best, ultimately benefitting the client.

Stobbs said that this approach requires clear business goals and a focused brief, not a catch-all list of potential activities, as success hinges on full collaboration between agencies and clients, including the sharing of data and knowledge.

"This level of transparency sets the foundation for achieving the agreed-upon goals and ensures that agencies are equipped to deliver exceptional results," he told *AdNews*.

"Enigma is continually pushing our performance-based clients to work towards an outcome-based model, and while we know there is no single solution for everyone now, we believe the journey we are taking them on is an important one, because it firmly puts the needs our clients at the centre of everything we do."

Time-based billing still has a place

Half Dome's co-founder and head of growth and digital, Joe Frazer, said that he thinks certain scopes of work and agency engagements are already being negotiated on a value-based model as opposed to strictly being tied to an hourly fee.

"Especially for performance focussed work, or digital first media remits, it is by no means uncommon to work on a percentage of media spend, which is often designed to incentivise the agency to support the client in driving scale into a performance media program," he told *AdNews*.

Frazer said, however, that while the conversation that sits behind this percentage fee model often falls back on the narrative of 'more spend = more work', there is equally and increasingly an acknowledgement that this is only part of the story and that incentivisation of the agency is actually a core benefit of this approach.

"Additionally, I have not been part of a tier one pitch that doesn't have a value-based portion attached to it – for example, client pays base costs that agency incurs in working with them, which is often captured as full-time employees plus overheads - and all profit upside gets tied to the business performance of the client," he said.

"These models are also largely about covering the raw cost of doing business and then rewarding shared success."

The MFA and AANA's guidelines said that with an outcome-based model, the agency takes all of the risk, and therefore would only agree to the approach if it is confident it can deliver the outcome and that the size of the prize is worthwhile.

"It also requires good data and confidence that the outcomes can be clearly attributed to the agency. As a result, this model is not often used," the industry bodies said.

Atomic 212°'s Rory Heffernan said while output-based models are "certainly rare", particularly within the core service of media planning and buying, his agency use does use it in service areas where clients (and importantly, procurement) are familiar with that structure - for example, data transformation, analysis and/or visualisation, SEO, research, digital and design/creative,.

"If an output-based model was more common currency for media agencies to deliver media buying, I don't think you'd find any objection to it - however the buyer needs to be on the journey with this shift as well," he said.

"Where there is no precedent set for how to value output over service or hourly rates, it's more difficult (and time consuming) for clients or consultants to evaluate proposals, and ultimately receive business approval on the cost."

Heffernan said that Atomic 212° would ultimately love to shift to a value based pricing model, whereby remuneration is linked to tangible results delivered back to the business, however this requires a level of data maturity and cohesiveness that is not always available - or the data itself is not available to enable that conversation in an already demanding and time-constrained procurement process.

"Another barrier to shifting to output or value based pricing for media would also be the understanding and transparency for both parties," he told *AdNews*.

"Along with there being no comparable contract to compare to (and ultimately show the savings that the procurement process has driven), it's less finite/capped than providing an hourly quote so the client/procurement would be reluctant. These factors are likely why the client or their representative ultimately provides an hourly rate / FTE sheet for the agency to complete."

Next&Co's head of strategy, Nick Grinberg, said that agencies need to be flexible with their commercial models to reflect the way that they service a client's requirements, and the methodologies they use.

"There are certain scenarios where time-based billing is still relevant, such as when human resources are used. When outputs are achieved by other methods, like AI generated, an output-based billing model can be added to support the time-based model," he said.

"When it aligns with the clients, agencies could also look to adopt 'incentive' models that reward the performance of their work, such as hitting a certain KPI.

"Overall – I think that output/outcome-based billing is something for an agency to reflect in their commercials but I don't think it definitively kills time-based billing."

Bench's Fargeot said that it is fair for advertisers to want to maximise the share of their investment that goes into media (as opposed to going into agency fees) but this can also create an unhealthy race to the bottom to win clients.

"More often, that doesn't translate into quality or isn't sustainable for the agency in the long term or both," he said.

Fargeot said that agencies should be clear what they are delivering to an advertiser for their money in terms of output, SLA's and hours, while still being competitive on price, quality and making it work financially.

"It's always healthy to track the percentage breakdown of media vs. agency fees to ensure a fair balance is being struck for both sides,"

"I have also seen more brands and agencies discussing bonuses when the agency hits the agreed KPI's for a period of time. I believe this addition to an agency fee model is a fantastic way to align goals between entities and foster trust and collaboration."

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Atomic 212°'s Heffernan said that for all parties to change the way these services are provided (and costed), there might need to be a seismic shift to disrupt the way the pricing and appointment process runs.

"AI could be that seismic shift given the expected efficiencies from its usage," he said.

"Clients in particular should have their eyes wide open should this speed up a race to the bottom, however critical thinking and strategic alignment/direction have always been the most highly valued facets of any partnership - how do you put a price on those?"

Awaken's Parker said that with AI becoming increasingly involved in day-to-day operations, the value of a brief is changing.

"Large budgets are being squeezed to be more efficient, allowing for investment in other areas. A value-based approach enables brands and agencies to be transparent about time, effort, and impact, leading to more strategic work and a higher calibre of output," he told *AdNews*.

He said that while AI is essential for back-end operations, relying solely on AI for creative and media strategy can result in generic and uniform outputs, as the competitive edge of agencies lies in delivering out-of-the-box thinking on output-based projects.

"AI will not be the sole driver of the shift from time-based billing," he said.

"The types of content that resonate with audiences will also influence this change. Gen Z, for example, is 40% more likely to engage with LoFi content online than traditional brand ads, and LoFi is much cheaper to create. Many content creators and influencers offer output-based pricing for content that connects, engages, and converts.

"Agencies need to pivot and be part of this trend or risk being left behind by AI and evolving consumer behaviours. This shift is not just a trend but a necessary evolution for the industry to thrive in a rapidly changing media environment."

Bench's Fargeot said that there is a fear that AI will take on many tasks and completely push people out of a job, meaning theoretically agencies would then charge less, with less staff on the payroll.

"That's obviously an overstatement (at least for now)," he said.

"Yes, AI will speed up some manual and/or time-consuming tasks but will still require human oversight and QA for the foreseeable future. Also, time saved on such tasks should be reallocated into valuable business areas such as strategic thinking or relationship building rather than going straight into cost-saving mode.

"AI is definitely a powerful and fast-evolving tool and agencies who embrace it the right way are more likely to prevail. I'm hoping AI will help with output delivery and quality rather than being used as another fee negotiation gimmick."

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