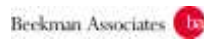




**AGENCY COMPENSATION
ASSESSMENT & BENCHMARKING**

December 3, 2009




Helping Clients Maximize Their Marketing Communications Investment



Agency Compensation Methodologies

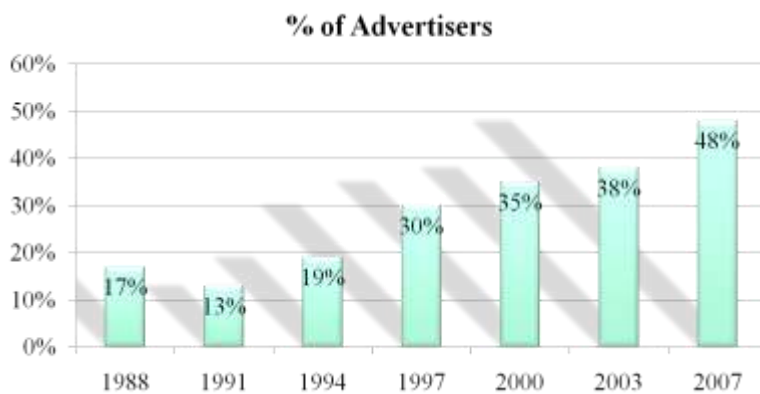


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Use of Incentive Compensation



SOURCE: ANA SURVEY 2007

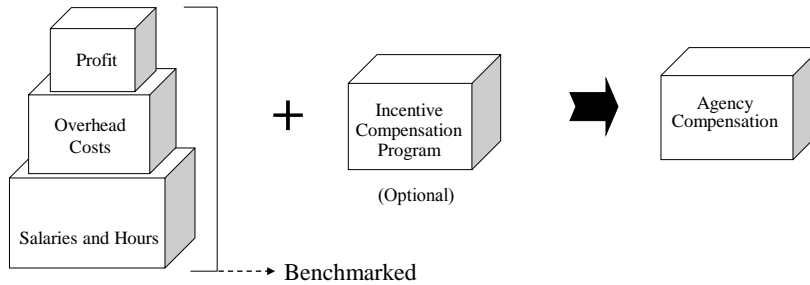
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Methodology

The building blocks of agency compensation:



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Applicable Disciplines

The assessment process is applicable with all types of agencies including:

- General Consumer Advertising
- Design/Brochures/Collateral
- Direct Marketing
- Diversity/Ethnic
- Event Marketing
- Internet (e-business)
- Media (traditional and interactive)
- Medical Education
- Pharmaceutical
- Promotions
- Public Relations
- Yellow Pages

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Appropriate Transparency

What information (transparency) is fair to require from your agency:

- Direct Base Salaries in aggregate by department

- Overhead by major subcomponent
 - Indirect Labor
 - Payroll Related (benefits)
 - Agency Employee Incentives (in aggregate)
 - Corporate Expenses
 - Parent/Holding Company fees/expenses
 - Professional Fees
 - Space and Facility Costs

- Profit Margin

- Direct Client Expenses (non-billable agency costs relating directly to your account)

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Appropriate Transparency

ANA and 4As guidelines for best practices:

- Two guiding position papers (provided in supplemental information)
 - 2002 *Guidelines for Compensation Agreements*
 - 2006 *Understanding Direct Labor, Overhead and the Components of Cost-Plus and Labor-Based Arrangements*

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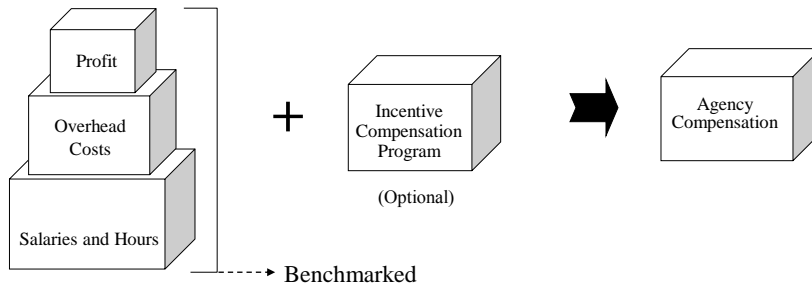
8

Agency Compensation Assessment and Benchmarking

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Methodology

The building blocks of agency compensation:



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Agency Compensation Review Process

Agency compensation five step process:

Step 1: Determine the facts

Agency Scope of
Work and
Compensation
Assessment and
Benchmarking



Step 2: Put them in writing

The New Standard
Client/Agency
Contract



Step 3: Motivate the agencies

Agency Performance
Incentive Program

Step 4: Bring it all together

Agency
Compensation
Negotiation and
Implementation




Step 5: Keep it on track

Ongoing
Maintenance and
Verification

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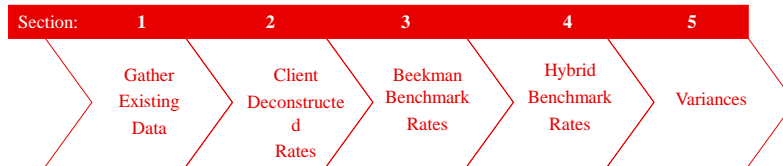
Agency Compensation Assessment and Benchmarking Hourly Rate Approach

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Assessing and Benchmarking Hourly Rates



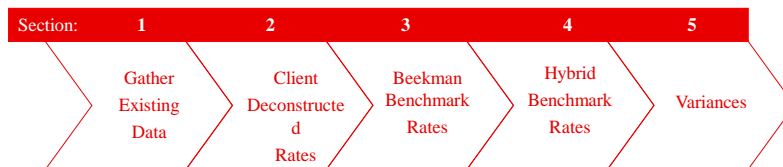
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Hourly Rates

Benchmarking Process



Most existing data can be obtained through existing sources such as the client contract and time reporting

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Assessing and Benchmarking Hourly Rates

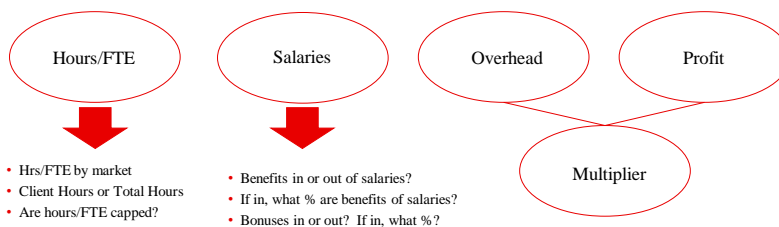
- What are the components needed to be understood:
 - Hours per FTE
 - Salaries
 - Overhead
 - Profit
- Where can you gather this data from?
 - The client/agency contract
 - Questions to your agency

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Assessing and Benchmarking Hourly Rates

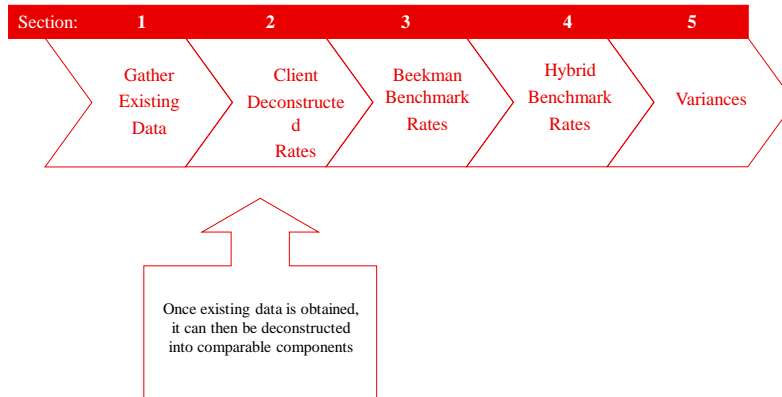
Determine the contract definitions & metrics:



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Assessing and Benchmarking Hourly Rates



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Assessing and Benchmarking Hourly Rates

Deconstructing an hourly rate:

Title	Hourly Rate	Hours/FTE	Overhead Rate	Profit Margin	Benefits
Account Executive	\$100	1,800	100%	10%	25%*

*The agency indicated it adds 25% to salaries for benefits (20% of total salaries)

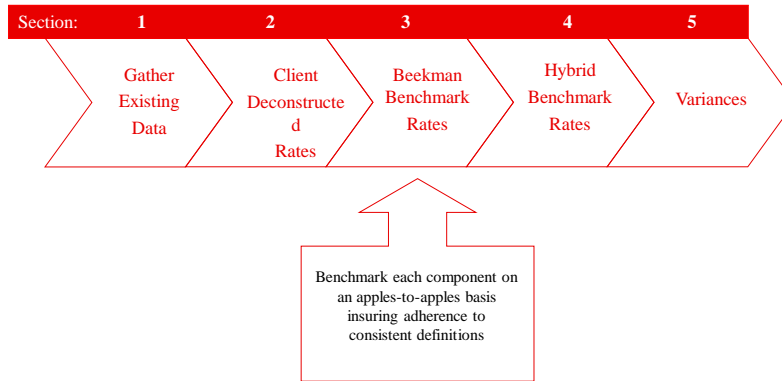
- **Total Annual Fully Loaded Cost** = \$100 x 1,800 = \$180,000
- **Profit** = \$180,000 x 10% = \$18,000
- **“Salary Costs”** = (\$180,000 - \$18,000) / (1 + 100%) = \$81,000
- **Base Salary** = \$81,000 - (\$81,000 x 20%) = \$64,800 **note: 25% markup is equal to 20% of gross**
- **Overhead** = \$180,000 - \$18,000 - \$64,800 = \$97,200 **or 150% of Base Salary = (\$97,200 / 64,800)**
- **Check:** Base Salary + Overhead + Profit = Total Annual Fully Loaded Cost / Hours/FTE = Hourly Rate

$$\$64,800 + \$97,200 + \$18,000 = \$180,000 \quad 1,800 = \$100 \quad \checkmark$$

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Assessing and Benchmarking Hourly Rates



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Assessing and Benchmarking Hourly Rates

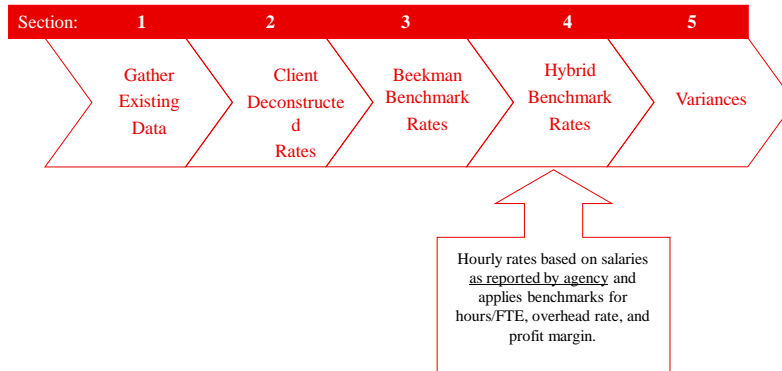
Compare the hourly rates to benchmarks and determine the drivers:

	<u>Example Agency</u>		<u>Beekman Benchmark</u>	
Hourly Rate	\$100		\$66	
Hours per FTE	1800		2040	
Base Salary	\$64,800		\$53,284	
Overhead	\$97,200	150%	\$61,277	115%
Profit	\$18,000	10%	\$20,217	15%

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Assessing and Benchmarking Hourly Rates



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Assessing and Benchmarking Hourly Rates

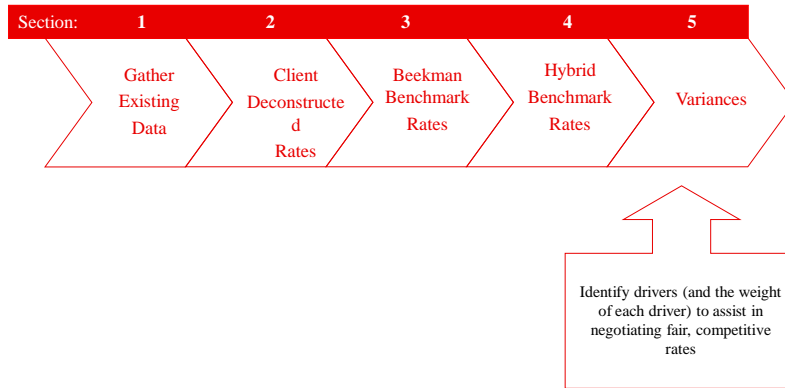
Apply benchmark hours, overhead and profit to reported salaries:

	<u>Example Agency</u>		<u>Beekman Benchmark</u>		<u>Hybrid Benchmark</u>	
Hourly Rate	\$100		\$66		\$80	
Hours per FTE	1800		2040		2040	
Base Salary	\$64,800		\$53,284		\$64,800	
Overhead	\$97,200	150%	\$61,277	115%	\$74,520	115%
Profit	\$18,000	10%	\$20,217	15%	\$24,586	15%

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Assessing and Benchmarking Hourly Rates



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Assessing and Benchmarking Hourly Rates

Determine what is driving the variance between your rates and benchmark rates:

	----- Variances -----	
	\$	%
Hours per FTE	\$8.13	24%
Base Salary	\$10.84	32%
Overhead	\$22.54	66%
Profit	-\$7.51	-22%
Hourly Rate	\$34	100%

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Assessing and Benchmarking Annual Agency Fees

Assessing and Benchmarking Annual Fees

We will need to save this for another day.

Appendix

Appendix 1 - Beekman Definitions

Beekman Definitions

DIRECT BASE SALARY DEFINITIONS

A. TOTAL ACTUAL HOURS

Total Actual Hours means (a) the actual number of hours of Direct Staff worked on the Client's account plus (b) the actual number of hours worked on other client accounts plus (c) the actual number of hours worked on non-client (Agency) matters such as new business development, executive and administrative matters, but excluding vacation, holiday and sick time. If certain hours are not available because the Agency is projecting for a future period, then historical average hours may be substituted for actual hours, in which case agency must state it is using average hours and give the average hours used. Do not use an agency Standard/Over formula.

Example: If a named Direct Staff person spends 1,000 actual hours on the Client's account during the period in question, 800 actual hours on other client accounts and 200 actual hours on internal agency matters such as new business development, executive and administrative issues (a total of 2,000 actual hours), and earns an annual base salary of \$100,000 per payroll registers, then the Direct Base Salary would be allocated as: \$50,000 for the Client's account, \$40,000 would be allocated to other clients and \$10,000 would be allocated to the Agency's Indirect Payroll portion of Overhead.

B. DIRECT STAFF

Direct Staff are those Agency employees who work hands-on Direct Departments (as listed below). Direct Staff does not include any Agency employees, regardless of their department, whose primary responsibility is in the area(s) of finance, accounting, secretarial, administrative, Agency related computer services or executive management. It is assumed that each Direct Staff person listed is a full-time, full-period employee of the Agency and any variances thereof should be so indicated.

C. DIRECT DEPARTMENTS

- Account Services** - Hands-on staff working on Client contact, marketing, planning, merchandising, etc., by principals and by account staff. Account Planners should be included under the Research/Account Planning/Creation and not in this section.
- Creative** - Hands-on staff working on the Client's creative including conceiving, copy writing, art direction, finished art, layouts, mechanicals, illustrations, stylists, etc.
- Account Planning** - Hands-on staff working on research, market analysis, account planning, library functions, etc. for the Client's business.
- Research** - Hands-on staff working on research including information specialists, researchers and other professionals.

(5) **Media Strategy/Planning** - Hands-on staff working on the Client's media planning, estimating, media research and strategy.

(6) **Media Buying** - Hands-on staff working on executing the media plan by negotiating, contracting, buying or tracking the Client's media.

(7) **Production** - Hands-on staff working on managing and performing all facets of the Client's production of advertisements for broadcast, print, and collateral.

(8) **Traffic** - Hands-on staff working on managing and performing all facets of the Client's trafficking of advertisements for broadcast, print, and collateral.

(9) **Interactive** - Hands-on staff dedicated to interactive activities including website development, programming, etc., but does not include the time of people in the Account Service, Creative or Media departments working on the creation or placement of advertising that will appear in an interactive medium (their time is collected in the respective departments above).

(10) **Other** - If any, must be agreed to in advance by the Client and be described in detail.

D. DIRECT BASE SALARY

Direct Base Salary is the base salary per the Agency's payroll register for Direct Staff employees (as defined above) and excludes any (i) bonuses, (ii) stock, (iii) deferred compensation, (iv) payments into retirement plans, (v) profit sharing, (vi) contributions to benefit or savings plans, (vii) benefits and perquisites, (viii) medical, dental, and disability insurance, and (ix) payroll related expenses such as payroll taxes, insurance, and other mandated employee benefits. These excluded items are included elsewhere.

Non-employees such as independent contractors and freelance workers, who work on Client matters, should be listed on the Staffing Plan as such at their net cost prior to benefits and overhead costs. Indicate if the person named is an employee by including an "E" freelance by including an "F" on a part-time by including a "P" after their name.

E. CLIENT'S SHARE OF DIRECT BASE SALARY

The Client's Share of Direct Base Salary is defined as each Direct Staff person's salary (as defined above) for the period being reported, multiplied by the percentage that is derived by dividing (i) in the numerator the person's actual hours worked on the Client's account for the period, and (ii) in the denominator the person's Total Actual Hours.

Beekman Definitions (continued)

OVERHEAD EXPENSE DEFINITIONS

Overhead Costs are all fees as the Agency business expenses that are necessary and related to conducting the Agency's operations, are not included in Direct Base Salary, are not an allocation of the costs of running the Agency's parent company, and are specifically included below within one of the five sub-sections of Overhead Costs.

A. Indirect Payroll

- Employee wages paid for new business development
- Employee wages paid for the Agency's technology and public relations
- Employee wages for human resources, recruiting, and staffing
- Employee wages for data processing, data management and computer maintenance
- Employee wages for human resources and personnel issues
- Employee wages for general office functions
- Employee wages for executive management
- The indirect portion (not a Client cost) of Direct Staff employee's salaries
- Temporary services for the above functions
- Other (if any, must be agreed to in advance by the Client and be described in detail)

B. Payroll Related Expense

- Recruiting and search fees
- Employee medical, disability, and other life insurance benefits
- Joint retirement
- Third-party payroll processing costs
- Meal and travel related costs
- Other (if any, must be agreed to in advance by the Client and be described in detail)

C. Employee Benefits

- Payment into retirement plans, all 401(k) plans and profit sharing that do NOT require employee deferral
- Employee insurance
- Employee stock option costs
- Other (if any, must be agreed to in advance by the Client and be described in detail)

D. Client-side Expenses

- Agency's own payroll advertising and public relations costs
- Telephone charges
- Printing and project necessary expenses
- Marketing and sales and other systems
- Travel related costs (business expenses not payroll related)
- Office supplies, printers and other equipment
- Postage and delivery charges
- Other printing expenses
- Equipment depreciation
- Internal network related network
- IT hardware
- IT software, software and hardware expenses
- Non-Business travel (not out-of-pocket costs)
- Office and workstations
- IT hardware
- Bank fees
- Other (if any, must be agreed to in advance by the Client and be described in detail)

E. Parent and/or Holding Company Expenses

- Allocation of directly payable expenses already included in the agency
- Allocation of human resources, treasury, tax, real estate, and other support staff (but excluding executive staff)
- Other (if any, must be agreed to in advance by the Client and be described in detail)

F. Professional Fees

- Other (if any, must be agreed to in advance by the Client and be described in detail)
- Outside Court and Public Accounting fees
- Outside legal counsel
- Outside consultants
- Other (if any, must be agreed to in advance by the Client and be described in detail)

G. Space & Facilities Expenses

- Rent, light, heat, electric and repairs
- Leasehold improvement and restoration expense
- Real Estate and occupancy costs
- Security
- Other (if any, must be agreed to in advance by the Client and be described in detail)

DIRECT CLIENT EXPENSES

A. Direct Client Expenses are non-salary, non-reimbursed, out-of-pocket expenses that are directly attributable to a client's account. (Client Expenses include:

- Non-reimbursed travel to and from client offices during the routine management of the client's business but does not include time for staff
- Non-reimbursed entertainment
- Non-reimbursed research costs directly attributable to the Client
- Non-reimbursed presentation costs
- Real estate and shared account services
- Foreign currency exchange program fees
- Media services including direct advertising
- Other (if any, must be agreed to in advance by the Client and be described in detail)

A. PROFIT

Profit includes the Agency's operating profit, transportation/marketing costs, general administration, interest expense.

Appendix 2 - Hours per FTE

Hours/FTE

ACTUAL VERSUS "STANDARD" HOURS

Example:

An Agency employee, Jane, earns \$100,000 works 2,000 hours/year as follows:

Client A	1,000 hours
Client B	800 hours
Internal Agency Hours	200 hours

Using a 1,600 "standard" hours/year cost calculation, Client A will be charged \$62,500 ($1,000/1,600 \times \$100,000$).

Using the actual hours per year, Client A will be charged \$50,000 ($1,000/2,000 \times \$100,000$).

If the agency uses 1,600 "standard" hours/year the agency overstates its actual costs and realizes a 25% windfall profit on top of its stated profit.

Appendix 3 - Understanding Agency Utilization Rate

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Agency Utilization Rate

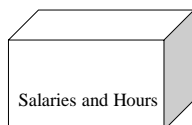
Direct Versus Indirect Hours

What's the difference?

- Direct hours - "direct departments" time on client business
- Indirect hours - time on internal agency matters such as new business, training, seminars, administrative duties, etc.

Why should you care?

- This can have a significant impact on agency compensation if agency utilization rates fall short of industry averages.



The Utilization Rate

How does it impact compensation?

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Agency Utilization Rate (continued)

Example:

An agency employee earns \$100,000/yr. and works 2,000 hours as follows:

Client A	1,000 hours
Client B	500 hours
Internal Agency Hours (new business/admin/training, etc.)	500 hours

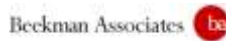
75% Utilization Rate
(1,500 client hours / 2,000 total hours)

Should client "A" be charged \$66,667 (1,000/1,500 or 2/3) of the employee's cost?

Should client "A" be charged \$50,000 (1,000/2,000 or 1/2) of the employee's cost?

The difference is 33% which carries through to create a 33% variance in the agency's compensation.

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Agency Utilization Rate (continued)

FACT 1:

The benchmark average agency utilization rate is 90%.

FACT 2:

Only the agency can manage its utilization rate.

SOLUTION:

Agree on an acceptable utilization rate (90%) and add the "un-utilized" time to the agency's fixed overhead, thereby capping the un-utilized time (10%) and placing utilization management on the agency, where it should be.

Under certain unusual circumstances it may be appropriate for a client to provide the agency with "relief" from a quick and significant reduction in the utilization rate particularly if it is caused by the client. Additionally, the agency will realize a windfall should it manage its utilization higher than 90%. Utilization rates are lower on "project" assignments.

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Agency Utilization Rate (continued)

Example:

An agency employee earns \$100,000/yr. and works 2,000 hours/year as follows:

Client A	1,000 hours
Client B	500 hours
Internal Agency Hours	500 hours

Using Client Billable Hours (1,500) the cost to Client A is \$66,667
(\$100,000 divided by 1,500 hours times 1,000 hours on Client A)

Using Total Hours (2,000) the cost to Client A is \$50,000
(\$100,000 divided by 2,000 hours, times 1,000 hours on Client A)

RECOMMENDED METHOD:

Accounting for the utilization rate the cost to Client A is	\$50,000 in direct salaries
	<u>\$5,000</u> (10%) in overhead
	\$55,000

Agency Utilization Rate (continued)

NOTE:

When moving 10% of the employee's \$100,000 salary to overhead (\$10,000), the client portion of the direct salary becomes \$90,000 (\$100,000 salary less \$10,000 moved to overhead.) Because the salary base is now lower (\$90,000) the actual ratio added to overhead should be 11.11% (not 10%).

The calculation:

Direct Salaries	\$90,000
Overhead	+ <u>10,000</u> (the ratio of \$10,000/\$90,000 is 11.11%)
Total	\$100,000

Therefore by putting 10% of direct salary costs into overhead the client should add 11.11% to the overhead rate paid to the agency.

Agency Utilization Rate (continued)

Outcomes for Client A using recommended method and various utilization rates:

(\$100,000/year salary)

	HOURS	HOURS	HOURS
Client A	1,000	1,000	1,000
Client B	500	800	900
Internal	500	200	100
Total Hours	2,000	2,000	2,000
Utilization Rate	75%	90%	95%

	CLIENT A COSTS	CLIENT A COSTS	CLIENT A COSTS
(Staffing Plan)	\$50,000	\$50,000	\$50,000
(11.11% added to O/H)	<u>\$5,555</u>	<u>\$5,555</u>	<u>\$5,555</u>
	\$55,555	\$55,555	\$55,555

USING THE RECOMMENDED MODEL, THE CLIENT'S COST DOES NOT CHANGE IF THE AGENCY UTILIZATION RATE CHANGES

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Agency Utilization Rate (continued)

Outcomes for the Agency using recommended method and various utilization rates:

(\$100,000/year salary)

	HOURS	HOURS	HOURS
Client A	1,000	1,000	1,000
Client B	500	800	900
Internal	500	200	100
Total Hours	2,000	2,000	2,000
Utilization Rate	75%	90%	95%

	AGENCY RECEIVES	AGENCY RECEIVES	AGENCY RECEIVES
Client A Direct Staffing	\$50,000	\$50,000	\$50,000
Client B Direct Staffing	\$25,000	\$40,000	\$45,000
Overhead (+11.11% of Direct Staff)	<u>\$8,333</u>	<u>\$10,000</u>	<u>\$10,555</u>
	\$83,333	\$100,000	\$105,555

THE AGENCY'S INCOME CAN VARY DEPENDING ON ITS UTILIZATION RATE (THEREFORE UTILIZATION RATE MANAGEMENT IS PLACED ON THE AGENCY) THE MIDDLE EXAMPLE SHOWS HOW THE AGENCY IS MADE WHOLE AT A 90% UTILIZATION

November 6, 2009



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About the Presenters

The Presenters

Mike Thyen, *Director, Marketing and Sales Global Procurement, Eli Lilly and Company*

Responsible for strategic sourcing and relationship management of advertising agencies, market research, media buying, marketing communications, exhibits and sponsorships and other marketing consulting services suppliers. Mike joined Lilly in 1982 and has experience in various sales and marketing assignments, including retail and hospital sales, market research, sales management, public affairs, corporate accounts, brand management, new product planning, and business-to-business segment management. In 2000, he moved into his current position in Global Procurement. Mike graduated from Xavier University (Ohio) in 1979 with a BSBA in Finance and from Indiana University in 1982 with a MBA in Marketing.

Bob Cauley, *Partner, Beekman Associates*

Over twenty years experience in senior financial positions at major national and international advertising agencies including CFO of major agencies • Expert in agency economics, agency compensation and contracts, audits, agency profitability/productivity • Past New England governor of the American Association of Advertising Agencies • counsel to Association of National Advertisers Finance Committee members • Successfully assesses billions of dollars in agency economics every year • Accounting and business degree from Sawyer School of Business, Suffolk University.

Lilly - Industry Leadership

Lilly, a leading innovation-driven corporation, is developing a growing portfolio of pharmaceutical products by applying the latest research from its own worldwide laboratories and from collaborations with eminent scientific organizations. Headquartered in Indianapolis, Ind., Lilly provides answers - through medicines and information - for some of the world's most urgent medical needs. Additional information about Lilly is available at www.lilly.com.

Beekman Associates - Industry Leadership

Beekman Associates is the leading expert in agency compensation assessment and benchmarking worldwide. Our experience not only includes working with many of the world's largest advertisers but also many of the leading industry organizations. We take great pride in our contribution to developing innovative ideas and practices regarding agency compensation, contracts and related matters. We work collaboratively with both advertisers and agencies to determine and implement fair compensation while promoting transparency and trust between the partners.

Beekman Associates provides many client-side trade organizations, on a pro-bono basis, advice and recommendations regarding industry best practices and innovative new ideas and approaches to agency compensation matters on a global basis. This work includes hosting seminars for the A.N.A. and the I.S.M. Beekman's recent seminars include *A Practical Guide To Agency Compensation Assessment*, *Taking the Mystery Out of Agency Overhead*, *Agency Utilization Rates*, and *Agency Incentive Compensation Best Practices*. Beekman also presented, as a featured speaker, at the Nomura European Conference on media and advertising.

We are often consulted by leading publications and stock analysts for our expertise and commentary on agency compensation practices and issues.

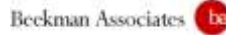
Most importantly, agency compensation assessment, benchmarking and contracting is all we do. We are committed to our clients, their agencies, and the industry to promote open and fair practices in a collaborative and professional manner.

Beckman Associates – Disclosed Clients

* indicates global client



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Thank You

Please let us know if you have any questions.

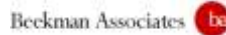
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