



House agency or independent agency?

Maybe it's not an either/or decision.

A recent Harvard Business Review working paper examined important factors in the in-house/independent agency decision. They also discovered some interesting anomalies which at first appearance seems counterintuitive to their analysis of the economics of the advertising "make-or-buy" decision.

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Double margins. The paper's first point deals with the possibility of avoiding double margins (or mark-ups) by handling advertising in house. Their analysis is based on the old commission system, because they include two types of margins or mark-ups:

1. The margin on internal services. This is the agency's compensation over and above the cost of the salaries and benefits of people who work on the account and overhead for things like rent, software and downtime. In other words, the agency profit.
2. The margin on outside production services. Under the old commission system this was a pretty firmly fixed 15%. It's now a negotiable item. In some circumstances it disappears completely in the fee- or retainer-based compensation systems which predominate in advertising today. (At BrainPosse we offer clients the option to be billed directly by outside production suppliers with no mark-up, so costs and compensation are completely transparent.)

Obviously companies can avoid paying mark-up on internal and external costs if they bring the marketing communications function in house.

Economies of Scale. An earlier study in *Marketing Science* by Alvin Silk and Ernst Berndt which found that a company would need to spend a minimum of between \$50 million and \$60 million (corrected for inflation to 2008 dollars) to match the scale and scope economies of a full service agency.

That surprisingly large number is the result of assuming that the in-house agency would provide all of the services and areas of expertise of an independent agency.

At an independent agency one research director might oversee studies for dozens of clients. An art director can work on several accounts. A TV production supervisor could conceivably produce all of the commercials a \$50 million agency does in a year (depending on the cost of media). And a top-notch media planner would have access to software that costs upwards of \$50,000 per year to license.

Add those all up, throw in some office space, hardware, a benefits package and it's easy to see why it takes \$50 million to \$60 million in billings (or about \$6 million to \$7 million in agency gross income) to pay for it all.

But that doesn't take the virtual agency model into account. Extremely professional and capable specialist media companies can handle the complex (and software intensive) planning and buying function on a fee basis. Or for a commission ranging from less than 2% to 5% or so, depending on the size and complexity of the account. Research not only can, *but should*, be outsourced. Because outside researchers don't have company biases or agendas. A company which only produces three or four TV commercials a year can hire a freelance producer to act as interface with the production company and do things like go over the bid form to eliminate waste and keep track of talent rights.

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The biggest advertisers outsource. The Silk and Berndt study pointed out an interesting anomaly: only five of the top 100 national advertisers used in-house agencies. Those are the companies that could best benefit from the potential savings of in-house agencies, because their budgets far exceed the \$50 million to \$60 million needed to economically provide full service internally.

But there's more at work here than money. Although Silk and Brandt's analysis focuses exclusively on economic factors – what does it cost to get the job done – they ignore qualitative differences between in-house and independent agencies.

In-house agencies become very knowledgeable about their companies' products and service, but there is no cross pollination with new developments in other industries or with other groups. On two occasions a BrainPosse principal worked at agencies which had free bars that opened after five. A copywriter working on a hair coloring account might hash over an idea with an account executive on an instant soup brand and get an insight that might never occur in isolation.

With an in-house agency there's also the possibility of falling into a pattern of "the way we always do things" that prevents new marketing communications ideas from breaking through.

The more tech, the more in-house. Although big advertisers generally don't have in-house agencies, one whale of an advertiser did, and their work was outstanding. GE had an in-house for over 50 years, principally because their B2B products were technologically complex.

That complexity meant that a great deal of time – and, of course, money – were required to bring a marketing communications team up to speed. Given the size of the investment, it was advantageous to recruit their own team of communicator/technologists.

In general, highly technological B2B advertisers are more likely than average to have in-house communications groups. Frequently these groups are not full-service in-house agencies, but task teams who handle part of the process in tandem with outside suppliers.

Retail keeps it close to the vest. Retail is probably the product/service category with the heaviest emphasis on in-house agencies.

Retail marketing communication is generally quite predictable. Most soft goods retailers have five key selling seasons and five sales immediately after those peaks. The red circle on the calendar at one chain highlights the same date that's circled on the calendars at every other chain in the same segment.

But one reason many retailers give for their in-house agencies is confidentiality. We're not persuaded that in-house marketing communications folks are any more respectful of their employers' privileged information than their independent agency counterparts, but some retailers feel more secure with all the details of the upcoming Midnight Madness sale locked under their corporate roof at night.

The other reason retailers frequently give for keeping advertising in house is speed. Many aspects of retail are tactically driven, with emphasis on a transactional rather than a relational sell. (See our earlier article "[The Price Is Wrong](#)." for more on transactional versus relational selling.) With that mindset fast turnaround takes on importance, and there may be a slight advantage to having one's art director down the hall rather than in the next time zone. But it's a pretty miniscule advantage now that we're all linked digitally.

It's not either/or any more. The virtual agency is a reality. The two most important business models in marketing communications today are the multinational mega agency and the task-team model derived from feature film production.

In the task team model teams of top professionals are assembled for specific projects, do the project and disperse. In some cases, such as a TV series, the same producer and actors may remain on the project permanently while different contributors are brought onto the team as needed.

That task-team model is working for us. And internal client groups are frequently part of the team. We have strong working relationships with client companies' in-house communications groups, integrating our work and ourselves into the processes and onto their teams seamlessly, and bringing them into projects for which we are primarily responsible.

For one client we provide marketing strategy, communications plan, print, web, direct mail, collateral, TV and radio copy and broadcast production supervision while the client's in-house group provides print, collateral, direct mail and web design, a media specialist firm provides media planning and placement in-house PR professionals handle employee communications, publicity and crisis communications and a specialist firm handles special events and government relations. The arrangement has worked smoothly – and has consistently produced solid bottom-line results – for more than ten years and still counting.

To find out more about the possibilities of in-house/independent agency collaboration, [click here](#) or call 865.330.0033.

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