ADVERTISING: The Supply Chain's Hidden Cost Reduction Gem

Though it may not always be considered a supply management responsibility, advertising purchases hold many opportunities for cost reduction by a supply manager.

Supply managers should be involved in the purchase of professional services such as advertising, legal counsel, consulting services, etc., if they are not already.

The author's experience with five Fortune 500 companies suggests that savings ranging from 5 percent to 48 percent (averaging 8 percent) are possible in as short as six months when the supply management and advertising departments work collaboratively to perform a structured analysis of advertising media and external supplier spend. These are savings obtained without layoffs of internal personnel, shifts in the media mix, changes to ad agency support levels, or reductions in total rating points (TRPs) — rating is equivalent to a percentage of the target audience reached; a rating point of one means the advertiser has reached 1 percent of a defined target audience, a rating point of two means it has reached 2 percent, etc. Results like these are possible because many of the skills, processes, tools, and concepts used in the procurement of traditional items are applicable to the purchase of advertising and other professional services as well.

EXAM ALERT
Modules 2 & 3

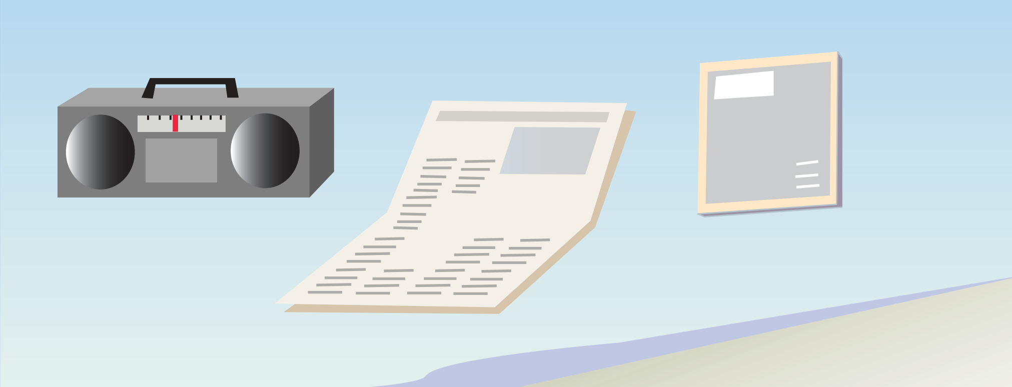
The Philosophy behind Ad Sourcing Work

The running joke in advertising circles is that 50 percent of advertising spending is wasted — but nobody knows which 50 percent it is. This is because advertising is a complex combination of art, psychology, philosophy, experience, judgment, statistics, and intuition. Few right and wrong answers exist, only cost-benefit trade-offs between creative and medium placement alternatives. Because of advertising's complexity and lack of definitiveness, the corporate advertising executive is better off letting his or her agency partners present and debate the creative and placement advertising alternatives and focusing, instead, on the real, measurable dollar trade-offs tied to the creative and placement recommendations that they make.

Points of Interest

At a glance, here are the main points covered in this article. By reading it, you will learn:

- Nine strategies for finding and delivering advertising purchase cost savings
- How complementary cross-functional skills can combine to financially benefit the organization
- The importance of working collaboratively with organizational subject matter experts outside of the supply management department
- Best practices and concepts applicable to the procurement of professional services in advertising and beyond



An advertisement should be viewed as a single opportunity to communicate a specific message to a targeted individual. The delivery medium (e.g., TV, radio, airplane banners, key chains, bumper stickers, tattoos, etc.) should not matter as long as the desired message has been delivered to the desired target. Neither should creative considerations be given undue weight. Legitimate creative and channel distribution trade-offs exist. The ultimate goal of any advertisement, however, should be to communicate the desired message to the desired target at the best possible value. Fuzzy arguments justifying costlier creative or placement alternatives need to be challenged relative to the incremental benefit they deliver. The incremental costs (e.g., hire the celebrity, film in Maui, and advertise during the Super Bowl) are always quantifiable and indisputable. The incremental benefits (e.g., resulting sales increases, brand enhancement resulting from the "halo effect" of using celebrity spokespersons or advertising on high-profile programming) usually are not.

How to Save on the Procurement of Professional Services

Evaluating the purchase of professional services such as advertising, legal counsel, consulting services, etc., can be challenging since the deliverable is often intangible or impacted by factors outside of the supplier's control. To measure effectiveness and efficiency, one needs to decompose the purchased services into components that can be analyzed and benchmarked to the market. The strategies that follow are described in terms of advertising services, but they are applicable to the procurement of all professional services.

Change the Planning Paradigm

The first question usually asked by the advertising agency at the beginning of the planning cycle is, "What is this year's ad budget?" If one were to walk into a car dealership and tell the salesperson that he or she has up to $30,000 to spend on a new car, the salesperson would point him or her to a car that costs (surprise) $30,000 — particularly if the salesperson is being paid on commission. Never mind that the dealer could offer a $25,000 car that would satisfy the person's needs or that the car being offered for $30,000 could be purchased for $28,000 through good negotiating. Likewise, when one begins the planning cycle by telling the ad agency that this year's ad budget is $10 million, the agency will likely find a place to spend $10 million; for agencies that receive a commission on the total media spend, every budgeted ad dollar left unspent represents a revenue opportunity cost.

Clients should enter any advertising (or other professional service) purchasing process with the paradigm of "This is what I want to buy," or "This is what I wish to accomplish. How much will it cost?" versus "This is how much I have to spend. What can I get for it?" Doing so may produce a result that accomplishes all desired objectives at a lower cost. This approach could also suggest that the desired objectives are unrealistic given the dollars that have been budgeted to achieve them.

Substitute Low-Cost Alternatives for High-Cost Ones Where Possible — Media Mix Redistribution

In general, it costs more (as measured on a cost per thousand (CPM) or cost to deliver 1,000 impressions basis) to deliver a single advertising impression using TV versus using radio versus using magazines versus using newspapers, etc. Each medium has its creative strengths and limitations, and it is intuitive that a richer message can be communicated using moving color images with sound than can be communicated by a black-and-white billboard passed in a car at 55 miles per hour. The challenge is to pick the lowest-cost medium capable of communicating the desired message to the desired target individual. There is an indisputable economic savings opportunity as media mix spending shifts from higher-CPM mediums to lower-CPM mediums. The supply manager must team with the internal (or external) advertising subject matter expert to identify and quantify the cost-saving opportunities here.

Seek Out Cost-Effective Alternatives — Intra-Media Programming Mix Modification

Think of a TV commercial you recently saw. Do you remember the show you were watching when you saw it, the time you saw it, the channel it was on, and whether the channel was on cable or network TV? Most of us don't. The cost trade-offs related to these dimensions can be significant. (It's not uncommon for one show to cost six times more on a cost per point (CPP) basis than another.) If the ad ran during the Super Bowl, it cost the advertiser significantly more to reach you once than it did if you were watching a rerun of "Seinfeld." While ad agencies often justify placing ads on "high-profile" or "high-quality" programs, the reality is, as this example illustrates, that (1) the message reached you in both scenarios, (2) you probably don't remember which show you were watching — offsetting the high profile/quality argument, and (3) the cheaper show may have cost 85 percent less. The analogy is more or less true for radio, newspapers, and magazines as well. Using ad agency provided, statistically sound research data from Nielsen, Arbitron, and other independent third parties provides the objective, data-supported fact base necessary to make cost-optimized programming decisions or, at a minimum, establish a programming mix cost-benefit trade-off comparison baseline. While the ratings data sources are not perfect, they provide a starting point upon which to make media investment decisions — post-run analysis and fusion with other data sources allow fine-tuning over time. Programming mix savings result to the extent that low-cost CPM programming can be substituted for high-cost CPM programming.

Compensate Suppliers Relative to Market Supply and Demand — Agency Compensation

A variety of agency compensation arrangements exist such as fixed fee, variable compensation tied to performance, commission on media spend, fee plus commission, and cost plus a negotiated percentage, to name a few. Regardless of the one chosen, the compensation arrangement should reflect the value equation of the agency's offering where value is defined as "what you get" versus "what you pay." The "what you get" portion of the equation represents the services and expertise that the agency provides in addition to its overall responsiveness and service level. The "what you pay" figure is a concrete number from your general ledger. This number should reflect the supply and demand of the marketplace for the services being bought. The literal item purchased from agencies is their employees and their time. As such, "what you pay" should equal the cost of the agency people you are "renting" plus a markup to cover (reasonable) agency overhead plus a (reasonable) profit for its expertise. When probing the agency's business model, one finds that large accounts often pay more than their fair share of firm overhead (on a relative basis) than small accounts. Instead of being rewarded, large clients often subsidize less profitable accounts. An organization may also discover that it is paying the agency $60,000 for 50 percent of a person's time, when that person could be hired on a full-time basis for $40,000 a year. When this is discovered, selective insourcing — or the credible threat thereof — is the cost-saving action to take.

You would not pay $1,500 for a personal computer made in 1989 when one made in

Nine Strategies for Achieving Savings with Advertising Service Purchases

	Leverage Point	How It Can Be Used to Reduce/Optimize Advertising Procurement Costs
Advertising Effectiveness and Efficiency	The Planning Paradigm	Purchasing advertising from the perspective of "This is what I want. How much does it cost?" vs. "What can I get for $X?" may achieve the desired objectives at a lower cost.
	Media Mix Reallocation	Shifting ad spend weighting from higher- to lower-cost mediums (i.e., from TV to radio or from radio to newspaper) can potentially communicate the desired message to the desired target at a lower cost per impression.
	Intra-Media Programming Mix	Choosing programs that reach the desired target market at a lower cost per impression can achieve desired objectives while saving money (e.g., advertising on reruns of "Cheers" costs less than advertising on the Super Bowl).
	Buying in Volume	Larger same-supplier spending volumes, purchase guarantees, and advance purchases can lower unit costs.
Agency Compensation	Compensation Arrangements	Periodic surveys of market commission rates and alternative payment arrangements ensure that agency compensation is in line with the supply and demand of the marketplace for the agency's service.
	Performance-Based Compensation	Linking a portion of agency compensation to measurable results (e.g., market share, sales, or awareness increases, etc.) or to periodic agency "report card" evaluations can increase advertising effectiveness and enhance agency service levels.
	Disaggregation	Disaggregating advertising services and purchasing them at the component level (vs. one-stop shopping with the agency) can reduce costs as sometimes the sum of the pieces is less than the current cost of the whole.
Production Costs	Fees and Markups	Ensuring that agency markups and subcontracted supplier production fees are in line with the supply and demand of the marketplace for their service prevents overpayment.
	Proactive Cost Trade-Off Management	Ensuring that premium-priced production recommendations can be justified (e.g., filming an ad on location in Maui with Julia Roberts vs. in a studio set with a company employee) will result in production cost savings.
Other Opportunity Areas	Invoice Audits and Error Elimination	Random auditing of agency and media supplier invoices ensures that the media purchases and pass-through costs reflect contracted terms and conditions.
	Print Advertising Demand Management and Sourcing	Analyzing number of circular pages, size of ad, number of colors, paper grade, etc., can reduce print advertising cost as can proper sourcing of raw components (e.g., paper, ink, etc.).
	Media Supplier Price Negotiations	Spot-checking the pricing negotiated on your account's behalf by compensated experts can ensure that your prices are in line with the supply and demand of the marketplace and that proper diligence is being performed to negotiate the best possible prices.

2001, which is 10 times faster with more features, costs $1,000. Neither should you blindly pay your agency year after year without knowing what new agency services are being offered in the marketplace and where the supply and demand of the compensation price point has moved. To produce ad agency savings, analyze the value equation delivered by the agency relative to the services it provides and the supply and demand of its marketplace. Value equation analysis can be applied to the procurement of all other professional services (e.g., lawyers, contract programmers, consultants, etc.) as well.

Disaggregate Service Purchases vs. Defaulting with One-Stop Shopping

Producing an ad requires definition of a message, identification of the target audience, creation of the ad concept, physical creation of the ad, placement of the ad in the media, and administration of supplier payment. Traditionally, an organization went to a single ad agency for one-stop shopping. Now, it is increasingly possible to disaggregate the supply chain and cost-optimize the pieces to reduce cost. For example, one agency can be used for creative, another for production, and another for placement. At best, the cost savings that result from supply chain disaggregation outweigh the added administrative effort. At worst, cost knowledge of the disaggregated supply chain can be used as a check on agency service component cost escalation, as the credible threat to outsource (or insource) selective services always exists. Sometimes the sum of the pieces can be less than the current cost of the whole. This concept, too, is applicable to the procurement of other professional services. For example, one could envision purchasing export law legal services from the incumbent law firm, purchasing intellectual property legal services from another firm, insourcing others, and going to a mediation firm for still other legal needs versus buying all legal services through a single, full-service law firm.

Scrutinize Cost-Benefit Trade-Offs

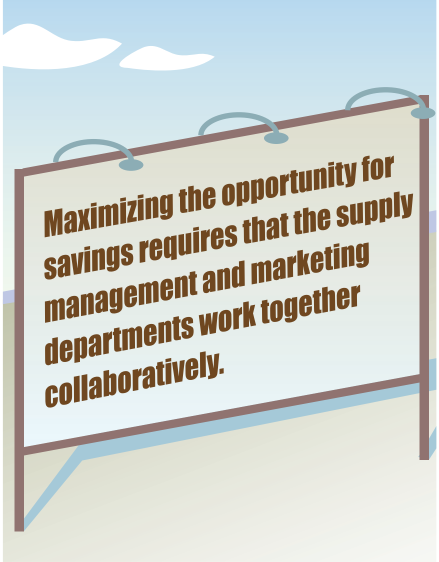
It would cost more to have Michael Jordan promote a product than it would to have an undiscovered, aspiring actor promote it. It probably costs more to have James Earl Jones do a voiceover on a radio commercial than it does to use a local disc jockey. To save money in ad production, the corporate advertising executive must strike the right cost-benefit balance, selectively making incremental investments above the lowest-cost alternative where there appears to be an intuitive benefit justification for doing so. Consider recycling (or buying) previously produced video clips, radio sound clips, and print ads versus producing new ones. Or choose to film the ad near the production studio versus at a locale somewhere on the other side of the globe. Agencies will cite many reasons why an incremental investment in production is justified. However, these justifications must be weighed against the quantifiable, incremental cost. These, again, are cost-benefit versus right-wrong trade-off decisions.

Leverage Buying Power and Negotiate Diligently

A media supplier is, just as a supply manager's organization is, subject to the law of supply and demand. Those advertisers coming to the supplier with larger spending volumes will usually be entitled to better financial terms. Those advertisers willing to guarantee volumes or buy in advance can also benefit from better financial terms. Because many agencies are paid a commission on total media spend, their financial incentives are misaligned with their clients', sometimes resulting in less negotiating diligence than might be expended if negotiating on their own behalf. While an agency might not knowingly negotiate a poor deal for its clients, it may follow the path of least resistance — particularly when the client has not created a climate of cost containment with the agency. Spot-check media supplier pricing from time to time by cold-calling a station or a newspaper and requesting the retail rate card. Compare these prices to those the agency is negotiating to ensure that the organization is receiving the buying expertise it is paying the agency a premium for. Also consider instituting a cost reduction benefit share arrangement with the agency to better align the financial interests of each party.

Identify and Eliminate Invoicing Errors

Unfavorable invoicing errors are surprisingly common. For example, Newspaper Services of America estimates that 20-plus percent of newspaper invoices arrive with an error; 90-95 percent of these errors are in favor of the media supplier. Some result from media suppliers charging for ads that did not actually run or that did not deliver the promised audience. Others are mathematical errors caused as invoices are handed from the media supplier to the agency to the client. Still others result when an agency estimates the cost of production, produces the ad, comes in under budget, charges the client the estimated amount, and keeps the underrun differential as incremental profit. In all cases, it pays to spot-check the accuracy of



invoices to make sure that no overpayment is occurring to media suppliers, production houses, ad agencies, or any other subcontracted supplier that a supply manager may be purchasing professional services from. Professional judgment and sampling techniques should be applied here to avoid spending more in labor than is saved from error elimination.

Manage Internal Company Demand — Print Advertising Spend Reduction

Analyzing coverage density, circulation, number of pages, number of mailers, number of colors, size of paper, and quality of paper will produce savings. Strategic sourcing of raw components (e.g., pulp, ink, etc.) can also yield savings if the buying volume is sufficient. As always, there will be arguments put forth to justify the highest-quality paper grade, 100-plus percent coverage, the number of pages in the circular, the size of the pages, the number of colors, etc. There will also be agency and field predictions of ruinous revenue declines if any modifications are made to the print advertising status quo. As always, cost-benefit trade-offs must be analyzed and measured against the golden rule: deliver the desired message to the desired target at the lowest defendable cost.

Conclusion

This article lists nine strategies that supply managers can deploy to generate advertising category savings; the clients that the author has worked with have averaged savings equal to 8-plus percent of their current annual external advertising spends by using them. Most of the strategies are applicable to professional service purchases beyond advertising. None require layoffs or investments that will take two to five years to pay back. Most deliver hard-dollar, bottomline savings in as short as six months. All require analytical rigor and a responsible cost-benefit analysis of the media, creative, and placement trade-offs. The savings that result can be reinvested in additional advertising (i.e., buy more advertising at no incremental cost), dropped to the bottomline (i.e., get the same TRPs at a lower cost), or
a combination of the two, depending on the organization's strategic and financial priorities.

Maximizing the opportunity requires that the supply management and marketing departments work together collaboratively, shedding the common mind-set of "supply management buys paper clips, and the marketing department buys advertising services." As long as credit for wins is divided equally and blame for past mistakes is avoided, collaboration will produce optimal results. In addition to providing personnel and complementary skills to historically understaffed marketing departments, the supply management organization can add value through support of ad agency contract negotiations, administration of the request for proposal (RFP) process for agency searches, random audits of invoice accuracy, strategic sourcing of print components, and providing media cost optimization analytical support. The net results to the organization are reduced costs and service that is more responsive.

The least expensive solution is not always the best solution. In tough economic times, however, it's often good enough. In the advertising space where there are few, if any, empirically supportable right or wrong answers, the least expensive solution that delivers the desired message to the desired target individual is a good place to start. It is only from here that one can perform a true cost-benefit analysis and put forth incremental spending arguments that are defendable. pt

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