

Summer/Autumn 2008

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Marketing monitor

This issue of Marketing Monitor saw improved productivity statistics reported across all marketing services disciplines. Industry commentators consistently note that clients are increasing their digital spend and this is reflected in the figures published. Advertising, Direct Marketing and Sales Promotion (DMSP) and Media Buyers all suffered a decline in margin as staff costs ate into profits, whilst Designers showed record improvements in margins.

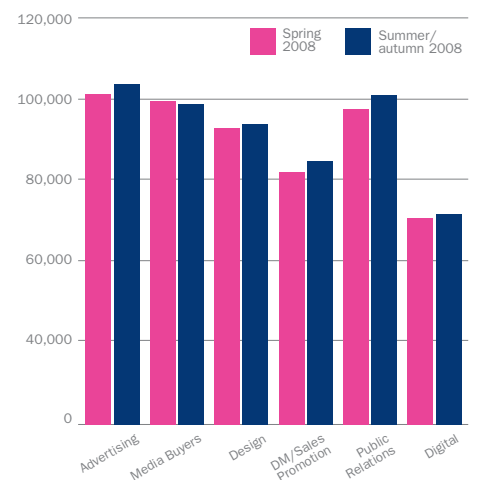
Design and Branding businesses showed a welcome improvement reporting double digit margins increasing from 8.6% to 10.1%. This put their margin higher than DMSP, which suffered a decrease. Digital agencies again showed a dramatic increase across the companies surveyed, with gross income increasing by 16%, this was not particularly surprising considering this is a high growth discipline compared to some of the other sectors.

Media Buyers continued to generate the highest level of profitability in margin terms but Advertising and PR were the only disciplines to break through the target £100,000 average gross income per head barrier.

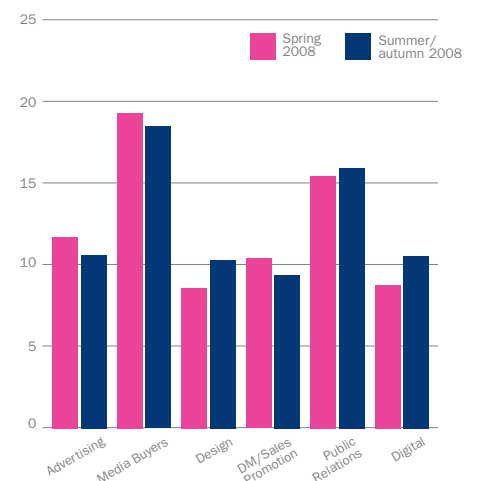
The two ratios that increased consistently across the board were productivity and staff costs per head. Average gross income per head, which indicates productivity, showed improvement within all but one discipline, but in some disciplines this was matched by an increase in staff costs per head. This meant mixed fortunes for profits. In some sectors the increase in productivity outweighed the increased staff costs whereas in others it didn't. Design, PR and Digital all managed to improve their margins whilst Advertising, DMSP and Media Buyers all showed decreases.

As the economic climate begins to show signs of tough times to come, the marketing services sector needs to ensure that its belt is sufficiently tightened. Many management teams will have successfully navigated themselves through the last downturn. Some of the newer agencies may not have such direct experience and need to be prepared for any difficult management decisions that need to be made. Balancing resource with income will always be the most challenging aspect. Those who get the balance right, keeping it lean but with enough room to take on and service new accounts, will surely weather any storm better. How resource and income are balanced will always be reflected in the ratio of employment costs to gross income, therefore regular monitoring of this all important Key Performance Indicator (KPI) will be critical to success. Anecdotal evidence suggests that the pinch may start to be felt in the fourth quarter of this year and the first quarter of next year, when marketing budgets get renewed. So, marketing services companies have until then to get themselves fully prepared.

Gross income per head (£)



Operating profit: Gross income (%)



Productivity improves once again

Increased efficiency does not increase profitability.

Productivity

Productivity has improved by 2.3% since the last edition of *Marketing Monitor* with gross income per head of £103,000 remaining higher than our target £100,000. At the top end of the scale £120,000 of gross income per head has been achieved by the top agencies and an impressive 18 of the Top 50 agencies are now exceeding this target compared to 11 in our last edition of *Marketing Monitor*.

Employment costs per head have risen slightly since the last edition of *Marketing Monitor* to £59,334. It is still unlikely that the competition for top staff is any less fierce but given other inflationary pressures within the economy it remains to be seen whether any below inflation increase in salaries can be achieved.

The continued pressure of non-staff costs, especially rental costs in central London, has meant that despite increased productivity and modest staff costs, operating profit per head decreased by 6% to £10,883 which is well short of our target of £15,000.

Profitability

Operating profit margins have decreased significantly since the last edition of *Marketing Monitor* to 10.5%.

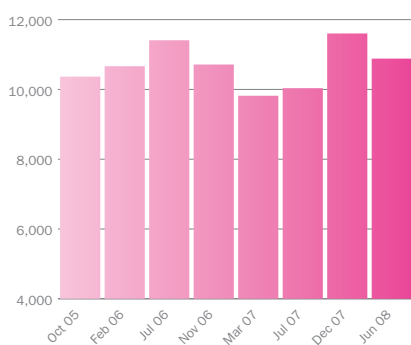
The percentage of gross income consumed by employment costs remains above our 55% target although there has been some further improvement since the last edition of *Monitor* to 56.6%. This target may be increasingly difficult to achieve due to inflationary pressures on staff costs.

Although non-staff costs have continued to increase since the last edition of *Monitor* and now account for 32.8% of gross income this rise has been broadly in line with the increase in gross income and so has not adversely affected profit margins.

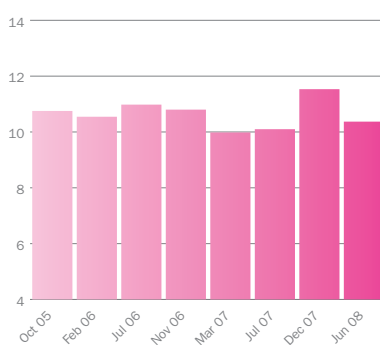
Conclusion

Agencies have taken a significant step forward in productivity without a corresponding increase in profitability. Gross income levels and non-staff costs have increased whilst at the same time staff costs and staff numbers are being controlled. The increase in non-staff costs has dented profitability.

Operating profit per head (£)

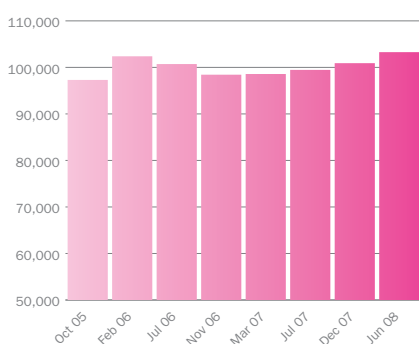


Operating profit: Gross income (%)

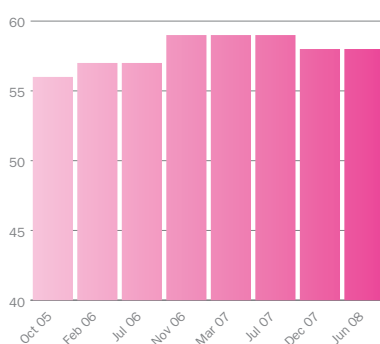


...operating profit per head decreased by 6% to £10,883 which is well short of our target of £15,000

Gross income per head (£)



Employment costs: Gross income (%)



Further Productivity Improvements

Further improvements in both profitability and productivity lead to record results.

Productivity

Productivity, as measured by gross income per head, has once again improved since the last edition of *Marketing Monitor* breaking the £100,000 barrier for the first time at £100,610 up from £95,651. This continues a trend of productivity improvements which now goes back four years.

This increase in productivity was achieved by a 4.2% increase in total gross income but with a less than 1% increase in overall staff numbers.

The continued improvements mean that consultancies are now, on average, exceeding our target of £100,000 gross income per head. With the effects of the credit crunch unlikely to hit reported results for another year this improvement is likely to continue for a while yet.

Profitability

Profit margins again increased and are now on average 16.5%, up from 15.3% in the last edition of *Marketing Monitor*. PR agencies are now comfortably within our target range of 15–20%.

This increased operating profit margin came largely as a result of a fall in the amount of gross income being taken up by employment costs. This is now an average of 59.2% down from 60.0% since December. This is, however, still slightly above our suggested maximum of 55%. With pressure on fee income likely to increase as consumer confidence falls it is important that consultancies keep a close eye on staff costs to ensure that they stay in line with gross income.

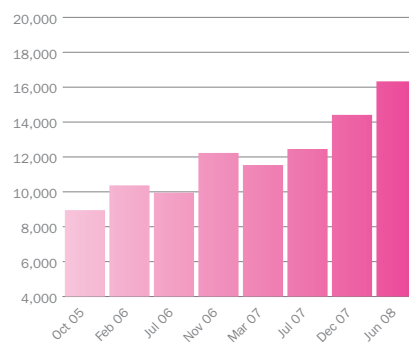
Operating profit per head, which is the key measure of both profitability and productivity combined now stands at £16,564, the highest level seen in recent years.

Conclusion

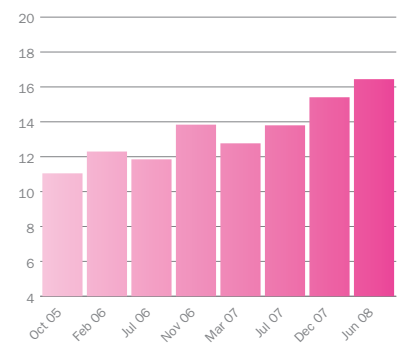
These results show PR consultancies are still reporting record results, the challenge now facing all consultancies is to maintain this level of financial performance in the more challenging times that lie ahead.

Operating profit per head... now stands at £16,564, the highest level seen in recent years

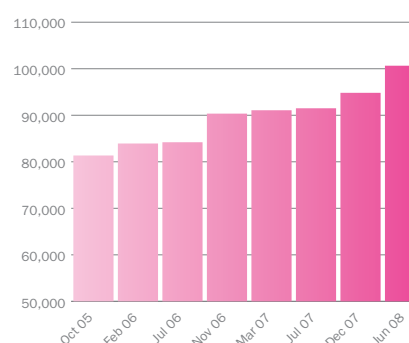
Operating profit per head (£)



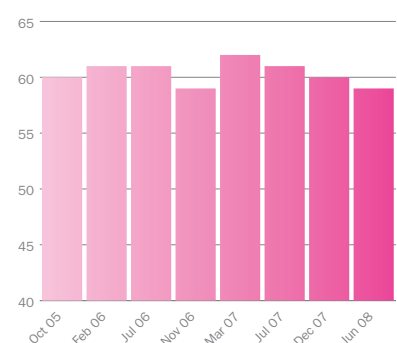
Operating profit: Gross income (%)



Gross income per head (£)



Employment costs: Gross income (%)



Spending cuts push margins into double digits

Decreased non-staff costs push designer's margins up to 10% which is much closer to our benchmark than recent results.

Productivity

Since the last issue of *Marketing Monitor*, productivity has continued to rise. Gross income per head is now £93,063, up from £91,549. This does not match the 12.3% increase seen in the previous period, but is nonetheless moving in the right direction.

Designers should aim to achieve gross income per head of between £80,000 and £100,000. Productivity continues to edge towards the upper end of the target.

Employment costs per head have increased for the second issue in a row, this time up from £52,694 to £53,533. This is in line with increased productivity.

Despite the increase in employment costs per head, operating profits have jumped further upwards from £7,764 to £9,352. This 20.5% increase suggests designers are making savings in non-staff costs. Operating profit per head still has a long way to go to reach our recommended target of £15,000, but is edging in the right direction.

Profitability

In this issue of *Marketing Monitor*, employment costs as a proportion of gross income have remained virtually static at 57.5%. This follows a large decrease in the previous period but needs to decrease further to come inside our target of 50-55%.

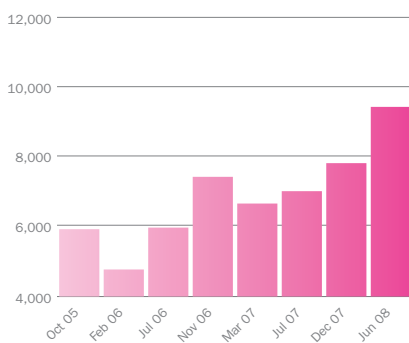
The ratio of operating profit to gross income has increased to 10.0%, up from 8.6%. This is further evidence to suggest that designers, who with their project based income have particularly struggled with margins over the last few years, are cutting costs on non-staff costs overhead expenditure. This is a welcome increase towards our target of at least 15%.

Conclusion

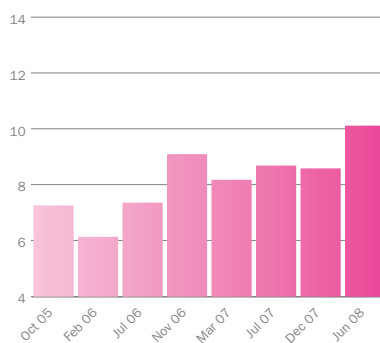
Although employment costs per head have continued to rise, this has been in proportion to increases in gross income per head. Operating margins have improved significantly as agencies make cost savings on non-staff overheads. Designers are now making strides towards the benchmarks we believe should be possible for a well-run design agency.

Operating profit has jumped further upwards from £7,764 to £9,352. This 20.5% increase suggests designers are making savings in non-staff costs

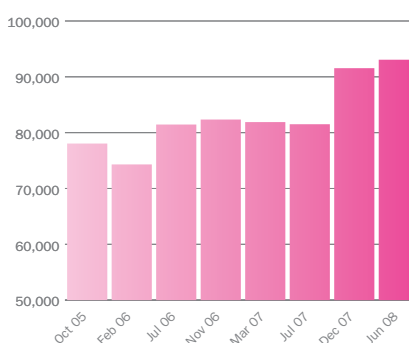
Operating profit per head (£)



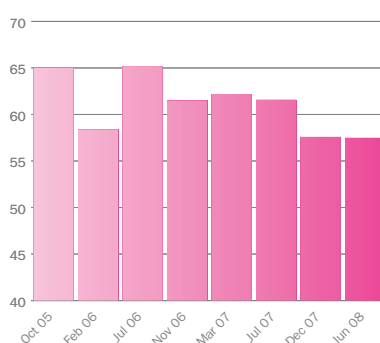
Operating profit: Gross income (%)



Gross income per head (£)



Employment costs: Gross income (%)



Productivity and profitability continue to decline

Downward trends continue but the sector still performs well.

Productivity

The trends highlighted in the last issue of *Marketing Monitor* have continued in this period. Marginal decreases have been noted in gross income per head and operating profit per head, along with a 4.6% increase in staff costs per head.

Gross income per head has fallen from just above £99,000 to just below this figure and operating profit per head had fallen from £19,000 to £18,000. A well-run agency should achieve a gross income per head of between £80,000 and £100,000, so the sector continues to produce results at the upper end of the range.

The fall in operating profit per head has been caused by an increase in employment costs per head from below £50,000 to nearly £52,000. Non-employment business costs remain unchanged as the industry keeps its spending in check.

Profitability

The effects of the changes discussed above have had a knock-on effect on profitability. Operating profit margins have fallen for the second period in a row from 19.1% to 18.4%. Compared to our industry benchmarks, the results remain within the suggested range of 15-20%.

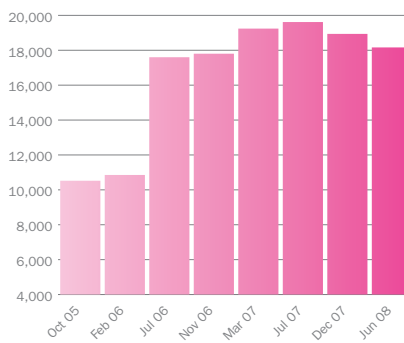
This decrease seems to have been entirely driven by the increase in employment costs. Salaries and wages now account for 52.5% of gross income, up from 50.0% in the last issue of *Marketing Monitor*. Again the industry remains within the target range of 50-55% of gross income.

Conclusion

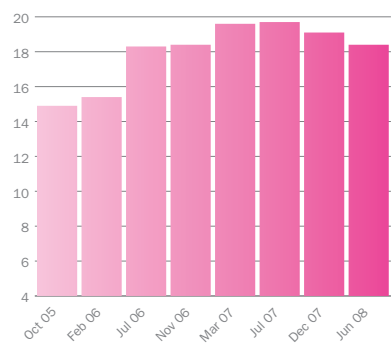
Whilst the sector appears to be stuttering, these falls in productivity and profitability are relatively marginal. It must be noted that the Media Buyers sector is still outperforming all other sectors featured in *Marketing Monitor* and continues to attain our suggested benchmarks for the industry.

The fall in operating profit per head has been caused by an increase in employment costs per head from below £50,000 to nearly £52,000

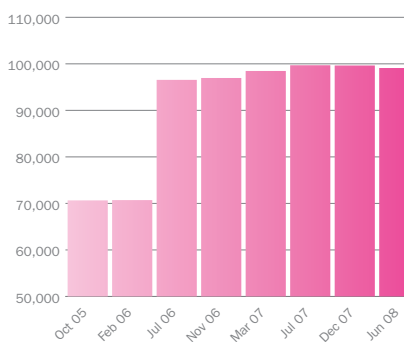
Operating profit per head (£)



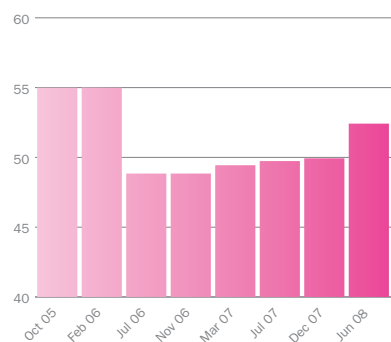
Operating profit: Gross income (%)



Gross income per head (£)



Employment costs: Gross income (%)



Profitability declines sharply as employment costs rise

A rise in gross income is outstripped by an even larger rise in employment costs, reducing bottom line profits.

The growth seen in the last issue of *Marketing Monitor* has continued. Gross income has increased by 7% but employment costs have risen by 10%. This has resulted in operating profit falling 4%.

Productivity

Gross income per head has risen to £85,425 compared to £82,608. This is a positive step, reflecting agencies are winning new business and increasing their efficiency per employee. This needs to continue if businesses are to reach our recommended £100,000 per head benchmark for gross income.

Agencies' head counts have increased by 3%. Employment costs per head have increased from £49,834 to £51,219, suggesting that businesses are having to offer more money to staff in order to attract new talent, and/or that the new hirings are being made at a more senior level.

As a direct result of the increase in employment costs, operating profit per head has fallen from £8,541 to £7,929.

Profitability

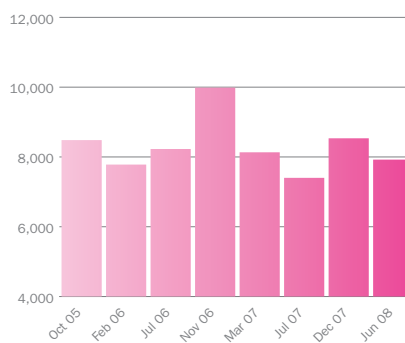
Operating profit margins have fallen to 9.3% from 10.3%. Gross income per head has shown an improvement, rising 3% whilst employment costs per head rose by 6.3%. The rise in employment costs has significantly outstripped the rise in gross income per head and as such, the operating profit margin has fallen. The ratio of employment costs as a proportion of income has worsened from 58% to 60%. Although a relatively small change, it moves the sector further away from the suggested target of 50 – 55% maximum.

Conclusion

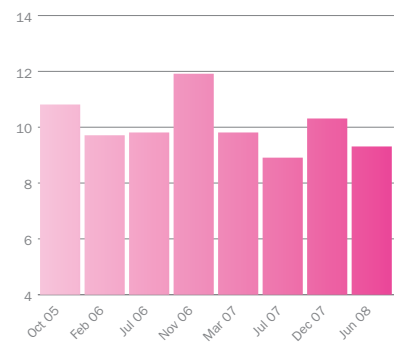
It is encouraging to see continued revenue growth since the last issue of *Marketing Monitor*. Agencies will need to build on this and continue to win new business, whilst keeping close control of their wage bills in order to drive up bottom line profitability.

Gross income per head has shown an improvement, rising 3% whilst employment costs per head rose by 6.3%

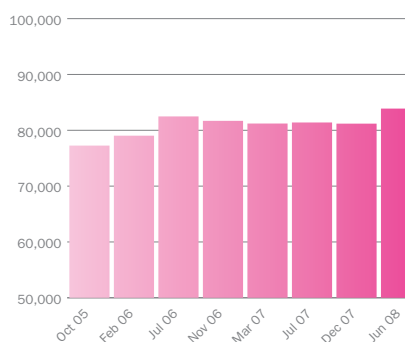
Operating profit per head (£)



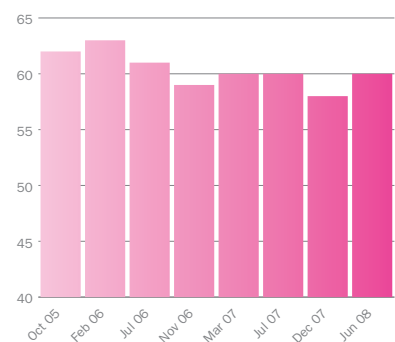
Operating profit: Gross income (%)



Gross income per head (£)



Employment costs: Gross income (%)



Margins return to double digits as the sector grows

Continued control of wages and non-staff overheads, coupled with significant growth in volume of business lead to margins improving from 8.7% to 10.4%.

Productivity

Gross income per head has remained relatively consistent at £78,142 (excluding the effect of a particular distorting agency). This is still the lowest of all the disciplines surveyed and when compared to our target gross income per head figure of £100,000 looks disappointingly low.

Employment costs per head have risen marginally to £40,441, and remains the lowest across all the disciplines, suggesting that a more junior mix of staff is being used compared to other disciplines which may go some way to explain the lower gross income per head.

Profitability

Total gross income across the sample grew the most of all the disciplines since the last issue of *Marketing Monitor*, increasing by 16%, which is consistent with the high growth that digital is currently experiencing.

Operating profit margins have also improved significantly to 10.4% from 8.7%. This is a very good result, putting Digital right up there with other disciplines in terms of profitability.

The 16% rise in total gross income was matched by a similar percentage increase in staff numbers. Therefore with little change in either employment costs or gross income per head, the ratio of employment costs to gross income has also remained largely unchanged at 59.3%. This is still too high however and needs to be reduced.

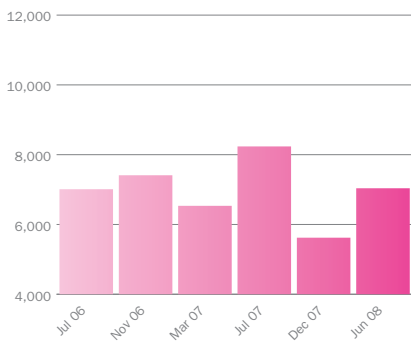
Operating profit per head is a key indicator of a company's performance as it combines both productivity and profitability. At £7,073, the operating profit per head has increased 25% from £5,734, whilst this is encouraging, the figure remains low when compared to the other sectors. With staff costs remaining in line with increases in income, this improvement would suggest that cost savings are coming from economies of scale on overhead costs, which is very welcome. We would hope to see more of this as the digital sector becomes even more mature.

Conclusion

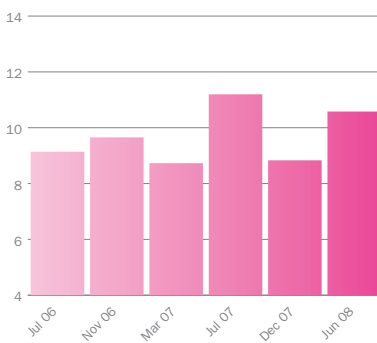
As the digital sector matures it is very encouraging to see an increase in margins. Agencies now need to focus on decreasing the ratio of staff costs to income, by ensuring that every spare bit of capacity within the agency is utilised as efficiently as possible, combined with making sure that they are charging properly for their services.

As the credit crunch looms it is likely that more measurable forms of marketing such as digital are likely to be more robust against budget cuts. It will therefore be interesting to see how margins compare to other disciplines going forward.

Operating profit per head (£)

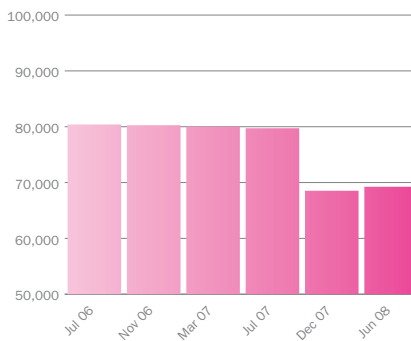


Operating profit: Gross income (%)

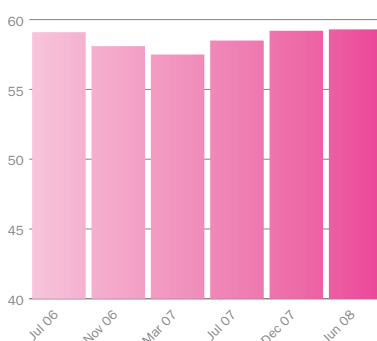


The 16% rise in total gross income was matched by a similar percentage increase in staff numbers

Gross income per head (£)



Employment costs: Gross income (%)



Ways through uncertain times



There seems to be no let up in the number of news articles pointing out the rising costs being faced by everyone throughout the UK today. Without exception, it looks like things will continue to worsen during the remainder of the year and into 2009.

For Marketing Services Businesses, the biggest challenges will continue to be ensuring ongoing profitability of their business and maintaining competitiveness when faced with the rising costs of labour and services, while at the same time providing their clients with increasing value for money against marketing spend.

Key to meeting these challenges will be the ability to keep talented employees challenged and excited in your business. Do you know what motivates your key people and can you ensure that they will continue to choose you as their employer? There are many different motivators to consider, aside from just the financial ones. Some examples are: fun working conditions, the opportunity to do exciting work with well known clients, status, flexibility, work life balance, recognition for achievements, development opportunities and good communication. It can be extremely costly to recruit new people so holding on to good people has to be a priority. If you have to recruit, just the average direct costs for a mid level role can very easily exceed £5,000 while a second tier management position could cost £25,000 plus to fill, and that's without even considering the other indirect costs such as management time, induction costs and reduced efficiency whilst the new person gets settled. It is highly likely that, if you end up losing talented people, your income and profitability will be adversely affected.

It can be extremely costly to recruit new people so holding on to good people has to be a priority

The development of Performance Management Schemes and Employee Incentive Schemes are great ways to incentivise employees and guide everyone towards the company's goals. Your scheme can be as simple or complex as you desire and may include a combination of company, department and individual targets. The key is to make sure that any scheme is effectively communicated to employees and they understand exactly what the inputs and outputs are and exactly what control they do or do not have over those inputs. Structured feedback is an essential part of any incentive scheme, all too often, employees will complain that they only receive feedback when something is wrong. Remember to give regular and positive feedback so they know they are performing to the standards you require. This will help reinforce the behaviours that you want, minimise performance issues and help drive towards the realisation of your targets.

Structured feedback is an essential part of any incentive scheme, all too often, employees will complain that they only receive feedback when something is wrong

Inevitably, there may come a time when the organisation simply cannot sustain its current cost base when faced with such a challenging economic climate. Consideration for and monitoring of all overheads should be given priority and a combination of strategies may be the key to ensuring the continuation of a profitable creative business. For Marketing Services Businesses, a large proportion of overheads will be payroll costs. In a stalling or shrinking economy, you may have to consider reducing your workforce by making redundancies. A redundancy is a dismissal and, to protect your business, care must be taken to ensure that the redundancy is a 'fair' dismissal.



You will need to ensure that the procedure you use includes: effective consultation with your employees (both the people adversely affected and those people staying that will be key to your future success); considering alternative employment opportunities for them within your organisation; using fair and objective selection criteria to identify the people that will be affected (whilst retaining the key skills and experience that you need for the future); and making all contractual and statutory redundancy payments due to employees. Great care should be taken to communicate changes and ensure that you are able to keep the talent needed for the future within your business.

However, redundancies are not always the only option. If your employment contracts allow, you may be able to 'lay-off' employees or introduce short-time working for a short period of time. This could create a breathing space for both the company and the employee before having to take any decision on redundancies.

The only sure thing is every Marketing Services Businesses will be feeling some impact from the current economic situation – finding a way to protect your business and people must be your prime focus and goal. HR Insight, Willott Kingston Smith's HR Consultants, with a dedicated team of HR professionals can provide focussed support, advice and guidance to help you – please contact us direct on 01708 758958 or speak to your regular Willott Kingston Smith Partner for assistance.

About Us

Willott Kingston Smith is based in London's West End, and the six partners specialise in advising creative, communications and consulting businesses on all aspects of finance, audit, accountancy and tax. Willott Kingston Smith is a specialist division of Kingston Smith LLP, one of the UK's top 20 audit and accounting firms.

Many of our clients are advertising, digital and other marketing services agencies but we also work with many TV and commercial production companies, consulting firms, live entertainment and music agencies. Our clients range from sizeable independents and multi-nationals, to start-ups which we have advised on a range of financial and business issues.

The businesses we work with have similar sets of challenges and opportunities, and with people being their key asset, employee incentive schemes and succession planning are just a few of the areas where Willott Kingston Smith regularly give tailored advice. Other issues such as recruitment, HR and remuneration are also very important. As part of Kingston Smith we can provide recruitment services through Balanced People, HR consultancy through HR Insight, and employee benefits advice through Blacktower Financial Advisers (authorised and regulated by the Financial Services Authority (FSA)).

Willott Kingston Smith also regularly advise in many other specialist areas such as business valuations, profit improvement reviews, business planning, due diligence on acquisitions, fundraising, grooming for sale and pre sale tax planning. Through the data we collate in our annual survey "Financial Performance of Marketing Services Companies" we are also able to give invaluable benchmarking advice on numerous Key Performance Indicators. By working with businesses with similar challenges we can understand our clients better and are able to advise on a wide range of financial and non financial business issues to a greater depth.

WKS Annual Survey

The 2008 Willott Kingston Smith Annual Survey of the Financial Performance of Marketing Services Companies will be launched later than usual to improve the quality of data. Look out for preview figures in trade press in December '08 and we look forward to seeing you at the seminar in January '09. If you would like to find out more about the survey then please contact Jane Wake on 020 7566 4000.

Contact Us

If you would like to discuss any of the matters arising in this edition or how we can help you, please contact one of the Marketing Services Specialists by email or on 020 7304 4646.

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