Procurement and Marketing:

Maximizing Value Through Trust, Collaboration and Transparency

SC&H Group
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Director
PROCUREMENT + MARKETING

Maximizing Value through Trust, Collaboration, & Transparency
AGENDA

• It’s a Two-Way Street
• Identifying Agency Risk & Transparency Concerns
• How to Improve Communication & Strengthen Relationships
• Q&A / Open Discussion
## ABOUT SC&H GROUP

<table>
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<tr>
<th>Founded in</th>
<th>Daily Record: Maryland’s <strong>Most Admired</strong> CEOs</th>
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<td>1991</td>
<td>DAILY RECORD: MARYLAND’S <strong>M ost A dmired</strong> CEOs</td>
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<td>Inside Accounting Top 100 Firms 2018</td>
<td>Best Places to Work</td>
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<td>25 Hours per Year per Employee on Avg. To Community Service Activities</td>
<td>World Class Client Satisfaction</td>
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<td>Client Service: <strong>“World Class”</strong> <strong>3x Industry Average”</strong></td>
<td>NPS® Score 84.4%</td>
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<td>Serving 46 of The Fortune 100</td>
<td>Best of The Best</td>
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<td>Firms 2018</td>
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<td>250+ Employees</td>
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Business Journal Baltimore Sun
Inc. Magazine 2018

Inside Accounting

Inside Firms 2018

**SC&H Group**
ABOUT SC&H GROUP

CONSULTING
- Accounting Solutions
- Business Performance Management
- Contract Compliance Audit Services
- Risk Management
- Technology Advisory

AUDIT
- Financial Statement Audits
- Employee Benefit Plan Audits
- Service Organization Controls (SOC)
- Due Diligence

INVESTMENT BANKING & ADVISORY
- Mergers & Acquisitions
- Employee Stock Ownership Plans (ESOP)
- Valuation Advisory
- Capital Raises

TAX
- Corporate Tax
- Cost Segregation Services
- Merger & Acquisition Transaction Tax
- International Tax
- Expatriate Tax
- Personal Income Tax

PERSONAL FINANCIAL PLANNING
- Wealth Management
- Tax Planning & Preparation
MARKETING & PROCUREMENT COLLABORATION
MUTUALLY BENEFICIAL GOALS
MARKETING & PROCUREMENT COLLABORATION
MARKETING & PROCUREMENT COLLABORATION

- Challenging relationships are often born out of mutual misunderstandings
- Get to Know Your Marketing Teammates
  - Schedule time with your key marketing stakeholders to gain a thorough understanding of:
    - Goals & objectives
    - What they buy
    - How they buy it
    - Who are they working with
    - Current and long term needs
    - Challenges and areas of concern – both internally and externally (i.e. agency transparency)
- Learn Marketing’s lingo
- Actively listen - Ask questions - Summarize
MARKETING & PROCUREMENT COLLABORATION

- Information analysis, relationship evaluation, risk management, monitoring performance, et al.
- It’s more than pricing and contract negotiations
- Create a playbook for marketing and procurement
- Monthly or quarterly check-in’s for stakeholders
- With time, rapport & respect will develop
AGENCY RISKS & TRANSPARENCY CONCERNS
AGENCY RISKS & TRANSPARENCY CONCERNS

- Marketing relies heavily on external agencies to help them achieve their objectives & often significant dollars are invested in these relationships.

- Given their magnitude, risks associated with agency relationships must be considered & managed accordingly.

- Contract terms & compensation structures impact risks.

- Agency size impacts risks – small / independent agencies vs agency holding companies.

- New technologies and the rapidly evolving digital landscape create exciting opportunities but also present challenges.
AGENCY RISKS & TRANSPARENCY CONCERNS

- Regardless of size, there is the risk that an agency puts its own agenda in front of their client’s best interests—this risk is mitigated by transparency and accountability

- Agency transparency concerns
  - Association of National Advertisers (ANA) releases landmark reports in 2016 & 2017
  - Reports claim that agencies & holding companies systematically engage in non-transparent practices and this activity is pervasive within media & production
  - Evidence that senior agency executives were aware of or even mandated these practices
  - Fundamental disconnect between advertisers & agencies regarding agency obligations to their customers—“best interest vs. contract”
  - In 2016 US Department of Justice launched an investigation into alleged bid-rigging by agencies related to production work
  - In June 2018 it was rumored that the FBI is probing media agency practices in the US
NON-TRANSPARENT PRACTICES

AGENCY RISKS & TRANSPARENCY

- Undisclosed Rebates
- Principal Transactions
- Bid Rigging
- Undisclosed Use of Subcontractors
- Payments for Unearned Fees
- Equity Investments in AGENCY’S SUPPLY CHAIN
UNDISCLOSED REBATES

NON-TRANSPARENT PRACTICES

- Cash
- Volume discounts
- Free or discounted goods, services, media, sponsorships, promotional space, etc.
- Service / Consulting engagements—often billed at a premium
- Debt forgiveness
- Contingent equity—stocks, options, warrants
- State commercial production incentives
PRINCIPAL TRANSACTIONS
NON-TRANSPARENT PRACTICES

• Agency acting as principal as opposed to acting as an agent on behalf of a disclosed principal / client

• Production – Experiential, Events, & Post Production

• Media
  • Agency purchases media on its own behalf, resells to agency of record (AOR) and / or client at higher cost
  • When AOR is a part of an Agency Holding Company media is often purchased via an Agency Trading Desk (ATD)
  • AOR is often unaware of the true cost of the media and / or benefits received by the Agency Holding Company
  • Clients opt-in due to perceived benefits of lower media cost and no agency fee on media purchased through ATD

• Benefits received by the agency or Agency Holding Company not disclosed and / or passed through

• Pressure for agency to direct spend to principal entities or investments
BID RIGGING
NON-TRANSPARENT PRACTICES

• Form of fraud—enforced by the Sherman Act
• Contract promised to a party—other bids secured to give appearance of a competitive process
• Examples of bid rigging include:
  • Non-competitive bids intentionally submitted in exchange for something in return – “check” or “complimentary” bids
  • Not submitting a bid in exchange for something in return
  • Related party bids prepared using insider information
• Agency-controlled bidding can lead to sub-optimal and costly decisions being made if left unchecked
• Marketers must be aware if their agency is bidding out work to related parties as well their policies surrounding the bid process to avoid conflicts of interest
• Five agency holding companies subpoenaed by the U.S. Department of Justice as of Dec 2016—still no conclusion
UNDISCLOSED USE OF RELATED PARTIES / SUBCONTRACTORS

NON-TRANSPARENT PRACTICES

- Agency may represent that all work performed by in-house personnel
- Work performed by related party resources may not be appropriately bid out
- Work performed by lower cost subcontractors billed using the agency’s loaded hourly rates - additional compensation retained by agency
RETAINING PAYMENT FOR UNEARNED FEES / EXPENSES NOT INCURRED

NON-TRANS transparent practices

• Billing to budget or estimate without reconciliation
• Retainer payments for dedicated resources – time not delivered to the client
• Fees or commission on undelivered media – if media purchased through an ATD they will receive reimbursement for under delivered media, credit may not flow back to client
EQUITY INVESTMENTS WITHIN AGENCY’S SUPPLY CHAIN

NON-TRANSPARENT PRACTICES

• “Preferred Partner” agreements between agency / Agency Holding Company in return for equity position & lower pricing

• Client spend directed to “Preferred Partners” to maximize investment return and profits – another conflict of interest
CONTRIBUTING FACTORS

NON-TRANSPARENT PRACTICES

- Pricing pressure applied by advertisers and their respective procurement organizations
- Advertisers struggling to keep up with rapid change and a lack of SMEs within their company
- Limitations on audit rights
OPTIMIZING AGENCY
TRANSPARENCY & RELATIONSHIPS
OPTIMIZING AGENCY TRANSPARENCY & RELATIONSHIPS

1. Review Existing Agency Contracts
2. Look at the Fine Print—The Devil is in the Details
3. Speak w/ Marketing about the Terms
4. Discuss Gaps & Concerns w/ Existing Contract Terms
## BEST PRACTICES FOR CONTRACT RECOMMENDATIONS

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AGENCY COMPENSATION
CONTRACT RECOMMENDATIONS

• Utilize not-to-exceed amounts—agency responsible for any overages unless:
  • Brought to marketing’s attention prior to incurring the overages
  • Justifiable
  • Approved senior marketing executives
• Define out-of-scope work and establish terms to govern these projects
• For retainer, cost reimbursable or prepaid compensation models contractually require reconciliation to actual time and/or expense
  • Set timeline to complete
  • Shortfalls immediately / credited to client
• Reserve the right to decrease agency fee for reductions in scope
RELATED PARTIES & CONFLICTS OF INTEREST

CONTRACT RECOMMENDATIONS

- Agency affiliates & related parties should be a defined term
  - Agency Holding Company should be the highest entity possible when applicable
  - Direct & indirect majority owned subsidiaries
  - Updated at least annually
- Related party transactions must be disclosed and approved
- Agency must provide quarterly & annual reporting on spend with related parties
- Agency should be contractually required to be a fiduciary and always act in best interest of the client
- Conflict of interest should be defined & require annual disclosures certified by agency senior executive
  - Incentive or bonuses received for spend
  - Financial interests or investments in third parties
  - Referrals to related parties or “preferred partners”
REBATES & INCENTIVES

CONTRACT RECOMMENDATIONS

• Should be a defined terms & include a comprehensive list of examples (See Slide 15, Undisclosed Rebates)
• Any rebates & incentives received by agency, agency affiliates, Agency Holding Company in connection with the work performed / spend on the company’s behalf
• Agency, agency affiliate, Agency Holding Company contractually required to credit or refund company’s pro-rata share of rebates
• Rebates received in the form of free or discounted goods, services, media, sponsorships, etc. should calculated as the difference between the fair market value of the item received & the amount charged to the agency
• Rebates received in the form of consulting / service agreements performed at a premium by the agency / agency affiliate should be calculated as the difference between the fair market value of the services rendered and the premium charged to the third party
• Amount of rebate credited / refunded to company annually certified by agency senior executive
PRINCIPAL TRANSACTIONS

CONTRACT RECOMMENDATIONS

• Should be a defined term & include a comprehensive list of examples

• Agency, agency affiliates, Agency Holding Company should be contractually required to act as an agent on behalf of a disclosed principal unless specifically approved by the client in the contract

• If applicable, the contract should specify a maximum markup percentage that agency will receive for principal transactions

• Prohibit the use of “dual rate cards” without the written client consent - rate cards in effect with agency, agency affiliate or Agency Holding Company is less than the rate card in effect with the client

• Transparency & fiduciary responsibility shall not be limited in any way for client approved principal transactions

• Rebates, incentives, benefits received as a result of principal transactions flow through to client on pro-rata basis or in full depending on the nature of the transactions
BID REQUIREMENTS

CONTRACT RECOMMENDATIONS

• Bidding policies & materiality thresholds should be spelled out in the contract; agencies should not be solely responsible for managing the bidding process & making awards

• Bids received from agency affiliates or related parties require disclosure to client

• Agency affiliate and related party bids must be prepared without dissemination of insider information

• Prohibit “check” or “complimentary” bids—require bidders to execute a NDA which certifies they are submitting a legitimate competitive bid, & not a “check” or “complementary” bid, which is illegal per the U.S. Department of Justice

• Copies of bids shared with Marketing & Procurement stakeholders for all outsourced work exceeding materiality threshold; Marketing stakeholders should make these awards

• Require agency to provide quarterly / annual reporting on third party bidders—count & value, in aggregate & by project
SUBCONTRACTORS

CONTRACT RECOMMENDATIONS

• Require disclosure & client approval for all subcontractors—including agency affiliates & related party resources
• Subcontractor charges billed at net cost, without markup—prohibit subcontractors being billed at loaded rates for hourly work
• Bidding requirements should apply to sourcing & selection of subcontractors
• Subcontractor also required to act as a fiduciary to client, disclose potential conflicts of interest, and maintain commercially reasonable insurance coverage
• Client reserves the right to discharge subcontracted resources that are no longer reasonably acceptable to client
PASS THROUGH EXPENSES

CONTRACT RECOMMENDATIONS

• Expenses should be defined term in the agreement

• Subject to client approval & policies

• Authorized & prohibited expenses should be clearly spelled out

• Agency, agency affiliate, & Agency Holding Company required to minimize the amount of expenses associated with the client’s work to the extent possible

• Expenses that are not authorized, approved, & supported by underlying receipts, invoices, & other reasonable documentation will not be reimbursed by client
RECORD RETENTION & DATA OWNERSHIP

CONTRACT RECOMMENDATIONS

Record Retention

• Records should be a defined term—all data, contracts, purchases, payments, receipts, invoices, timekeeping, & any other information associated with the clients work or reasonable required by client or their auditor to validate compliance with the executed contracts

• All records must be maintained during the term of the contract & six years after termination

• Records will be maintained with Generally Accepted Accounting Principals (GAAP)—auditable upon request

Data Ownership

• All data pertaining to the client is owned by the client—not the agency, agency affiliate or Agency Holding Company

• Client has the right to access, download, store, track & use data related to client
AUDIT RIGHTS

RESTRICTIVE TERMS OBSTRUCT TRANSPARENCY & DEEMPHASIZES ACCOUNTABILITY

• Auditor selected by client – internal audit or external, independent auditor

• Client determines the scope of any / all audits – agency will support audits at no cost to client

• Auditor will have access to all agency, agency affiliate, Agency Holding Company, subcontractor, & third party records reasonable required to validate agency compliance with the executed contract(s)

• Any records considered confidential should be specifically defined (i.e. agency overhead, employee compensation, other agency client information)

• Records related to principal transactions / markups & rebates / incentives should not be considered confidential & should be subject to audit
AUDIT RIGHTS

CONTRACT RECOMMENDATIONS

• Overcharges and rebates / incentives not passed through to client must be refunded within seven (7) days – reserve the right to offset and assess interest

• Specify an audit materiality threshold - agency pays for audit if overcharges are in excess of specified dollar amount (i.e. $100K) or percentage of spend (i.e. 2%), whichever is lesser

• Agency feedback on auditor observations required within five (5) days of submission

• Client & agency to agree on timeline to remediate any material deficiencies identified by auditor
OPTIMIZING AGENCY TRANSPARENCY & RELATIONSHIPS

Validate that the relationship is operating as intended while promoting transparency & accountability.

Create a baseline for compliance moving forward & supports long-term ROI.

Provide access & visibility.

Provide the clarity needed to ensure that critical elements are aligned to help your company maintain a competitive edge.

Lead to contract, process, & controls enhancements which mitigate risks & non-compliance going forward.

The cost is a fraction of the annual contract value & may be offset by the recovery of non-compliant charges & future savings opportunities.
SUMMARY

- Marketing + procurement + communication + collaboration = successful outcomes
- Agency partnership selection is critical
- Transparency & accountability > agency interests
- Consider agency risks & manage accordingly – transparency, transparency, transparency!
- Speak with marketing re: agency processes & contract language
- Execute periodic agency audits
- Audits enhance contract, process, & controls; maximize marketing ROI
CHECK OUT OUR LATEST RESOURCE

The New ANA Template Should Make You Ask: How Well Do I Know My Agency?

SCHGROUP.COM/ANA18
QUESTIONS?

Okay, so if nobody has any questions...
Session information and evaluation how-to’s

**Why?**
- Your feedback **drives SIG Event content**
- By signing and submitting your evaluation, you are automatically entered into a prize drawing

**How?**
From the **App**:
1. Select **Sessions**
2. Select **Day**
3. Select **Session**
4. Click on **Clipboard Icon**
5. **Complete and submit evaluation**

This was **session # 3**

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