Measuring and pricing creative work in the creative agency sector

Applications to RED Collective Oy

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GLOSSARY OF TERMS AND ABBREVIATIONS USED

ANA=The Association of National Advertisers

FTE=Full Time Equivalent

GRP=Gross Rating Points

HRT=Hourly Revenue Target

KPI=Key performance Indicators

VBC=Value Based Compensation

SME=Small and Medium Enterprise

SMU=Scope Metric Unit

SOW=Scope of Work

SOV=Share of Voice

FOREWORD

From a young age, I've been able to witness the life in creative agencies through my mom's work. She used to take me to her office which was filled with the most interesting objects such as inside fountains, game flipper machines and colorful plants. For a kid this was a paradise with immense amount of things to explore, needless to say I told everyone I will be an office lady as an adult. Growing up, I decided to focus on financial management instead and I would have never guessed that my path would cross creative agencies again.

One interview can however click all the puzzle pieces together. My creative mindset, love towards arts and passion towards business came into one during my practical training period at Red Collective Oy. I would like to thank my vibrant coworkers and my boss for the past year and for inspirations for this thesis.

Michael Farmer is never likely see my thesis, but I did see his book and read it into pieces. I would like to thank him, for making the financial side of the industry summarized and understandable in between the covers of one book.

The warmest thanks go to my family and friends, who inspired when in doubt, listened my continuous thesis complaints and pushed me on when I wanted to give up.

1 INTRODUCTION

1.1 Background

The current situation of the creative agency industry is getting more worrisome year by year. The agencies meet increasing pressures from different parties. The customers demand heavier workloads as the media outlet keeps expanding together with the demand for continuously available service. The outdated budgetary planning and insecurity of the creative product's results have decreased the customers' willingness to pay the agency fees. This has lead the agencies into considerable price drops meanwhile the media suppliers keep raising their prices. In addition, the situation is suppressed by the management's demand to expand, grow profit margins and cut costs.

The bread-and-butter work of the agencies is creative work, such as designing and creating graphical solutions. This work is rarely actively measured, because the appropriate metric doesn't exist. The work is being discussed in a sense of "scope of work" (SOW), but the planned scope rarely matches the reality or the outcome. Even more rarely this is actively followed during the process or after. Besides missing an accurate metric, there are various factors behind the lack of follow-up including the laissez-fair management style of the agencies, volatile work environment and fast work phase. One of the few that has written about the topic is Michael Farmer, and he describes the issue as "creative workloads grow independently, almost as if they were unrelated to the agency's resource or fees" (2017, p 28). Establishing a clear follow-up system will bring improved structure to the efficiency analysis and strengthen the pricing of creative work. Hence the relationship between creative work and its price is one of the key issues dominating the creative industry.

The similar issues are addressing Red Collective Oy, which is used as an example company in this paper. The agency was established in 2002 into the highly competitive market of Helsinki (Muukkonen, 2015). What distinguishes Red from other market players

is its' small size and market image of as an alternative and affordable creative agency. To its 15th operational year the company employs four designers, the CEO, two external marketers and a few interns operating in financial management, design and marketing. After the financial hit in 2008, the agency has managed to gain back its stability, however the industry trends are preventing it from returning to the past's glory. Like in most agencies, the workload and its real price don't follow active feedback loop in Red Collective Oy, but rather the agency delivers according to customer continuously changing needs. As a result, the total understanding of creative hours is vague.

The topic is significant since it carries global implications and it is applicable to large multinationals as it is to small agencies. The organisational issues are not widely acknowledged, because the measuring is not practiced by the management. The entire industry is evolving, and hence sooner or later it needs to change from its core way of doing business. The paper begins by looking into the theoretical part of the past and present pricing methods and the current trends shaping the creative agency industry through a descriptive desktop research. After this Michael Farmer's and Paul Roetzer's theories on unified metric are presented and Farmer's model is applied to raw data collected from Red Collective Oy in order to see, whether it follows the industry standard (gold standard) in its creating working hours and if the industry pressures apply.

1.2 Research Aim

The aim of the research is to compare and contrast the SOW method and its unit (SMU) to other formulas used to evaluate the efficiency and the pricing rates in the creative agencies. Different ways of pricing creative work are compared to find a method that acknowledges the link between complexity of creative work, the industry growth trend and its price. The application to the example company draws out another aim, which is to evaluate does the gold standard apply to an SME sized company, hence do the current trends apply to the example. The aims are connected, as the first is used in order for the second to occur and they are directly related to the research questions.

1.3 Research Questions

The two research questions (RQ) explored in this paper are:

RQ1: How can creative agencies establish a relationship between their creative work and the pricing process?

The first research question can be directed towards the empirical part of the paper, where an example company is selected, by replacing the words "creative agencies" by the company's name. This forms the second research question discussed in this paper:

RQ2: How can Red Collective Oy establish a relationship between its creative work and the pricing process?

2 RESEARCH DESIGN

2.1 Demarcation

The research questions establish boundaries to the topic by the selection of words "creative work" and "creative agencies". This creates limitations to the scope of the essay, as they form a focus to a specified industry and type of work within the selected industry. Geography is not used as a limitation, since the underlying issues of the agencies are present globally.

The word creative agency is used to replace the two other names "marketing agency" and "adverting agency", which are often used interchangeably. The term is adopted to bring coherence to the structure and the services of creative agencies, hence it acknowledges the modern ages' wide selection of media marketing options. The start of the paper uses the word "advertising agency" as it is focused on the past, when the agency activities were restricted around the traditional print adverts.

The paper takes a very critical perspective to the current practices. Due to the fact that the modern issues are not widely acknowledged and the discussion is ongoing, the paper may have some bias to the few critical works published by the point of writing this paper. The main focus is on Farmer's SMU-model, because it reflects the many forms of project complexity, and hence it is seen by the writer as the best available industry representative. The analysis-part objectively discussed about the formula and the constant variables defined by Farmer.

The results from the example company applications are not held accountable to represent the Helsinki scene or small creative agencies in general but rather to work as an individual study. The application is done to test the selected model's credibility and it is used to benefit the agency in improving its practices. The applications also reveal, whether the increasing pressure applies to the example selected.

2.2 Method and material

The theoretical data of the paper is a desktop research, which draws out from different books written by the old gurus of advertising agencies (such as David Ogilvy) and the more current ones (such as Michael Farmer). The mix is done to establish an accurate understanding of the development of the creative work pricing within the agencies. The pricing models used to value creative work fall into three categories: the value based models, hourly rate charges and performance based models. The hourly rates are not discussed in the theoretical section, since they are often only used by freelance workers. The theoretical part is mainly qualitative and descriptive however it does contain numeric examples and formulas which are further used in the empirical part of the paper. A problem oriented approach is taken.

The second part of the paper, the application to the example company, is based on quantitative first-hand data. The data is received directly from the company and it is processed by the formulas explored in the first part. Hence, this is the empirical part of the research. The data collection is done through examining the company's invoices from

2017 and a digital system Taimer, that the company uses for worker hour reporting. The variable data elements include for example number of the projects completed in 2017, the number of hours worked within specified projects and other financial data from 2017. Any sensitive data of the company, such as the prices and the customers, is not brought up in the paper.

The data analysis is based on comparing the given benchmark examples in the theory section to the results gained from applying the company's data to the given formulas and unit matrix. The reliability of the results is then discussed and based on the final evaluation, a proposal is created for the company's future practices.

The study completed is exploratory in its kind. The example company is used as a test to see whether the formulas apply, and therefor can provide help for the company's pricing policy. A mixed data method was used to support this.

3 THEORETICAL FRAMEWORK

3.1 Compact history of the advertising agencies and their pricing methods

The whole idea of advertising changed in 1960s, when a group of scholars focused on marketing studies moved the discussions from the role of exchange in selling into the core of marketing concept (eg Kotler and Levy, 1969; Arndt, 1979). The title "exchange marketing", or more accurately the "relationship marketing", was officially born later in the 1990 (Berry et al, 1991). The change in thinking involved shifting the focus from the exchange-transaction into the social interaction that happens meanwhile selling (Grönroos, 1982; Gummersson, 1987; Ford, 1990; Miettilä et al, 1990). This social process has been a subject of academic research ever since. Around the same time the first known advertising agency was opened in Philadelphia by Volney Palmer in 1841.

Palmer is seen as one of the first to use the term "advertising agency", however his concept was limited to newspaper media only. In 1877 N. W. Ayer acquired Palmer's agency, and hence it is considered as the oldest advertising firm in United States (Crouse, 2010; Holland et al, 1976).

The "golden age of advertising" is seen to have begun after the end of the Second World War. In the1980s most of the advertising agencies' spending was targeted towards the media suppliers such as magazines, other print medias and television, hence named "media spending". When invoicing the customer, the agencies added "media commission" on top of the "media spending" to act as the profit margin from being a middleman in between of a media company and a creative entity. The margin was used to cover the fixed costs within the agency itself (Barton, 1995, p. 9). In order to moderite the free margin setting system, N. W. Ayer had introduced "open contract -system" in 1897, which became dominantly spread by 1901 (N.W. Ayer & Son, 1909; Barton, 1955, p.7). The open contract set a fixed 15-percentage commission rate that was given from the media producer to the advertising agency. Ayer himself described the system as follows: "(it) pulled the advertising business out of the muck and mire of bidding and faking, and made the advertising agent and the agent of the customer rather than an agent of any publication or group of publications" (N.W. Ayer & Son, 1909). His system was aggressively lobbied by The American Association of Advertising (4S) in 1934, because it encouraged price competition and was overall unfair, since it put single advertisers and agencies into unequal setting (Haase, 1934, p 128). In his paper for the Association of National Advertisers (ANA) in 1934, Albert E. Haase described the open contract system as "the easiest way for the agencies to get paid".

The advertising remunerations were relatively high when compared to the 21st century situation where there is no dominant margin system for the agencies. In 1948 a financial management accountant Ira W. Rubel described the income structure of an advertising agency so that 55% of the income would cover the expenses of client serving people, 25% of to cover the overheads and 20% left as a margin (Rubel, 1948, p 121).

The commission setting changed in 1960, when Shell took Ogilvy, Benson & Mather as their marketers. Shell based their fee on the actual operation costs of the agency's pro-

jects plus 25 % margin. This gave the overall margin of 20 % for the agency (Farmer, 2017). Ogilvy who is often considered as the "guru" in marketing defined four advantages in the new pricing: The customer pays for the services it wants; "every fee account pays its own way"; temporary cuts in your client's projects don't mean you should cut your staff; and "when you advice your customer to increase advertising, he doesn't guess your motive" (Ogilvy, 1983, p. 55). By 1990s the "fee-system" became widely adopted, and by the year 2000 the old open contract system was nearly abolished from use (Farmer, 2017).

The fee-system was able to adapt to the price inflations, and it maintained the creative agencies' inflated pricing structure. The energy crisis and recessions experienced during the 1970s, 1980s and 1990s changed the world, which brought significant changes to the agencies as well. Many of the agencies went public after which they were managed by their holding companies. The new management created a new pressure for the agencies to grow, cut costs and to expand in international context. By cutting the wages and staffing, the margins fell shorter. The customers increasing curiosity on price transparency made it impossible for the agencies to follow the previous margin systems. By 2004, the balance between the creative workloads and the fees paid by customers fell out of proportion (Farmer, 2017).

3.2 The current challenges faced by the agencies

3.2.1 Growing workloads

Currently the state of creative industries is in a flux. The key issue is the unbalanced relationship between the growing workloads (both creative and service) and declining client fees. The customer analysis shows that the workload growth compounds annually by 2-3 % together with the declining fees of 2-3% (see figure 1). The changes are applicable to small and medium sized businesses (SMEs) and the large market leaders in cross-country perspective (Farmer, 2017).

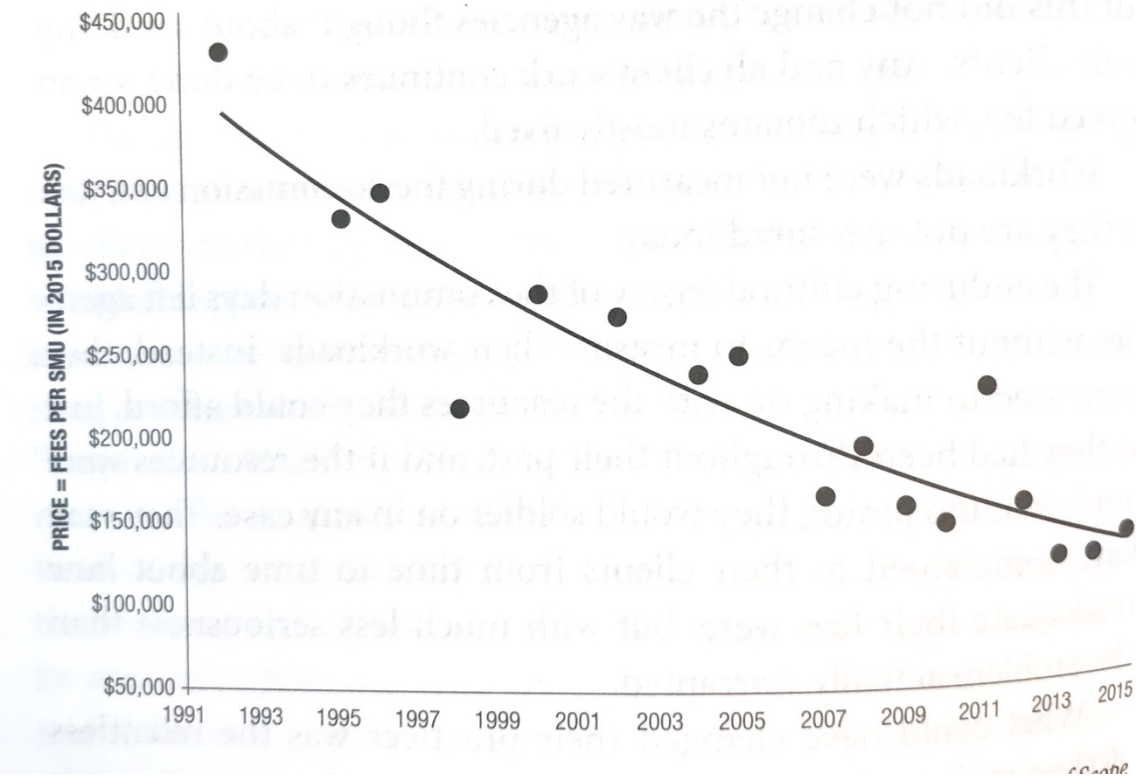

Figure 1: Advertising agency price curve 1991-2015 (prices in US dollars per SMU)
Source: Farmer, 2017, p 30.

The workloads are growing together with the expanding media outlet. The standard media selection is now topped up with digital channel options, which customers wish to experience with. Often it is considered that digital media options are cheaper, but this is not necessary true. The continuous development requires constant education and specialised workforce (Farmer, 2017).

3.2.2 Customers willingness to pay for the creative services

The fall in customer's willingness to pay for the creative services can be partly seen as a result of decreasing advertising budgets. It is still common to base the budget planning on Gross Rating Points (GRPs) and share of voice (SOV) that are based on gaining market share through television media, hence the planning tools are obsolete from today's media map. In addition, the media costs are in positive growth curve. The following graph shows Coca Cola's media budget from a 5-year period. The budget is adjusted by media market's inflation rates (Jaffe, 2013).

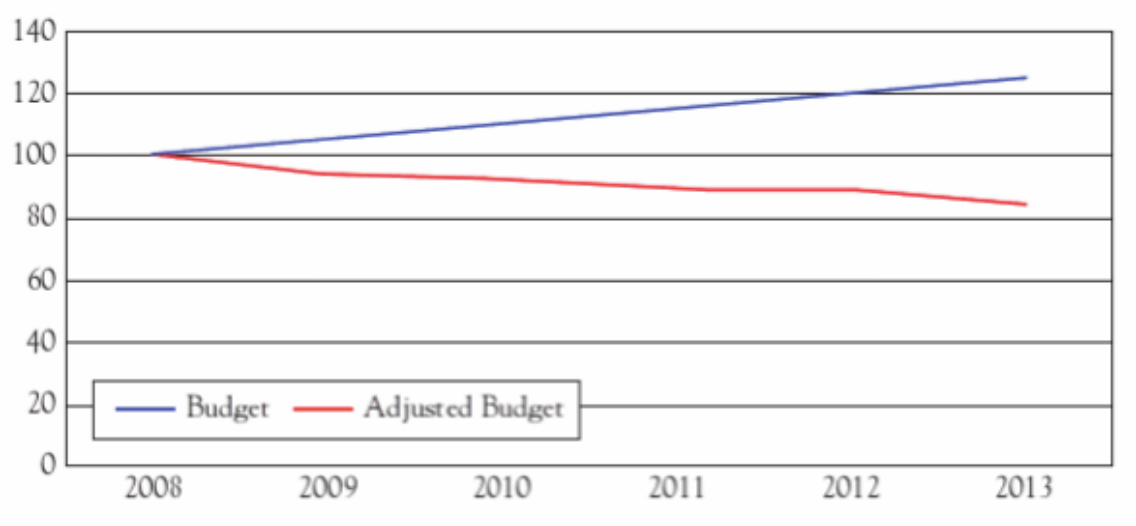

Figure 2: Coca Cola's media budget from 2008 to 2013.
Source: Jaffe, J. et al. 2013. Z.E.R.O.: Zero Paid Media as the New Marketing Model. P 24.

The modern customers are more price conscious, and often demand full transparency on the creative agency's hours and media prices given by the agency. Especially the latter, is nowadays easy for the customer to benchmark to the media service providers own prices through e-mail and internet. The media providers own price is obviously lower and the customer becomes conscious of the agency's margin that they most likely have set on their price on the media service providers product, hence the margin setting can't be as ruthless as in the past.

3.2.3 The pitching process and the customer-agency relationships

The standard creative process involves meeting with the customer and receiving a brief for the project (this is more often done through e-mail), cost evaluation and its agreement between the seller and the buyer, execution and a feedback loop with the customer, which often involves additional changes or elements to the original brief. These changes are impossible to evaluate beforehand, and hence changing demand from the customer is rarely proportional to the pricing, which is determined beforehand in the cost evaluation leading to pricing. The strong emphasis on the customer relationship and continuous concept work encourages a barrier for the agency to decline extra work or to

create additional costs for the customer. When new customers are acquired, the agency often has to go through a pitching to which it creates an idea presentation that is given for the possible future customer. The general practice is that the agency doesn't charge the potential customer for the presentation, so in other words it gives out ideas for free. The pitching is not binding, and often pitches bring in zero income for the agency. Still, the new customer acquisition remains necessary for today's business. In 2013 The Campaign and the Bedford Consulting group estimated that the average relationship between a client and a creative agency has fallen to two years and six months from 1984s into average of seven years and two months. The drop is partly due to the volatile economy that has forced both of the parties to cut costs, work with smaller teams with lower hierarchy. The increasing levels of stress and the absence of consensus on how the results of creative work can be measured are some of the factors speeding up the agency switch-rate (Kleib, n.d.p).

3.2.4 Measurement system for the creative hours

The two questions which become relevant now are: Why aren't the agencies billing more hours from the increasing work they do; Or why aren't they developing a measure for the results, which could be used as the base for the customers' fee setting process?

This leads to the most critical cause to the present day's work-fee unbalance: the agencies are not actively measuring the creative work hours completed. There are many excuses for the lack of tracking such as laissez-fair management style, the fluctuating amount of work, the different work types, tight schedules and lack of systems. However, the main factor is the lack of a unified metric that is able to compare the hours spent on different media project types and their complexity. The effect of this is lack of knowledge, hence even the agency CEOs are often unable to acknowledge the work hour expenditure, which makes the main problem of the current creative agency industry without public attention (Farmer, 2017). By charging from the pitches and by raising the hourly rate the company is likely to lose its already existing customers and its means to compete with other agencies.

3.3 How to measure creativity and pricing in the agency context

"Nobody counts the number of ads you run; they just remember the impression you make"

(Bill Bernbach. 2011. Bill Bernbach Creative Revolutionary. Adweek August 8-21, 2011.)

Despite being a representative from the creative era, Bill Bernbach's quote on impressions aligns with the modern idea of pricing advertising services and reflects the management problems. Creative work is often classified within three pricing categories: Value based pricing, hourly rates and performance pricing. In his book The Marketing Agency blueprint, Paul Roetzer, encourages the agencies to focus their pricing method to value based pricing or value based compensation (VBC). The idea of value based pricing connects with Michael Farmers idea of SMU unit system, since they both base on to careful SOW planning and follow-up. The concept of value acts as a bridge between a customer and the agency as its sets a common goal for both. The companies and the agencies want to create lasting impressions and memories by their work instead of identifying how many adverts it takes them to create a hit, as said by Bernbach.

The agencies often employ freelance staff to support the in-house creative staff on hourly or concept basis. If an agency would adopt hourly rate pricing, they would retain colliding interests with the customer, since the agency wishes to bill as much as possible from the customer and the customer aims for low(est) price for the project. The empirical study has a focus on in-house creative workers and therefor the hourly rate concept is not expanded.

In addition to the VBC models and the hourly rates, a performance based pay based on key performance indicators (KPIs) is sometimes used. The KPIs must be established together with the customer, and they must define and isolate the effect of the campaign or individual product. Mark Weiner defines the creative KPIs as "These KPIs must be attributable to specific media tactics and not be open to wide interpretation. We must

also monitor these KPIs for a reasonable amount of time, since there can be a lag effect between media exposure and user action" (Weiner, 2013). The long monitoring process extends the payment collection, which is risky for the already unstable revenue collection of the creative agencies. However, the performance based pricing works well with digital marketing projects, since they have shorter display time and KPIs are more easily defined (number of views, number of clicks) (Cowley, 2013).

3.3.1 Paul Roetzer and Point-Pricing model

Paul Roetzer argues that making value based pricing transparent, he creates defined projects that are more reliable for the customer. He approaches the price structure through hourly revenue target (HRT) calculation. He defines price as:

Price = estimated hours X HRT

The estimation represents an average time in which the agency is able to complete the service, and the "clients should not pay for agency inefficiencies" (p. 18). The definition of HRT is:

Number of creative hours per year X HRT = annual revenue goal

Through reorganizing the formula we receive:

$$HRT = \frac{Annual\ revenue\ goal}{Number\ of\ creative\ hours\ per\ year}$$

Roetzer highlights the role of revision, and says: "accurate time tracking becomes more essential in order to monitor efficiency and productivity" (2011, p. 18). The HRT formula is highly based on estimation, and hence carries high error percentage. The term "annual revenue goal" is fully based on the management estimation and ideal of future goal, which carries little accuracy and customer interest, hence the HRT tells how much

the price should be in order to reach the revenue goal. The HRT model is simplified and doesn't consider the different project and customer types.

Roetzer himself said in an article published in 2017, that when the Marketing Agency Blueprint was published in year 2011 they "hadn't cracked the code" for creative pricing (Roetzer, 2017). Like Farmer, Roetzer was also looking for "a value metric (that) is a pricing unit – (aligning) with the value (created for the customers)" (Roetzer, 2017). The approach prevailing in the book is focused around creating set service packages with fixed value based price. In late 2012, the Point Pricing method was invented by Roetzer. In the Point Pricing-method the customer is able to purchase points through an online system with a fixed price or a project package formed by points. The points are used to "buy" different marketing services, that are priced according to the Fibonacci sequence also called the golden ratio. The price is based on the active hours used for the service creation, which are then rounded up to match the sequence. This is because predicting the real hour expenditure for any selected project is just impossible task for a human to do due to unlimited number of factors. By using a pre-defined scale such as the golden ratio the model eliminates uncertainty from 8 to 13 hours into 8 or 13 hours (numbers part of the sequence). The further you go in numbers, the more limited options Fibonacci sequence provides. Roetzer says that the Point Pricing-model has increased the transparency of agency pricing and improved its efficiency.

3.3.2 Farmer and Scope Metric Unit model

The more defined value based model is introduced in Michael Farmer's book Madison Avenue Manslaughter (2017). He focuses on the creative project pricing through Scope Metric Unit (SMU) created by Farmer & Company. The unit looks at the unbalanced structure in between client income, client resources and client workloads. Two factors, the client income and client resources are related, therefor big customers often are set higher hourly pricing. Workload again is a random variable. The following figure repre-

sents the ideal structure. If the unbalanced structure was to be shown in the figure, the tip of the triangle would be shifted towards the left or the right bottom angle.

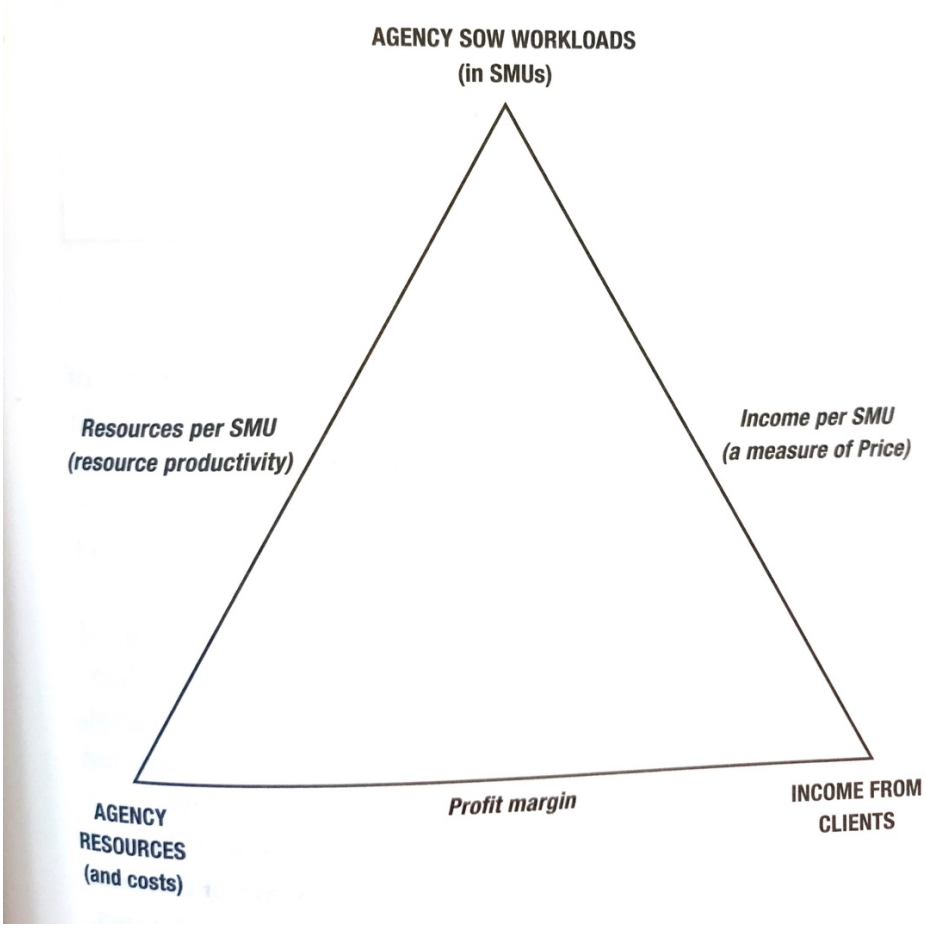

Figure 2: Ideal alignment of resources in project work
Source: Farmer, 2017, p 119.

The purpose of the unit is to create a consensus of the number of advertisements, and hence to assist the income structure analysis in a creative agency. The different complexities of the advertisements make them incomparable as in the regular counting process. One cannot juxtapose a creation of a print advertisement to for example a creation of a new visual brand image. The unit system is based on simplification of the creative work. The SMU unit represents the creative man hours per creative per project with no rework. Through this, a standard can be built to describe the project types and their complexities. The standard helps to build the SOW-process in which "unit price (fee divided by workload) and unit cost (cost divided by workload)" are defined through the

SMU level (Farmer, p. 159). To simplify; SOW is the estimation of the work that the advertisement creation will require, and it is used as the base for pricing, and SMU is the unit used to describe the actual work put into the advertisement creation. Hence, SMU is used as a basis for SOW.

The SMU unit system is based on David Ogilvy's quote from year 1983: "the average copywriter only gets three commercials a year in air". Taking this as the bottom line, Farmer evaluated yearly compound increase of 1,5%. Therefor if in 1983 the SMU value was 3, in 2005 it was 4,1 per creative. One of the case study examples given in the book, the Daedalus agency in New York, resulted through manual counting an SMU of 4,0 in 2005. Farmer uses this as an indication of the accuracy of the SMU value compound percentage.

He creates an individual "gold standard" for each company based on resource values on different media types and complexities. The complexities Farmer separates in three classes: the most complexity (no pre-existing material), medium complexity (some pre-existing material) and low complexity (all material is pre-existing). The sub-classification, which he calls the adaptations define the time needed for return brief or the feed-back based adjustments. The gold standard is calculated as a multiple of the SMU level and full-time equivalent(FTE):

The Gold SMU standard = the SMU of the year X FTE of the project type

The FTE per project type:

FTE = all hours used on project type in a year/ all creative hours per year per creative

The FTE and SMU value standards require the following fixed variables:
-The FTE of one creative per year
-The SMU compound value of the year

The two following tables show the gold standard FTE and SMU for three media types:
(Note that these are made to match the 2005 SMU levels)

	Low Creative Complexity	Average Creative Complexity	High Creative Complexity
Full-Up Originations	Creative FTEs Rounded	Creative FTEs Rounded	Creative FTEs Rounded
TV/Cinema	0.10	0.15	0.35
Print/Poster	0.06	0.11	0.27
Radio	0.08	0.10	0.23
Adaptations			
TV/Cinema	0.02	0.03	0.04
Print/Poster	0.01	0.02	0.02
Radio	0.01	0.02	0.03

Table 1: The creative FTEs at gold resource standards for a selection of brief types. (creative FTE = 1,800 hours)

	Low Creative Complexity	Average Creative Complexity	High Creative Complexity
Full-Up Originations	SMUs	SMUs	SMUs
TV/Cinema	0.40	0.62	1.43
Print/Poster	0.25	0.43	1.09
Radio	0.32	0.43	0.93
Adaptations			
TV/Cinema	0.09	0.13	0.15
Print/Poster	0.05	0.07	0.10
Radio	0.05	0.08	0.11

Table 2: SMU values for a selection of brief types based on 2005 SMU level

Source: Farmer, M. 2017. Madison Avenue man slaughter: An inside view of fee-cutting clients profit-hungry owners and declining ad agencies. Second edition. LID Publishing Ltd. (p.170)

Some generics about the ratios, that can be derived from the tables are:

-The FTEs used for high creative work are on average 28,5% times larger than for the low creative work. The ratio follows to the SMU values (28,7%) remains the same.

-The Adaptations used for high creative work are on average 44,4% times larger than for the low creative work. The ratio follows to the SMU values (33,8%) falls about 10%.

These show, that all creative work cannot be treated as equal. There is significant attention in the adjustments in high creative work. These works should be charged by the highest hourly pricing, and also carry remarkable attention from the customer.

According to Farmer, some of the key changes identified from Daedalus agency example (2005-2013) are representative about the industry's situation. During the eight-year span, Daedalus changed some of its customers but retained the same total. Despite, they earned 15% less revenue from the clients. The creative staff was cut out six times more than the client service and managerial staff. The managerial staff layoffs included senior level workers, which decreased the salary expenses. The SOW items or briefs tripled their amount and the total SMUs grew from 340 into 465. This means increase in the workload by 37%. For an individual creative this means growth from 4 SMUs into 5.8 SMUs per year. The prices declined overall by 38%, which means 2% annual compounding fall.

4 EMPIRICAL RESEARCH BASED ON SMU ANALYSIS

4.1 Why was SMU analysis chosen for the raw data study?

So far, the paper has compared and contrasted the views of the two active businessmen engaged with the current issues faced by the creative agencies. Roetzer keeps his latest

model, the Point Pricing method, unpublished as Farmer has published his metric in his book from 2017. Farmer's model is used as a base in the empirical study because of its accessibility, transparency and understanding of the different effects shaping the creative work, including complexities in the original and feedback work, project types and yearly compounding industry growth.

4.2 Red Collective Oy operational year of 2017

Red Collective is a small-sized creative agency operating in the Helsinki sector in Finland. The daily operations of the creative agency employs three permanent creative workers and one full-time trainee in addition to the sales team and administration. The size of the creative in-house workforce has remained the same within the past three years. The agency is known from its societal campaigns and rebellious attitude. The year 2017 marks the 15th operational year of Red Collective Oy. The company is privately held limited company.

During the financial year of 2017 Red Collective Oy has managed to retain its sales constant from the previous year and at the same time to gain more financial solidity for the company. In 2017 the company's revenue shrank from 2016's revenue of 821 367,46€ by three percent into 789 195,80€. Despite this the company's profits doubled from 21 189,71€ into 44 163,33€ in 2017. The management of the company is solely up to the CEO and without continuous follow up the overall understanding of the efficiency and profit margins on project base are unclear for the staff.

4.3 Raw data on the creative projects completed in 2017

The following table depicts the different creative projects completed in Red Collective Oy during 2017. The project types are divided into three categories to help the understanding of the medias. The categories are however overlapping, since for example they are all based on a visual design and generated by digital tools.

Visual design-category is used to describe products that are intangible or not ready to use as they are after the design phase. Print material designs are ready made materials in a digital form to be sent to a printing house. Digital material design –category represents finished digital products, that the customer can use internally or externally.

The second column defines, whether the product is based on pre-existing material or not. The material base is defined either as “Non”, “Some” or “All”. “Non” is used to describe a design process based on a written or oral brief, in which something new that is not based on pre-existing visuals or text is being made. “Some” is used in projects that are based on pre-existing visuals, that are edited to a new form or layout. “All” is used when a project is an edit of past material, and hence has no “new” material creation, for example when an old text is substituted by a new one. This classification was not done before inside the company, and hence here it is done after the work has been completed by deducting the efforts from the invoice texts and their final sums.

The third column tells how many projects there were in 2017 that fit the previous column definitions. The fourth column consist of reported hours per product type. These are taken from Taimer, which is the data system that the company’s creative workers use independently to report their hours. The individual values are separated by a plus, to show the range and the number of reported hours. The last two columns sum up the hours and draw out and average hours spent on project type.

The * sign in “Leaflet/pamphlet” row is used to indicate that 2,5h recorded was used in 3 leaflets, hence to be taken into account when calculating the average.

Project types	Pre-existing material	No of projects	Times spent on wor	Sum (h)	Average (h)
VISUAL DESIGN					
Concept/campaign Design	Non	24	3,5+32,5+7+12+10,5	394,50	32,88
Pencil Design	Non	1			
Logo design	Non	7	1+1+2	4,00	1,33
Merchandise design	Non	3			
A sign design	Non	6			
Year plan	Non	1	12,5	12,50	12,50
Car and bus branding	Some	2	12	12,00	12,00
Mobile application design	Non	1			
Package design	Non	1			
PRINT MATERIAL DESIGN					
Poster	All	29	4,5+2,5	7,00	3,50
Leaflet/pamphlet	All	13	2	2,00	2,00
-	Non	13			
-	Some	10	2,5*+2,5+7,5	12,50	2,50
editing		7			
Menu base	All	5			
Flyer	All	12	2+1,5+4	7,50	2,50
- update		2			
Stickers	All	3			
Magazine ad/announcement	All	23	0,5+1,5+1,5+4+1	8,50	2,13
	Non	5	3+1+1+4,5	9,50	2,38
Rollup	Non	6			
Beach Flag	Non	1			
Announcement template	Non	5			
Word or Indesign style	Non	2			
Promopoint's stand	Non	8	5	5,00	5,00
Wall advert (design)/branding/	Some	2	15,6	15,58	15,58
-	Non	2	16,5	16,50	16,50
Longer magazine, year synopsis	Some	6	26,5	26,50	26,50
Window advert/branding	Non	4	2,0	2,00	2,00
Paperbag design	Non	2	2,5	2,50	2,50
Nametag base, signature	All	1	3,0	3,00	3,00
Businesscard design	Non	4	2,0	2,00	2,00
Banderoll	Some	4			
Envelope design	Some	4			
A pin design	Non	2			
Flag design	Non	1			
Stamp design	Non	1			
DIGITAL MATERIAL DESIGN					
Banner changes	All	23	6+1,5+1+3,5	12,00	3,00
Digi and plasma screens	All	35	1	1,00	1,00
Icons	Non	1			
Social Media package	All	5			
editing		1			
Google adverts	All	2	3,83	3,83	3,83
ppt	Non	10	7,5	7,50	7,50
- editing		2	11,5	11,50	11,50
Newsletter	Non	3			
Lightly animated ad	Non	1	5,5	5,50	5,50
Website visual planning	Some	6			
Word base	Some	1			
Hiring ad	All	2	2,5	2,50	2,50

Table 3: The raw data: Number of Red Collective Oy's creative projects during 2017 and their average time spend

4.4 The SMU value of 2017

In 2005, the SMU value was 4,1 per creative, which means that in a year one creative was able to create 4,1 advertisements by themselves. The basis for this statement come from David Ogilvy's quote from year 1983 as stated in section 3.3.2. of this paper. Farmer describes the compounding work with 1,5% cumulative rate, then the SMU value in 2006 was…

$$4{,}1 * 1{,}015 = 4{,}1615$$

Since 1,5% = 0,015 and if the compound is considered the multiplier is 1,015
Hence,

2007: $4{,}1615 * 1{,}015 = 4{,}2239225$

…

2017: $4{,}82959064 * 1{,}015 = 4{,}9020345 \approx 4{,}9$

4.5 All creative hours of Red Collective Oy in 2017

There are three visual workers with a permanent contract and one trainee visual worker. All of the workers work full eight hour days, with one hour lunch break. Since the agency is small, they are rarely creative teams parallel working on same cases. The four in house visual workers are supported by freelance copywriters and other creative professionals such as photographers or stylists.

An average day constitutes of 30 minutes of morning meeting (sometimes not held, hence the 30 min equal chatting with colleagues), a few toilet and smoking breaks (20 min) and occasional email exchange with colleagues (max 15 min). Hence one workday constitutes of 5 hours and 55 minutes (5,916… hours) of efficient creative time. On these basis, an average day would have creative productivity of 85% (5,916…h/7h hours = 0,84514286 ≈ 85%). The days vary a lot, and sometimes they involve customer meetings or presentations, which is away from creating something new. The amount of these is difficult for one to estimate. Considering to the size of the agency, it's safe to say that there's at least one customer meeting per week, which takes at least 3 hours

away from the creative time. In one year that would be 3 hours times 52 weeks which equals 156 hours away from the creative time. The average productivity is close to Farmer's estimation of 86,5% (Farmer, p 161).

The average sick leave a person takes off in a year is 16,7 days according to Finnish occupational health institute in 2016. The average has remained stable since 2013, so this paper assumes 2017 follows the trend (Työterveyslaitos, 2017). In 2017 there were 9 holidays that occurred during a regular working week (laskurini.fi, 2018).

The agency is also closed in July for a holiday month (21 workdays) and the workers receive 1 week skiing holiday during the year (5 days). In 2017, there were 251 weekdays (Monday-Friday) (laskurini.fi, 2018).

So the creative hours are estimated as:

(weekdays (Monday-Friday) in 2017 – holidays and sick leaves per person) * 7 creative hours per day * 4 workers * 85% efficiency – hours used in meetings

(251-5-21-16,7) * 7h * 4 * 0,85 – 156h
= 4 801,54 creative hours in 2017
Per creative this equals to:
5388 / 4 = 1 200,385 hours ≈ 1 200 hours

4.6 The FTE standard per project type in Red Collective Oy

From table three representing the raw data, one can see that there is serious lack of data on hourly spend per project and that some projects were more popular than others. The FTE calculations in the following table were made on project types that had more than ten projects and at least some hourly spend data collection. This was done to bring some data reliability, because of the data limitations. The selected project types are highlighted by green color in the original raw data table (table three). The FTE number was cal-

culated by using the FTE formula given and the creative FTE value of 1 200 hours as calculated. The results were rounded up to three decimals to show variation.

Project type	Pre-existing material	No. of projects * average (h)	Creative FTE values
Concept/campaign Design	Non	789	0,658
Poster	All	101,5	0,085
Leaflet/pamphlet	All	26	0,022
-	Some	25	0,021
Flyer	All	30	0,025
Magazine ad/announcement	All	48,9	0,041
Banner changes	All	69	0,058
Digi and plasma screens	All	35	0,029

Table 4: Creative FTEs for selection of project types (Creative FTE = 1 200 hours)

The FTE values are used to indicate how much of the total creative time per year per creative is used per project type. For example, from table four one can see that on average "Concept/campaign Design" takes 65,8% of one creatives work per year and represents the most time consuming project type in Red Collective's product catalogue.

4.7 The SMU standard of Red Collective Oy

The creative SMU values were calculated using the SMU formula given, the given FTE values in table four and the SMU value on 4,9 per creative per year.

Project type	Pre-existing material	Creative SMU values
Concept/campaign Design	Non	3,22
Poster	All	0,41
Leaflet/pamphlet	All	0,11
-	Some	0,10
Flyer	All	0,12
Magazine ad/announcement	All	0,20
Banner changes	All	0,28
Digi and plasma screens	All	0,14

Table 5: The SMU values for selection of project types (based on a creative productivity level of 4,9 SMUs per creative per year)

5 RESULTS

During 2017 Red Collective Oy had 314 completed projects, from which 586,91 hours were reported in the work data base, Taimer. The most projects were done in digi-and plasma screen formats and the second most projects were in the field of print poster media. Concept and campaign design took the third largest role in the project distribution and it was also the most time consuming brief type with the most reported hours.

The SMU value had grown into 4.9 in 2017, which is much higher than the value in 2002, when the company was established. The 2017 value is also different from the SMU value of 2005 (4,1) used in the Gold standard model in Farmer's book. The FTE of an individual worker in Farmer's model was 1 800 hours, as it was 1 200 hours in the example taken from Red Collective, hence the amount of creative hours was larger in Farmer's model. Therefor one can say that the fixed variables for the example study are significantly different from the ones used in determining the Gold standard in 2005. The poor work-hour record of the company deteriorates the raw data results, and hence the only comparable SMU value category between the given gold standard and the example results is the Print/Poster value (because of the same brief category and available raw data gathered from the example). Red Collective seldom participates in creating TV/Cinema or Radio projects, and hence the creative project types given in the Gold standard and the raw data from Red Collective Oy don't match to create reliable results apart from Print/Poster section.

If the Gold standard given by Farmer was to be matched to the 2017 level, the Print/Poster section would have the following SMU values:

Low Creative complexity: 0,06 * 4,9 = 0,294 ≈ 0,29
Average Creative complexity: 0,11 * 4,9 = 0,539 ≈ 0,54
High Creative complexity: 0,27 * 4,9 = 1,323 ≈ 0,32

In the raw data, the project complexities are grouped since there was no evidence that any of the project types had differences in complexity. However, if you look at the two times recorded in the raw data (4,5h and 2,5h) it's evident, that the other had significantly less work than the other. Therefor it can be said, that the raw data collected from poster creation in Red Collective Oy didn't classify the complexities correctly because of lack of record. In order to compare Farmer's gold standard to the raw data results, an average is taken from the different creative complexities in poster making:

$$= \frac{the\ sum\ of\ SMU\ values\ of\ n\ complexties}{n} = \frac{0{,}29 + 0{,}54 + 0{,}32}{3} = 0{,}383\ \ldots$$
$$\approx 0{,}38$$

Comparing the two results, SMU from raw data 0,41 and the adjusted SMU average from the given standard 0,38, there is a relevant relationship between the two, hence the example case made on Red Collective Oy supports Farmer's SMU modelling's gold standard.

According to Farmer, the SMU values are never the exact same between two agencies. Something to take into account, is that the Gold standard utilized in this paper, is representative of the year 2005. If we would change the fixed SMU value of 2005 into 2017 value, the results would be the following for the Gold standard:

Eliminating the fixed SMU value of 4,1 from 2005 through division and multiplying the remaining FTE value by the 2017 SMU standard of 4,9

$= \frac{0{,}383}{4{,}1} \times 4{,}9 \approx 0{,}458$ SMU

The FTE value alone for the poster creation on Gold Standard (ignoring the complexities, hence taking the average or $\frac{0{,}383}{4{,}1}$) is ≈0,093. For Red Collective Oy this was 0,085 (Table 4). This means, that the Gold Standard company uses 8% more time per year on poster creation than Red Collective Oy. This also partly explains the difference in the final SMU values for poster creation.

The fixed variable of 3 adverts a year with 1,5% for the yearly compound is based on a quote from the 1983. The growth percentage is deduced by Farmer, hence holds no factual evidence in his book. The variable holds a significant role in the calculations. So to test, if there was no yearly growth at all in the amount of work, the SMU value every year would be 3, hence the SMU value for poster making in Red Collective Oy would be ,

$$= 0{,}085 \times 3 = 0{,}255$$

To make this comparable to Farmer's gold scale we calculate the average of the FTE complexity values of poster making (p 31 = 0,093) multiplied by three,

$$= 0{,}093 \times 3 = 0{,}279$$

The difference between the two is 0,024 SMUs as it was 0,03 SMUs when the compounding growth was included. If there was no fixed SMU value at all in the calculations, only FTE value would be calculated and hold as a scale. The FTE value is simply a percentage of how much of the total work is used on certain project type per year per individual.

6 DISCUSSION

The main limitation in the results and the alarming signal in the raw data, is the lack of creative hour reporting. The results show, that only 26% of the creative hours were reported. The lack of hour records prevents the company from using its SMU values in its SOW planning and from establishing a clear standard for invoicing and defining an accurate pricing system. As suggested earlier, this is the main cause for the unrealistic illusion of actual work hours and the invoiced hours. The growing disproportion in between the two already significantly influences the companies' profit margins and barely covers the agencies fixed costs together with the wages. Therefor the creative agency market is not seen as profitable as during the times of fixed margins.

The SOW planning is a way for a company to connect its resources, efficiency and pricing. Without a functional hour follow up system and already existing data record from at least one year, the planning is unable to occur. Farmer highlights, that each company is unique and exactly same SMU values are almost impossible between different companies. The values are highly dependent on corporation culture, efficiency and individuals. The SOW planning helps the agency to create more accurate invoicing base, because the SMU analysis on past record shows on average how much work goes into defined project type. The SMU unit system creates a passage between invoicing and work hour reporting by acting as a measurement of work. This also answers the first research question presented in the paper. For Red Collective Oy this type of further planning and analysis were impossible to make, since the hourly record from 2017 was inadequate. In order for them to create a similar system to Farmer's SOW planning and lay stable bases for their pricing, the hourly records must be kept constant for a year after which the SMU analysis leading to SOW planning could be done. This determines the answer to the second research question.

The popular media types show the sign of the digital transformation. Two of the most common project types in the example raw data show focus on publicity-centered media demand, and the thirdly most common need for creative strategic design. Also, Farmer brings this up towards the end of his work as he describes the clients' perception of creative agencies work more as a "commodity" rather than as something "strategic" (2017, p187). The raw data shows that 67 percent of the reported hours were concept or campaign design projects, hence the creative workers are more eager to report these hours than regular creative hours among lower-profile projects.

The FTE values vary between the model example and the data study done on Red Collective because the efficiency of the workers and the number of holiday days have cultural and company differences. The evaluation done on the efficiency on Red Collective was optimistic. The creative pressure is tougher in a small scale company than it is in a big one, where the designers attend on customer presentations and meetings much less. A high FTE value is either a result of an hour consuming project type or large number of the selected projects. The differences can be skewed, if the agency is specialized in a certain project type and hence uses a lot of time on these projects, therefor having a high

FTE for the project type. Alternatively, the agency can have pretty evenly distributed project types, but some type might require more time than the others. The scenario can be specified by looking at the number used to generate the FTE value. In addition, the FTE values per creative type are simplified as some of the designers work on higher level than the others. The senior designers tend to do more concept design than the lower level designers that are given easier works to complete. Hence, the FTE level acts as a generalization and not as a portrait of an individual work distribution.

The general SMU value of a certain year and its compound of 1,5% are not further expanded in Farmer's book. The SMU value has significant influence of the final gold standard values (0,255 SMU without growth and 0,410 SMU with growth from the raw data), hence it's use should be justified. If the fixed SMU value based on the quote from Ogilvy and the growth were not used in the calculation, the formula would simply be an average of how much work is put on a certain project type in a year per creative. Therefor the evidence behind farmers SMU-model does remain questionable.

7 CONCLUSION

The tipping point of meeting the fixed costs with the marginal profit is already been tiptoed in the creative agencies industry. The possibility to change the agency management and pricing remains open for theories and new discussion. The long lasted freedom in the industry and the customer's search for transparency are setting colliding interests in between the creative creators and the customers. This paper looked into two industry scholars current models and views on the industry, from which Farmer's formula was looked into detail.

Farmer's SOW planning system is neither based on simple hour collection or value definition. The system requires a coherent and continuous hourly record per project type changed into SMU unit scaling. The further analysis on yearly base and hence SOW planning for the future could be done for example by dividing the revenue by the SMU total of all work and comparing this to similar calculation in which the costs act as a numerator. In addition, the solid creative hour records help to establish a unified standard between project complexities to act as a base for invoicing.

Farmer's model is partly based on evaluation. The fixed FTE value per creative per year is a deduction of the overall efficiency of the workforce. The fixed SMU value per year with the compounding growth of 1,5% per year are not further expanded in Farmer's book, The Madison Avenue Manslaughter, and hence their credibility remains questionable, which weakens the overall model. Still form the industry representatives present at the point of writing this thesis, Farmer's model is the most complex and open for the industry challenges.

The SMU values can't be held solely accountable to the price. Other elements such as management needed for the project, schedule and so on also take their influence on the final price. The process of pricing a creative service product is complex, which is one reason why this thesis focused on only the creative hours. It is important to remember, that the calculations are purely theoretical and creative workers are never equal in their working habits. As said by Michael Farmer, no creative agency is ever equal to another.

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