BUSINESS

Big Companies Put the Squeeze on Ad Agencies

P&G is part of a trend as it pares its roster of marketing firms

Procter & Gamble, maker of Tide brand laundry detergent, hopes to save up to half a billion dollars in fees. *PHOTO: DANIEL ACKER/BLOOMBERG NEWS*

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The world's largest advertiser wants to spend less on marketing, dealing another big blow to an industry already battered by corporate cost-cutting.

Procter & Gamble Co. is preparing to make deep cuts in the number of advertising agencies it works with, hoping to save up to half-a-billion dollars in fees that it now pays to outside firms to help pitch its myriad everyday items, from Gillette razors, to Tide detergent, to Pantene hair care, to Bounty paper towels.

What worries Madison Avenue isn't only the pressure agencies will feel as P&G tries to wring better prices from them—or risk losing the business altogether—but that the consumer-products giant is joining other big companies, including Unilever, L'Oréal SA, Coca-Cola Co., S.C. Johnson and Visa, that are evaluating some part of their ad accounts.

In all, companies with nearly $20 billion in media buying power have some part of their agency business under evaluation. That makes this an unusually risky stretch for an advertising industry that has seen accounts steadily whittled down in recent years as their clients try to offset slow growth with cost cuts.

The pressures have prompted extensive industry consolidation, culminating in the merger attempt between advertising giants Publicis Groupe SA and Omnicom Group Inc. that collapsed last year. Yet agencies are still at the behest of clients in an increasingly frugal mood.

P&G Chief Financial Officer Jon Moeller said Thursday that the household-products giant plans to "significantly simplify and reduce" the number of agencies it works with on ads, media buying, public relations, package design and in-store marketing.

Unilever, which spent roughly $7 billion on advertising and marketing last year, is currently reviewing its global media-buying business. The process is being driven in part by the need to find "cost savings and efficiencies," a person familiar with the matter said.

Snacks giant Mondelez International is expected to put its media-buying business in review in coming weeks, another person familiar with the matter said. A Mondelez spokeswoman said the company's media contracts don't expire until the end of the year and it currently doesn't have a media review going on.

Companies often have multiple reasons for calling reviews. Many hold contests so they can make sure they are getting the best services. Other times brands are testing whether their agencies are up to speed on the latest marketing methods in an industry being transformed fast by technology.

Still, the current round of re-evaluation threatens to hit the ad industry in the pocketbook.

"It's a tsunami of reviews right now," said Russel Wohlwerth, the principal of ad consulting firm External View Consulting Group. "Companies are looking for savings from everything, and marketing" is clearly in finance-department sights.

P&G spent $9.2 billion on advertising in the year that ended last June. Its plan to drop a significant number of agencies comes after years of deep cost-cutting in other operations to accelerate growth and escape a reputation for bloat.

The company said last year it would exit 100 brands to focus on the 65 biggest and most profitable such as Pampers, Crest and Head & Shoulders. Because it has so many brands, P&G contracts dozens, if not hundreds of agencies all over the world to help it manage everything from ad campaigns and events to package design and product launches, PR and displays inside Wal-Mart and other retailers.

The culling will take place over the next two years, a P&G spokesman said, adding that each of the company's brands will determine its needs and review its agency use. P&G doesn't disclose how much it spends on agencies, but former employees say that the company used to spend roughly 15% of its advertising budget on fees.

"What we are talking about is being as efficient and effective as we can in spending those dollars where they drive returns," Mr. Moeller said Thursday.

Clients have been putting pressure on advertising companies as procurement officers exert more influence over marketing budgets. Procurement departments review everything from agency fees to production costs, looking to cut expenses where they can. Many big companies are also stretching out payment to agencies from 30 days after a piece of work to 60 days or even more than 120 days. Two years ago, P&G told its agencies and other suppliers it would pay them in 75 days instead of 45.

The global advertising industry is dominated by conglomerates WPP PLC, Omnicom, Publicis and Interpublic Group of Cos.—four firms that together generated nearly $50 billion in revenue in 2014.

Martin Sorrell, chief executive of WPP, the largest of those, said Thursday that clients are "examining their costs with increasing rigor," a trend that is going to continue as companies contend with sluggish growth. WPP reported revenue growth of 8.3% for the first quarter, boosted by currencies and acquisitions.

Interpublic Chief Executive Michael Roth said on an earnings call Friday that agencies are under pressure to show that their efforts produce a measurable return. Interpublic said its revenue rose 2.4%.

The glory days of "Mad Men" are long gone, and extended marriages like Leo Burnett's 57-year relationship with Allstate Corp. are few and far between. A decade ago, the average tenure of an agency-client relationship was about seven years, said Drexler Fajen & Partners, a media consulting firm. Now, it is around three and a half. Unilever reviews its media-buying agency account every three years.

A recent study from the Association of National Advertisers, a trade group, found that only 40% of agencies believe they are fairly compensated, even though 72% of clients think their payments are appropriate. "They always feel you can squeeze labor a little bit more," said Ann Billock, a partner at Ark Advisors, a firm that advises marketers on agency selection. If cuts are too deep, an agency can be forced to shed staff, she said.

The fee pressure has eroded margins at the agencies that come up with the ads as well as those that place them in the media. The big advertising holding companies have managed to offset those pressures by expanding into higher margin businesses like automated ad buying and data analytics. Broadly, though, budgets are tightening.

"Any given agency needs to be able to do the same work they did last year for less than they did it last year," Pivotal Research analyst Brian Wieser said.

The newness of some of those services may also play a role in driving some of the reviews. Real-time programmatic buying—where computer software makes instantaneous decisions on where to place ads around the Internet—is hard for clients to track.

Last year the Association of National Advertisers and Forrester Research surveyed about 150 senior marketers and found that 46% expressed concern about the transparency of their media buys.

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