The Ripple Effect of Extending Payment Terms

Guidance from the 4A's

As a service-oriented business, marketing and communication agencies want to drive their clients' growth and do what's right for their clients' business but they also need to be able to pay their staff, invest in new tools and technologies and make a profit. While most marketers would not dispute this, the **tug of war** between marketers and advertisers around what fair payment terms are still exists despite the continuous attempts by industry advocates like the **WFA**, **VoxComm**, **IPA**, and **ID Comms** promoting best practice of 30 days. We hear continually from members about the unproductive hours they spend in client conversations defending payment terms beyond the standard.

Many agencies (especially during reviews of current business and pitches for new business) are being told that more than 30 and up to 120-day terms are standard for fees, production, and even media. There is nothing "standard" about a 120-day term for an industry that relies on the important task of balancing payments to media suppliers, production companies, and meeting their own business requirements. Anything beyond a normal 30-day cycle is incompatible with the typical agency commercial model, and particularly destructive with respect to zero margin pass-through billing, forcing agencies to act as banks to their usually better capitalized and profitable clients. Extended billing terms represent a sub-optimal cost allocation of the final product value chain ultimately increasing costs to the consumer without returning any benefit.

> "As an advisor to advertisers, at ID Comms we have learned of many examples of where advertiser and agency relationships have broken down over the impact of unreasonable payment terms. Even in an age of algorithms, we observe that so much of the value delivered from agencies is still discretionary and based on people and relationships. Agencies tend to have preferred clients and it is these clients that invariably get access to the best talent, creativity, first-look opportunities, and innovations. I doubt many of those advertisers demanding 90- or 120-day payment terms will be topping any agency's preferred client lists. Onerous or unfair payment terms can have a significant detrimental impact on the overall value delivered by an agency."
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> - Tom Denford, CEO & Co-Founder, ID Comms

The ANA 2020 study on payment terms highlighted:

> "Extended terms can create 'ripples through the system.' Extended terms often come with consequences, including strained relationships with vendors, reduction in flexibility, and higher prices. In addition, the business models, and livelihoods of smaller players in the marketing supply chain can be threatened by extended terms. Client-side marketers need to consider what is fair and how they would want to be treated. If the payment terms they are suggesting to their suppliers would not be acceptable to them as suppliers, a reconsideration might be in order."

While an individual request from one client might not seem that significant, accepting the idea that extended terms are a market norm is a slippery slope. The aggregate impact to an agency's business is unsustainable and far beyond what the business model can or should absorb.

For example, Ad Age's 2023 report of the World's Largest Agency Companies lists US 2022 revenue for the top 10 agency companies as roughly $50 billion. Using this as an example and assuming all media and production are cash neutral (neither the advertiser nor the agency experiences a disproportionate burden in terms of cash flow), if these largest agencies were to extend payment terms by 30 days, they would need to collectively raise approximately $4 billion of new cash from the financial markets at a cost of more than $200 million annually, straining their collective P&L and balance sheets. Extending beyond 60 days doubles the borrowed amount to well over $8 billion - and doubling it again for 120 days is clearly untenable.

The situation worsens when clients ask agencies to fund media in addition to agency fees. With the current interest rate environment, this is more prevalent than expected. Total media billings for the top six holding companies were $73 billion according to the COMvergence 2021 Media Agency Billings report representing 52% of the US media billings of $140 billion. For illustrative purposes, clients requiring agencies to agree to 90-day payment terms for media (where media vendors are typically paid on 30 days), would require these top holding companies to borrow approximately $12 billion of working capital, or $18 billion to support 120 days. Most agencies are walking away from these terms but if they were to agree, the additional borrowing would lead to unsustainable debt. If you starve the agency's capital, you destroy a major growth engine.

Incremental borrowing for both fees and media with no other change to the industry's business model would be crippling. The additional borrowing and administrative costs are likely not reflected in the pricing or in the rates agencies charge. Borrowing funds to bridge the gap is an unrealistic expectation. Adding significantly to an agency's debt load and overburdening their balance sheets will impede their ability to invest in the very tools, technology and talent needed to drive clients' growth – which is the very reason they are hired.

> "While the ANA does not recommend any specific payment terms practice, there have been situations that have crossed the line. Agencies are hired to drive business results – they should not be hired to be banks for client-side marketers. Extended payment terms are not in the best interests of agencies and clients need to be sensitive to their negative ramifications – most notably strained relationships with agencies, which ultimately could impact the work."
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> \- Bob Liodice, CEO, ANA

It's important to recognize that the reported gap between fair and standard payment terms has significantly widened from 30 days shown in the 4A's 2010 and 2013 studies compared to 60 days as noted by the WFA's 2022 Global agency remuneration trends referred to in **Adweek**. The 60-day term is also shown in the **ANA 2020 study** noting average payment terms for agency fees at 58.1 days. However, what is not supported are the advertisers who continue to quote anything from 75 days, 90 days, or 120 days as "standard industry practice". Clearly, if left unchecked, clients will continue to pressure agencies for increased terms until they reach an unsustainable level. Any benefit derived by any single agency from accepting extended terms is short-lived and unlikely to result in a long-term competitive advantage.

Guidance

This guidance is intended to help member discussions with clients about why agencies need to decline extending payment terms. Agencies need to be able to drive their clients' growth – which is why clients hire them in the first place. Additionally this document contains general information about why clients are requesting extended payment terms, how to explain the agency's business model, best practices and possible solutions, and benefits to cash neutrality for both the advertiser and agency. The Appendix includes FAQs on managing these difficult discussions with your clients. Assume your client is open to these discussions. There might be a solution that is mutually beneficial.

A respondent of the ANA 2020 study noted,

> "Extending payment terms is a blunt instrument for improving a company's financial situation. There might be other options, leading to better financial outcomes, taken off the table because of the singular focus on payment terms."

Why Clients Ask?

It is important to understand why clients ask for extended payment terms. Many large advertisers are under pressure to improve their working capital and cash flow. By improving their cash reserves and minimizing debt, they look more attractive to investors and the additional cash provides funds for future acquisitions and other capital investments. This strategy is becoming a common way for corporations to improve their balance sheets, without having to raise money from the financial markets. Their goal is to use their suppliers as a source of free financing. Unfortunately, this is a zero-sum game in which any improvement to the client's cash position has the exact opposite effect to the agency's cash position.

The Agencies’ Business Model

Unlike other non-service companies, ~75% of an agency’s cost base consists of salaries and the related payroll expenses paid to employees each month. The remaining costs for an agency business include taxes, rent, telecommunications, utilities, and the ongoing general expenses of operating a business. Property costs are paid in advance and most other expenses are due during or within 30 days of the month of service. Agencies do not have the luxury of passing the burden of extended payment terms to their employees, landlords, or utility companies. The only way an agency can accept extended payment terms is to borrow money from a bank or other financial institution.

Agencies process billions of dollars of media and production expenses annually for their clients and the media and production suppliers are unable or unwilling to extend payment terms. It’s inefficient and against the clients’ own long-term interest to ask agencies to act as a vehicle to finance clients’ marketing expenses and growth.

Best Practices and Possible Solutions

The principle that the industry has operated under for decades regarding invoicing and payment terms are as follows:

Fees are structured to have the client’s cash in hand to fund operations 30 days after the end of the month when the service is provided.

For large expenses like media and production, agencies require clients to pay them before payment is due to the media and production vendors. This requires advanced billing and prompt payment terms with all clients for pass-through expenses.

While specific circumstances may vary, for production costs where production companies have significant up-front out of pocket expenses, clients should be invoiced at minimum 50% of the estimate at the start of the project with payment timed to achieve cash neutrality. In the ANA 2020 study, 68% of respondents said they were billed prior to services being rendered.

Better PO and Billing Practices

The **Adweek** article referenced above states that the WFA Global agency remuneration study found that while clients are quick to commission work when marketers have an urgent need, they are not as fast to follow through on their obligation to make the funds available on a timely basis, whether signing a scope or issuing a PO (Purchase Order). The study also reveals that only 18% of agencies never start work without a PO and only 52% of marketers allow billing before services are received. These practices are problematic with the current term structure and exacerbated by longer payment terms and should not be accepted.

Training staff so they understand the importance of getting paid should be a part of an agency's DNA. We encourage agencies to start tracking the date the work begins and the date when the payment is received. More importantly, make the client aware of it. Agencies will better understand the impact to their cash flow and be better prepared to negotiate for acceptable payment terms.

Also, consider adding a penalty for delayed billing mechanisms (signed scope of work or a PO).

Other Considerations

It is important to note that most agencies have successfully pushed back on requests for extending payment terms. It is also important to note that very few agencies have lost business because of holding firm on payment terms, even though procurement may say differently. An agency that is not performing may be told they lost business due to payment terms since this is an easier narrative than telling them their work was not valued. This reinforces that while payment terms discussions are challenging, it is not a deal breaker.

Benefits to Cash Neutrality

Cash neutrality provides several advantages to both advertisers and agencies and by aligning their financial arrangements, both parties can focus on their core business objectives and achieve mutually beneficial outcomes. Here are some of the benefits:

Financial Planning & Cash Flow Stability: Cash neutrality ensures that both the advertiser and the agency maintain a stable cash flow and allows for more accurate financial planning. By aligning payment terms, they can avoid significant fluctuations in their financial position enabling better budget allocation, resource management and timing of investments.

Reduced Financial Strain: With cash neutrality, neither the advertiser nor the agency experiences a disproportionate burden in terms of cash flow. This helps reduce financial stress and enables both parties to meet their financial obligations more comfortably.

Improved Client-Agency Relationship: Cash neutrality promotes a healthier and more collaborative relationship between the advertiser and the agency. There is less strain on the financial aspect of the partnership by aligning payment terms and it allows both parties to focus on the quality of work and achieving mutual business objectives.

Enhanced Business Stability: Cash neutrality contributes to the overall stability of the advertiser and the agency. By avoiding cash flow imbalances, they can maintain operational continuity, sustain their workforce, and invest in growth opportunities thus promoting long-term business stability.

Efficient Resource Allocation: When cash flow is stable, it becomes easier for both the advertiser and the agency to allocate resources efficiently. They can invest in the right talent, technology, and marketing initiatives without disruptions caused by cash flow constraints.

Long-Term Collaboration: Cash neutrality can foster a sense of trust and commitment between the advertiser and the agency. By maintaining a balanced financial relationship, they are more likely to continue working together in the long-term, ensuring continuity and fostering a productive partnership.

What is Supply Chain Financing, and Should You Accept It?

Financial institutions such as Citibank, JP Morgan, BNP, Bank of America, and several others offer programs where they pay the invoices on behalf of large advertisers. Other specialist financing companies such as Prime Revenue, C2FO, Taulia and Orbian provide similar services as the banks.

These banks and service companies pay the full amount of the invoice to the agency in, say, 120 days, but pay a lesser amount if agencies want to be paid in, say, 30 days.
As an example:

A $100 invoice will be paid in full in 120 days or the bank will pay the agency $96 in 30 days. This is known as Supply Chain Financing.

The bank discounts the invoice in return for paying the agency early. The amount the banks keep is based on an interest rate plus a service charge.

The clients get a cash boost when they pay the bank later in 120 days, and the banks earn revenue in the way of interest while agencies are left with less money than was invoiced.

The banks and the clients win, at the agency's expense. The agency essentially ends up paying the financing cost for the client.

Supply Chain Financing (SCF) has limited benefits to an Agency. While it may provide an agency which has limited access to capital with access to cash, there is a high cost of borrowing, a high administrative burden and legal cost to operate and implement the program and could be extremely complex in multiple country scenarios. Other challenges to SCF include the possibility of violating the agency's debt covenants with their bank and because it is offered independent of the contract, the bank can withdraw SCF at any time leaving the agency committed to the extended payment terms but with no means to finance them. Furthermore, in some markets, notably the US, the agent - principal relationship impedes SCF from being used.

Some agencies have tested Supply Chain Financing and other structured discounting programs with a few of their clients, but we are unaware of any example that has worked effectively and has not penalized the agency.

Unless the client is willing to repay an agency for the interest and additional administrative costs as well as reverse the extended payment terms should the bank withdraw the SCF program, both of which are unlikely, supply chain financing is a bad deal, even for those agencies who are looking for alternative sources of capital financing.

Agencies should articulate the value of the services that they provide to their clients and how this work is far more important than an agency trying to be a lender. Agencies should be clear on the specific (ideally measurable) value they add, as it often gets forgotten or dismissed during difficult discussions around payment terms.

Appendix: FAQs

Question	Answer
Why shouldn't we agree to delayed payment terms?	A delay in payment means that the agency must borrow money to pay salaries and fund operating costs. Your business model and overall cash position is not able to fund operations longer than you currently do. Nor do you have the cash to finance a client's production expenses and/or their media.
If we are unable to accept 120 days, should we accept 75 days or 90 days?	The answer to this should be 'no'. Extending payment terms beyond your current agreement requires access to new cash. Also, accepting a small extension opens the agency up to accepting longer terms over time.
Should I agree to the longer terms if the impact is not significant?	As above, this should be 'no'. If you accept longer terms with one client, it will be assumed that other clients can also be given delayed payment terms. Many agencies have small assignments but the cash impact when adding them all together can be untenable.
Should we make use of the client's supply chain financing facility?	It's not an optimal scenario given the programs are uncommitted finance lines that could potentially create significant refinancing risk for an agency. Consider the repercussions if obligations aren't met.
The client told us that if we do not accept extended terms, we may not keep the business.	This type of threat is disappointing, but some clients do try bullying agencies to create fear and uncertainty. Your value to your client must be greater than being their bank. Their need for excellent marketing services is far more important for top-line sales than the small improvement to their cash position by delaying payment of agency fees and their own pass-through expenses. Lastly, data seems to indicate that most clients do not follow through on this threat.
Why are marketers so aggressive about seeking delayed payment terms?	All large clients are trying to make themselves appear more attractive to investors. It is procurement's job to put these initiatives in place and it may be a part of their personal performance deliverables. Failure to implement, may have a direct impact on their personal incentives.
Our client tells us our competitors are accepting 120-day terms.	Some agencies have accepted longer payment terms for one client without realizing the long-term impact of extending payment terms for multiple clients.

Appendix: FAQs (cont'd)

Question	Answer
The payment terms issues are hurting my day-to-day relationship with the client. What should I do?	The best approach is to advise your client that you are unable to agree to payment terms beyond what is cash neutral due to the impact to the business model. Explain that you understand the pressure they face for extending payment terms but that your role is to help them manage their marketing efforts and not their cash flow.
How should payment terms change according to the date of invoicing?	Agencies should consider when the payment is invoiced. If it is at the beginning of the project, there is more leeway to adjust payment terms. If it is invoiced at the end of the project, there is less room to adjust. The same applies to retainers, whether they are billed monthly or quarterly in advance.
The client indicates that the agency is one of their biggest suppliers, and therefore critical to meeting their own objectives on extended terms.	If you look at the portion of billing that relates to fees, the size of the opportunity is not as material as it seems. While agency passthrough billing is significant in aggregate, it actually represents not one but hundreds if not thousands of individual suppliers. The agency does not set the terms of the marketing ecosystem. Therefore, the agency's ability to consistently pass extended terms to such a large number of suppliers is unlikely to be successful and would require a multi-year effort in the making. As such the agency cannot commit to extended terms "up-front".