

# Producer price index for the Advertising Services industry in Australia

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## 1 Introduction

The Australian Bureau of Statistics (ABS) is undertaking a long-term development program to progressively extend the scope of the producer price indexes into the services sector of the economy.

On 18 April 2000, the ABS launched a new quarterly publication, **Producer Price Indexes for Selected Service Industries, Australia (Cat. no. 6423.0)**. This publication presented quarterly price index numbers for most industries within the transport and storage, and property and business services sectors from September quarter 1998 to March quarter 2000. More recently, the ABS has combined all producer price indexes into a single publication: **Producer Price Indexes, Australia (Cat. no. 6427.0)**; of which a complete section is devoted to service industries.

The Advertising Services industry price index has been compiled on a quarterly basis since the September quarter 1998.

## **2 Nature of the Industry in Australia**

### **2.1 Industry definition and relation to CPC**

The service industries price index development work is taking place within the classification framework provided by the Australian and New Zealand Standard Industrial Classification (ANZSIC). Advertising services fall within the ANZSIC class 7851. The main activities of this class are:

- advertising agency service;
- advertising placement service;
- advertising preparation service;
- advertising service (except sale of advertising space in own publications or broadcasts);
- advertising space selling (on a commission or fee basis);
- aerial advertising service; and
- samples distribution service.

The equivalent industry under the CPC is 836 Advertising Services, with sub industries:

8361 Planning, creating and placement services of advertising.

8362 Purchase or sale of advertising space or time, on commission.

8369 Other advertising services

This description would indicate that the scope of ANZSIC class 7851 and CPC 836 are very similar. The ABS only intends to produce an index for the Advertising Services industry in aggregate (i.e. no sub indices will be produced).

### **2.2 Size and type of businesses**

There is a general lack of quality statistics on the structure of the Advertising Services industry in Australia. From the statistics that are available, it is evident that most businesses are small, with approximately 95% of businesses involved in the industry employing 5 or less people.

There are three different types of businesses providing advertising services in Australia, they are:

- (1) Full service agency - providing all advertising service needs of a client;
- (2) Creative agency - providing creative advertising services (i.e. producing advertisements for clients);
- (3) Media buying agency - purchases advertising space from a distribution medium (e.g. television, radio, newspaper) and sells this to clients.

Due to the lack of consistent quality statistics on the Advertising Services industry in Australia, it is difficult to accurately assess what the proportions of main revenue earning functions for the industry are. However, it is clear that the main revenue earning function is media placements, dominated by placements on free to air television. Earnings from creative services are also significant, but probably less than 30% of total industry income.

### **2.3 Government regulation**

In 1997, the industry was deregulated. The previous government regulations stipulated fixed charges for advertising services, basically consisting of a set agency commission of 10% and a service fee of 7.5%. Despite the deregulation, key industry associations recently spoken to suggested that approximately two thirds of agencies still use the same method to charge clients. According to industry sources, the main impact of deregulation has been for agencies to specialise as either a creative agency or a media buying agency, rather than providing a full advertising service which was more common in the past. In the past few years, several large international specialist media buying organisations have entered the market.

## **3 Charging methods used by businesses**

The charging methods employed by most businesses are still relatively simple, and similar to the approach used under industry regulation.

### **3.1 Fee billing**

The most common form of billing within the industry is the fee method. With a fee arrangement, agency costs are recovered and an additional service fee is charged. Common forms of fee based billing are:

#### ***Cost based fee***

This can be for total agency service, an hour of service, services from a particular group of agency people, services from a particular project or any other grouping of agency people. This fee includes recovery of all direct costs (labour, materials) plus the agency contribution (indirect costs and margin).

### ***Cost plus fee***

This includes an amount added to the agreed cost for the agency service (i.e. the agency estimates its costs up front and adds a margin).

### ***Minimum fee guarantee***

Is used to describe an amount the agency is guaranteed for a specified amount of time (usually a year) for its service, a category of service, or the service associated with a specific project. A price is negotiated with the clause that, after agency costs, the agency margin is within a certain range (e.g. between 15 and 20 percent). At the end of the contract if the agency margin is less than the agreed minimum the client must pay the extra, if it is above the maximum the client is reimbursed.

### ***Fixed fee method***

A fixed amount is agreed in advance by the client and agency, which can apply to different categories of service, different periods of service, or with specific projects. The fixed fee amount is usually put in the contract before any of the services take place. Regardless of the costs incurred by the agency, this amount will not change.

## **3.2 Other billing methods**

For media placements, some agencies have arrangements with clients where charges consist of some combination of fees and commission. The common methods of billing under these arrangements are:

- media commissions plus an overall additional fee;
- media commissions, but with a profit floor or profit ceiling arrangement; and
- minimum fee against which media commissions are credited.

Creative advertising agencies may also enter into more speculative billing arrangements, such as remuneration based on sales performance.

## **4 Current pricing methodology employed**

The ABS is currently covering commissions and fees from television advertising placements. Anecdotal information from media buying agencies suggests that this accounts for roughly 80% of income generated from media placements. Industry statistics suggest that income from media placements accounts for over 50% of total industry income.

For the largest advertising agencies / media buying houses, we are currently pricing their charges to clients for prime-time 30 second television commercials played during 30 minute programs, for each of the three major television networks in Sydney and Melbourne only. Due to the sensitive nature of commissions and fees for individual client contracts, our respondents are asked to report the average price (for the middle month of the quarter) they charge for the specified item across all clients. Whilst this average price approach is not ideal, respondents are not willing to provide details from individual client contracts. This information is collected by mail on a quarterly basis.

The pricing basis (i.e. 30 second commercials in 30 minute programs during prime time) was considered the most representative way to capture prices, as prices differ for longer shows (e.g. movie length). The bulk of the price we capture represents the average price the advertising agency / media buying house pays the television stations for these commercials, rather than the commission and fees charged to their clients. Whilst agencies have been unwilling to provide details of actual contracts with clients, they have stated that commission and fee arrangements do not change overtime for a client purchasing the same quantity of advertising space. Therefore the average price paid by the media buying house is considered a good proxy for the item we are trying to capture, as price changes to clients are driven by the cost of advertising time purchased from the networks. We concentrated on Sydney and Melbourne (Australia's two largest cities by population) only as these are the highest contributors in terms of turnover.

## **5 Technical concerns**

There are a number of technical concerns with the Advertising Services industry price index in its current form, best summarised under the following headings.

### **5.1 Coverage and representativeness**

Whilst television advertisement placements are the major revenue earner for the industry, price movements for these services are not representative of the output of the remainder of the industry. This is due to the extremely seasonal nature of prices for television advertisement placements, corresponding to television ratings periods. The series provided in Attachment 1 shows quarterly movements of greater than 20% in some cases between the December and March quarters, and March and June quarters (the March quarter is the low rating period). Such large swings in this index, which carries the weight for the whole of the Advertising Services industry at present, is often a key driver of changes in the overall Business Services index, despite having a relative weight of only 5%. A special note is included in the publication to draw attention to users of the limited coverage of the Advertising Services industry price index.

The ABS is planning to cover other media placements, such as radio and newspaper, in the near future. This will extend the coverage of the index and help moderate to some extent the seasonal impacts of television advertising placements. Ideally our development work will extend to pricing the outputs of creative (i.e. advertisement production) services. Whilst we are hopeful of developing an appropriate methodology for this, discussions with industry associations and respondents thus far have not been encouraging due to the extremely diverse nature of this service to different clients.

## **5.2 Pricing methodology**

The current pricing methodology is essentially a unit value method and can be biased by significant changes in the mix of clients our respondents have each quarter. Also, we are reliant on the stability of industry charging practises. If the method for determining client fees begins to change within the industry (e.g. as a driver to attract more business), then our current pricing approach is less likely to pick up pure price change. At present this is not a large threat as commissions and fees charged by the agencies for media placements are a small proportion of the overall charge (i.e. the bulk of the charge is for the cost of the advertising time purchased from the television station).

## **5.3 Benchmark data**

At present, there are problems with the statistical data underlying the index weights. Various sources of official (ABS) and unofficial statistics over the last 10 years have estimated the total industry revenue to be between 1 and 10 billion Australian dollars. This appears to reflect a lack of standardisation in classification, and the potential inclusion of revenue for the mediums themselves (i.e. the income for media placement agencies should be net of the cost of the media placements they purchase from the various advertising mediums). This impacts of how the Advertising Services industry index should be combined with other service industries in constructing broader indexes. Statistics on the main revenue earning activities of the industry are also of poor quality. For example, estimates of the proportion of revenue earned from media placements range from 50% to 70% according to source, and estimates of the split on media placements between television, radio, newspaper, cinema etc. are also variable. This issue will require close examination when the coverage of media placements in the index is extended.

## 6 Conclusion

The ABS Advertising Services industry producer price index is very much in a developmental stage. Whilst it covers the major earning activity of the industry in television advertisement placements, the resultant price series is not likely to be representative of the remainder of the industry due to its extreme seasonality. As such, the index is potentially misleading as a price index for 'Advertising Services' as a whole. The published data therefore needs to be treated with caution, and coverage of the index needs to be improved as soon as possible.

### Attachment 1      ABS Price Index of Advertising Services

<b>Quarter</b>	<b>Index number (a)(b)</b>
September 1998	103.7
December 1998	108.1
March 1999	83.5
June 1999	104.8
September 1999	112.9
December 1999	115.2
March 2000	87.9
June 2000	109.8
September 2000	117.4
December 2000	120.4
March 2001	97.1
June 2001	120.9

(a) Index reference base: 1998-99 = 100.0

(b) Covers television advertising placement services only, where charges are associated with television ratings periods. Other advertising services will be included in due course.