CL MANAGEMENT CONSULTANTS

# BUILDING A DIGITAL AGENCY GROUP

## OUT WITH THE OLD, IN WITH THE NEW?

## AT A GLANCE

- The big six holding companies that have historically dominated marketing services are being challenged by a new breed of digital-first agency group.
- These digital groups focus on leveraging data and insight across the marketing funnel, delivering significant value not only to CMOs but also to CTOs.
- M&A can turbocharge growth but needs to be focused on high growth sub-sectors or complimentary services that can drive cross-sell.
- Post-acquisition integration needs to focus on optimising margin (through back office synergies) but also on driving revenues, often with brand and sales alignment.
- We believe there are seven key areas that should be prioritised when it comes to creating an effective digital group strategy.



# THE CHANGING MARKET

For many years, marketing services have been dominated by publicly listed holding companies. However, a new breed of digital-first group, with a very different model, is taking share from these industry goliaths.

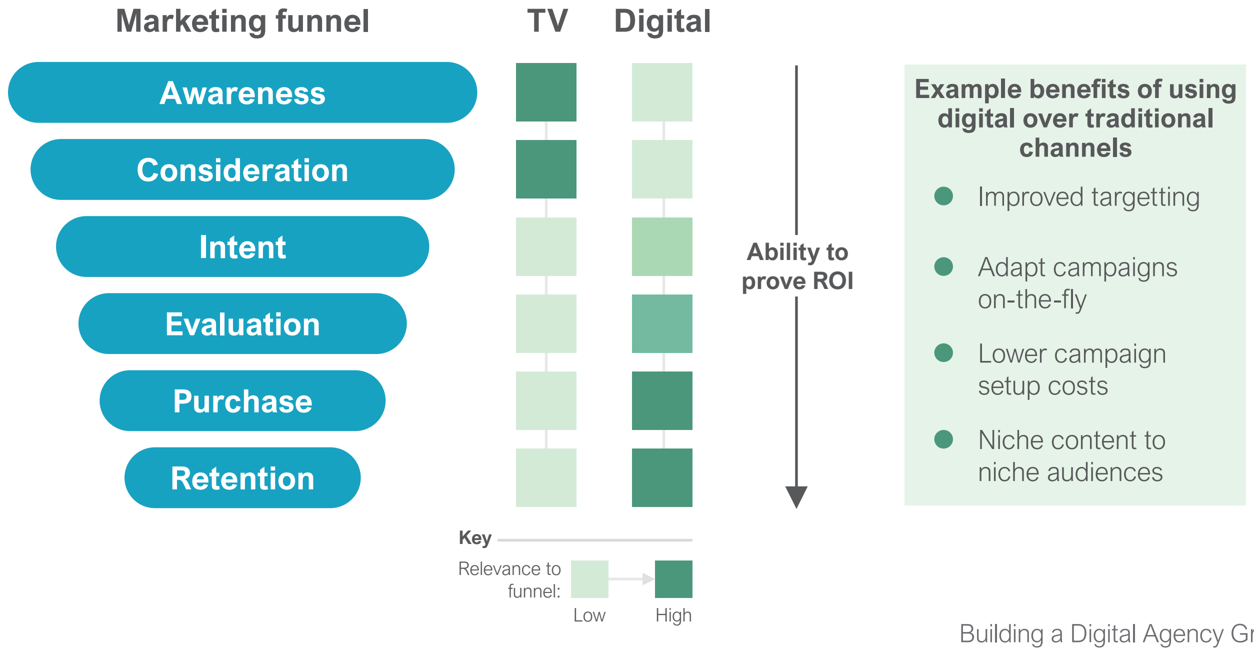
Historically, the ‘big six’ holding companies (holdcos) owned and operated multiple global agencies. These usually operated separate P&Ls and would frequently compete with other agencies in the group. This model allowed the holdcos to serve global, often competing, clients and build market share by delivering reach based on strong creative offerings and purchasing power in print and broadcast media buying.

However, the shift to digital has changed market dynamics dramatically. Brands are increasingly prioritising direct relationships with customers and the focus is as much on data and personalisation as it is on creativity and reach. More importantly, it has allowed an exciting new breed of independent agency group to emerge and tap into the ~70% of UK advertising spend that is being channelled into digital.

While the holdcos are trying to transition both organically and through acquisition, they are constrained by their rigid operating models and are struggling to grow. While Publicis grew 10% organically in 2021, this was buoyed by 14% growth in digital transformation and 13% in data. Its heritage creative and media brands only grew in the mid-single digits. By comparison, the new independent digital-first groups are achieving over 20% organic growth.

The focus of the new digital groups is on building data and insight and leveraging this across the marketing funnel to deliver value to clients. They are also developing automated tools and processes that allow services to be delivered faster and more cost-effectively. The support provided by these agencies can range from top-of-the-funnel work, using data to inform high-level marketing strategy, to optimising customer conversion with better digital design, to real-time analysis of campaign data to inform performance marketing strategies and tactics. The groups often have complimentary service offerings that encompass both the digital and commercial needs of a customer, addressing both the CMO and CTO agendas.

### Digital marketing services across the marketing funnel



# PRIORITISING M&A

For these digital groups to rival incumbent holdcos they need to deliver both the breadth (e.g. an international footprint) and depth (e.g. an expanded service offering) required to serve larger clients and increase share of wallet. M&A can turbocharge this.

With many opportunities out there, a clear strategy is required to ensure acquisitions are both optimal and complimentary. Priorities typically fall into one of three categories:

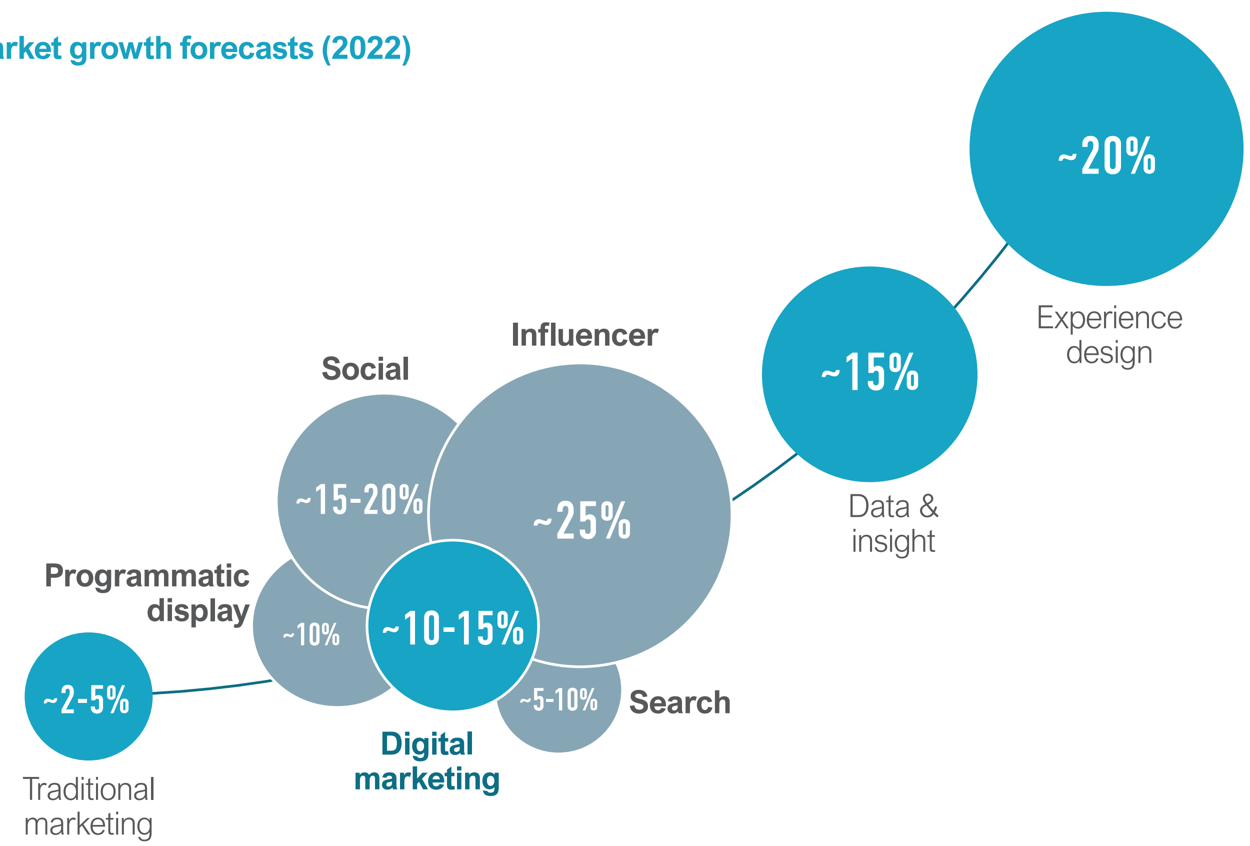
**Access to higher growth, resilient market segments**
Certain markets, such as martech, data and insight, web and app user experience design are growing rapidly (>20% CAGR). Combining agencies that offer services in these segments will enable a group to deliver a strong blended growth rate.

**Enhanced geographic footprint**
Acquisition to access new geographies can be an attractive driver of growth. The UK has a strong heritage in seeding entrepreneurial digital marketing agencies, but the UK only accounts for 6% of global advertising spend.

**Adding new capabilities**
Acquiring new technologies and capabilities is more efficient than developing them organically. Technological investments in areas that take cost out of an agency, such as dynamic creative, are particularly favourable. Group capabilities should be managed centrally – not doing so will increase the risk of duplication, lead to competition (both internally and externally) and muddy the go-to-market strategy.

Building a larger digital agency platform can offer an opportunity for valuation arbitrage. Individual agencies can be acquired at high-single digit multiples, while integrated groups are valued in the low-double digits (typically 10 to 15x EBITDA). This arbitrage reflects the synergies that a group can deliver.

**Market growth forecasts (2022)**




# OPTIMISING VALUE

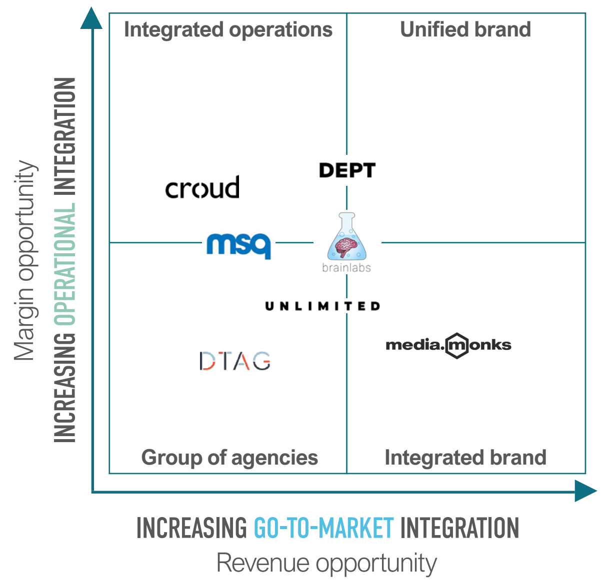
When combining agencies, there are several considerations investors and businesses need to be aware of when defining and implementing the future business model.

**Defining the future model**
Agency groups can combine in a number of ways.

The margin opportunity
This is typically the first step. Centralising and integrating back-end functions, such as HR and finance, reduces operating costs and can drive margin uplift. In addition, with scale, the marginal cost of investing in value-add infrastructure (e.g. data, management information and IP) improves.

The revenue opportunity
Increasingly, groups are also looking to integrate go-to-market approaches. Sales functions (such as account management and business development) can be centralised to reduce customer acquisition costs, facilitate seamless and proactive cross-selling and create a more unified approach to large clients.

**Digital groups current position on integration journey**




**Implementing & embedding the future model**
Initially, post-acquisition, groups typically operate as a 'group of agencies', each with its own brand and client relationships. Ultimately, most groups work towards a unified model to optimise the group benefits.

Creating a unified brand is complex; it is about more than just sharing a name. Customer relationships need to be managed centrally to optimise cross-selling. However, delivering cross-sell may not be straight forward. Decision-makers may vary by product and service while some customers will procure locally or regionally and others globally.

The transition from discrete agencies with discrete brands and cultures to a unified group carries inherent risk and needs to be managed carefully but decisively. The leadership skills required to operate a group are different to those required of an individual agency. New management capabilities and roles may be needed, with knock-on impacts on existing team hierarchies. Incentives and equity will need to be focused on driving group success, in addition to that of individual agencies.

Operating models need to be fit for the group's growth strategy and must be reinforced by KPIs that encourage the desired behaviour and outcomes. Investment may be required to set-up or enhance centralised functions. While ultimately this should increase efficiency and effectiveness for both the group and individual agencies, such investment may cause friction in the short term with client facing teams.

# ACHIEVING SUCCESS

We believe there are seven key priority areas for achieving an optimal digital group strategy.

**1 Have a clear vision and go-to-market strategy for the group brand**
Some level of brand integration is likely to be required to optimise an agency group. Aligning agencies under an overarching brand or by divisions or capabilities is a common strategy. Any brand strategy needs to be complimented by the group's go-to-market approach. Competition between agencies and discrete agency-specific P&Ls should be discouraged.

**2 Spend time defining a target operating model**
The operating model (covering governance, culture, systems, processes, metrics, incentives and people) will need to evolve. It must be well defined, be supported by the appropriate KPIs and, crucially, be "bought into", if a group is going to realise the synergies underlying any M&A strategy.

**3 Put data at the heart of decision making**
Data-led decision making is at the heart of most successful groups. This is not only about the correct operational KPIs, but also about building and using data to determine optimal client outcomes and to demonstrate and improve client ROI. Customers increasingly expect agencies to be open about reporting and transparent about margins with no hidden rebates, as historically was the case with holdcos.

**4 Acquire complimentary capabilities, rather than clients**
An acquisition can be a cost-effective way to gain new capabilities that compliment the wider group. This should typically be prioritised over acquiring a company for its customers.

**5 Target resilient and high-growth market segments**
It is sensible to prioritise high-growth market segments. This will not only accelerate growth in the short to mid-term but will protect the group's position in the longer term.

**6 Improve revenue quality and margin opportunity**
Acquiring contracted and/or recurring revenue can improve revenue visibility and de-risk a group, particularly if some individual agencies are exposed to project-based models. In addition, focusing on agencies that have outcome- or deliverable-based models (not 'cost-plus' as with creative agencies) can improve quality of earnings and allow for margin optimisation through investment in technology or other efficiencies.

**7 Ensure "buy-in" across the group**
As with any people business, alignment of interests (and ultimately incentives) is key. Incentives need to focus on long-term value optimisation to reduce the risks of churn post earn-out period. In marketing services, cultural buy-in is also important. Acquisitions need to be complimented by a clear plan for how people across the entity (not just senior management) will be integrated and aligned with the wider group's strategy.

# OUR EXPERIENCE

We have extensive experience advising both management teams and investors across the marketing services value chain.

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## GET IN TOUCH

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