

Managing the Downside of Newspaper Advertising Contracts

By Ed Strapagiel

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The Importance of Contracts

Newspapers place great significance on establishing contracts with advertisers. Annual plans often require sales managers to sign up some value of contracted business for the coming year. Rate cards detail lower rates for more volume and specify that “a signed contract is required”. Frequency packages, rateholder plans, and other such programs are also types of contracts.

Since the newspaper’s largest accounts are typically on contract, they can represent as much as 80% of total annual ad revenue. Properly negotiating and managing contracts is therefore critical to a newspaper’s financial success.

The Perils and Pitfalls

The principle behind the contract is that the advertiser receives lower rates, higher discounts, or other concessions and inducements, in return for committing to some amount of future business. This is essentially a volume agreement, a business-to-business sales practice used in many industries and commodities, including the paper that newspapers buy to print their product on. It all seems quite straightforward. Nevertheless, there are many issues to be aware of with advertising contracts.

It’s a Best Guess

The contract is based on a forecast of the advertiser’s future business with the newspaper. But advertising needs are not steady and predictable like manufacturing or office leasing, and can vary according to market trends, economic conditions, competitive developments, emerging business plans, the weather, and a host of other factors. It is not easy to forecast advertising and promotion needs accurately, and so all contracts start out by being built on a shaky foundation.

An Awkward Process

Neither newspapers nor advertisers particularly like the contract setting and negotiating process:

- Advertisers feel that newspapers are forcing them into a commitment on something they can’t accurately predict or control;
- Newspapers feel that advertisers use the occasion to extract additional discounts and concessions from them.

As it turns out, both parties are correct. But that’s cold comfort, and it does not exactly set the mood as being “in the spirit of partners moving forward together”.

Lots of Administration, Not Always Well Done

Newspapers can have thousands and even tens of thousands of accounts. Negotiating, managing, tracking, and checking compliance of advertising contracts on even a portion of these can generate significant administrative overhead. The use of frequency plans, rateholder packages, and similar programs only adds to the load.

Some newspapers use “silo” sales and pricing practices, requiring separate contracts for display, classified, preprints, online, and so on. This means even more administration.

Perhaps because of the number of contracts involved, newspapers often do a poor job of basic administration. Sales staff may get little in the way of training or guidelines on how to properly execute a contract. Write-in changes are not always initialed, and some contracts even go through without actually being signed. General terms and conditions (buried at the back of most newspaper rate cards) may not be referenced, in which case they don't legally apply. Some newspaper can't even locate all their original advertising contracts.

In the course of our work, Kubas Consultants talks to sales staff at all types of newspapers, and one of the most common complaints we hear is “too much paperwork”.

Defeating the Rate Card

Even though rate cards already set out contract rates, most advertisers – and certainly just about all accounts of any size or smarts – know that they can extract an even better deal. In other words, the contract is often not about *applying* the rate card, but about *under-cutting* it.

Furthermore, advertisers feel they are under pressure to drive a better bargain because they “know” their competitors are getting a deal too. The newspaper for its part is quite willing to deal and discount in return for the security of the contract commitment.

This has become the “new normal” in the business. The phrase “off rate card” used to describe the exception, but now it is more often the rule.

The Rate Trap

The current state of affairs is that it's worthwhile for an advertiser to negotiate aggressively. The result for the newspaper is less revenue. Advertisers have come to expect that newspapers will deal and discount. So rather than increase their budget, advertisers simply negotiate harder. The result for the newspaper is even less revenue, and so on.

To get out of this trap, newspapers can raise their published rates to make it look like the advertiser is getting a better deal, but this just creates other problems. The disconnect between published (rate card) and negotiated actual rates is now wider than ever in the newspaper industry, and the gap is continuing to grow.

The Cost of Custom

The advertising contract is a one-to-one deal, so it can contain almost anything – a free color ad every other week except on Sundays and holidays, 50% off pick-up ads in a zone edition with a minimum of two insertions, an additional discount to run in the sports section, extended days for the online directory listing with one copy change, and so on. This flexibility is often held as a strength, namely that “we can put together a custom deal for just that one advertiser”.

But customization comes at a cost, not only for the concessions and inducements directly, but also for the application, administration, and tracking of unique terms and conditions. This can make checking compliance at the end of the year a nightmare, multiplied by the number of contracts.

Another consequence of customization is that it's usually impossible to codify and capture contract information in a database. Ideally, newspapers would want to analyze and control their ad contracts, because they are the filter through which such a large portion of revenue flows.

Due Diligence?

In other industries that use volume pricing, the draft agreement is first routed to the Finance department. A financial analyst will go through it with a fine tooth comb, and calculate exactly how many dollars the deal is going to cost, what the real margin is, how far off it is from list price, risk exposure of the performance terms, how it compares to contracts with other customers, and so on. Then the CFO will have a look and make a recommendation.

This sort of objective analytical scrutiny however is not done often enough in the newspaper business. Instead, contract recommendations usually rely on the Sales departments' view, which is often some variation of "we know this account well and this is best we're going to do", or "they're talking about decreasing their budget so we have to go along". Not only is that hardly analytical, but it's also a bit like letting the fox guard the henhouse.

Separating the Wheat From the Chaff – But Ending Up With the Chaff

As a result of the above, there is often extreme variability in negotiated rates among accounts. It's quite common that one advertiser might be paying half the effective rate than another of the same type and who spends just as much over the course of a year. The good account, the advertiser paying closer to full value, ends up effectively subsidizing the low-rate account.

The danger is that the advertiser paying the higher rate, and getting a lower ROI (return on investment) on their newspaper ad spend, is more likely to move their money elsewhere. Then the newspaper will be stuck with the other advertiser, the low-ball account, whose generous deal is enshrined in a contract.

Short Rates and Rebates: Newspapers Stand to Lose

Short rates and rebates have to be enforced for contracts to have any effect, but these can be a major sore point between newspapers and their customers. If the newspaper doesn't short rate however, advertisers will soon learn to overstate their commitment to get a better rate than they deserve without penalty.

Rebates are almost always worth a hundred cents on the dollar, because advertisers will demand and get every penny. But advertisers may pay only a portion of a short rate by negotiating a settlement ("business has been bad", "you need to give us a break"), or by threatening to take the money out of their current budget or move it to the competition. With complicated contracts, just calculating the short rate can be difficult, and the newspaper usually has to give the advertiser the benefit of the doubt if something is unclear.

Overall, the newspaper is in a poor net position when it comes to short rates (maybe less than full value) versus rebates (almost always full value), and the best it can hope to achieve is breakeven. Any exceptions can only mean one thing: newspapers lose.

The Games Advertisers Play

Due to the necessity of short rates and rebates, strategic game playing often enters the picture. Some advertisers over-commit hoping that they won't get hit with the full value of a short rate. They know that some newspapers are reluctant to antagonize their customers in this way, especially over more modest amounts. Other advertisers under-commit as a matter of being conservative, in case they have a bad sales year for example, and look at the rebate as a nice little potential future windfall or "money in the bank". It's difficult to know however which advertisers are doing what at any time.

What this means is that, despite having a contract, the newspaper can never really be sure how much revenue it will actually produce.

By the way, the considerations here are anything but trivial. The 2005 Nobel Prize in economics was awarded to two distinguished professors "for having enhanced our understanding of conflict and cooperation through game-theory analysis".

Revenue Security – Are You Sure?

Newspapers see contracts as an assurance of revenue for the coming year. That sounds good in theory, but how true is it in practice?

In 2005, auto dealers were hit with a margin squeeze, and most of them cut back their advertising spending. Many didn't make their contracts, and U.S. dailies' automotive classified revenues were down 9% for the year, according to Newspaper Association of America figures. Some auto dealers still increased their spending with the newspaper, but others had double digit declines. In this case at least, having a contract didn't help the newspaper. A similar situation occurred with department stores a few years earlier.

Overall, it is still the business conditions that advertisers face over the course of the year that determine their ad spend, and hence the newspaper's revenue. Advertisers don't see their ad contract with the newspaper as sacrosanct in comparison to their profitably objectives.

Contract Basis Matters

Many advertising contracts are based on the annual volume of lines or inches an advertiser agrees to buy at a certain rate. It's simple to multiply the volume by the rate and declare the result to be the dollar value of the contract.

The advertiser however may run some ads in zone editions, under a frequency program, in a special supplement, or in some other lower rate product. Some newspaper rate cards even state that these lines or inches count fully toward contract compliance. In this case, the revenue generated will always be less than the initial simple multiplication of contract volume times rate.

Spending based contracts at least offer protection from this "discount fallout" effect. If an advertiser does enjoy a discount on some ads, the savings would still have to be spent elsewhere to achieve their total dollar commitment.

"Locking In" Ad Dollars

Another rationale for contracts is locking in the advertiser and taking money off the table in case a new competitor comes to town. The average daily newspaper however only gets about a 1/4 to 1/3 share of local advertising spending, so there's still plenty of money for a new competitor to target. Also, one has to consider how often this actually happens, and that at best a contract only provides a delaying tactic, not a permanent solution. The strategy can even backfire – when a new competitor comes along, the time to start fighting back is "yesterday", and not wait behind or rely on the supposed security of a contract.

The locking in aspect may even be a double-edged sword, namely, also locking *out* additional spending. This occurs when the advertiser comes into some extra money or needs to boost promotion for any reason. An advertiser might be reluctant to try to revise their contract and endure a renegotiation just to spend more money with the newspaper. The locking in feature, in other words, can work just as easily in reverse.

How Sharp Are the Sales Reps?

An advertising contract can be put to bed in as little as one day. So what does the sales rep do for the other 364 days of the year? Is his or her role on the account reduced to merely "order taker" or "booking clerk"? With a contract in place, what is the sales rep's motivation to up-sell?

Certainly, sales reps have other duties, including promoting new products, selling special features, sourcing new business, and so on. Nevertheless, much of their time on contract accounts may go into servicing, not selling. It's even possible for a senior rep to have a stable of established accounts which practically guarantee a steady and comfortable commission stream (sometimes to the dismay of other reps who have to work harder for their pay).

No one knows how much of a factor this is in newspaper ad sales. But it may show up when that new competitor does roll out, with a hungrier sales force, sometimes on 100% commission.

Plan B, The Open Rate

In theory, if the newspaper and the advertiser can't agree on contract terms, the fallback is that the open rate applies. Open rates however are often artificially and exorbitantly high, and even the newspaper is loath to pull out this "ultimate weapon" for fear of driving away the advertiser's business altogether (which is likely an accurate assessment of the situation).

This presents a problem with contracts, or more precisely with what the alternative is. Plan B, the open rate, is simply not a very good option for either party, because it's too drastic.

Plan C, Verbal Commitments

What more often happens is Plan C, a verbal contract, or some other arrangement, even a "grudging understanding" if necessary. Somehow, the newspaper and the advertiser manage to find a way to do business. Plan C however is informal, undocumented, ad hoc, subject to interpretation, and often based on sheer trust, all of which can present problems.

Plan C is not limited to cases where the parties can't agree on contract terms. Every newspaper has advertisers – even long established accounts who always pay on time – who simply refuse to sign a contract. So there is a "handshake agreement", namely, Plan C. Newspapers may also offer rateholder or frequency plans, requiring an advertiser to run some minimum volume on a regular weekly or monthly schedule. These constitute a type of contract, but written agreements may not be signed to avoid the administrative burden, so it's Plan C again.

Most of the time, things still run smoothly. But the downside of Plan C can really become apparent when the advertiser has a slow year or the sales rep leaves.

In any event, Plan C's days may be numbered, due to the following.

Sarbanes-Oxley, C-198, and the Advertising Contract

All newspapers should be prepared to tighten up and formalize their annual advertising contracts and related procedures due to the Sarbanes-Oxley Act. It has also set a precedent for initiatives in other countries, including Bill C-198 in Canada. The legislation requires publicly traded corporations to apply a higher standard of reporting, control and transparency than in the past. Executive managers, like the President and the CFO, can even be held responsible for the accuracy of financial information.

Sarbanes-Oxley and C-198 are primarily intended to protect shareholders and investors. Any guidance a newspaper company may give regarding future earnings however, may in part depend on the quality of contracts held with advertisers.

Private companies are not off the hook. It is likely that bankers, equity partners, suppliers, publicly traded advertisers, and others that a newspaper deals with, will also require the same level of documentation and disclosure to protect their interests under the legislation.

Several potential implications arise for newspapers:

- If your advertising contract procedures are not of a high standard currently, it could be a good time to start cleaning up your act;
- Verbal contracts and other deals made on a smile and a handshake may not be compliant;
- If advertising contracts have to be disclosed for any reason, there could significant trouble when some advertisers find out that others, including their direct competitors, are getting a better deal from the newspaper than they are;
- There's potential opportunity here too – regulatory requirement can be a lever for getting advertisers to actually sign a proper contract.

No one knows yet just how deeply the legislation will reach into a company's day-to-day affairs.

Recommendations

The prospect of dealing with the downside of advertising contracts is unlikely to inspire eager enthusiasm. But it is necessary for “taking care of business”.

- Have your legal counsel draw up a list of requirements and guidelines for advertising contracts to ensure basic good practice, particularly in the post-Sarbanes-Oxley world. Make sure these are “in plain English” and not legalese.
- Develop a standard form for contracts to be used across all departments. It’s not unusual that Retail, National, Auto, Real Estate, etc., already have their own standard form, but not all of them can be the best.
- When your new rules, guidelines and forms come out, monitor how well they are actually being applied, and – there’s no better way of putting this – keep beating Sales over the head until they get it right.
- Make sure the newspaper’s team arrives at contract negotiation sessions with specific sales revenue objectives in mind and a detailed history of that account’s past activity.
- Simplify contract terms as much as possible and minimize unique conditions. Ideally, use a universal spending based discount approach and reduce the whole deal to just one number, the percentage the advertiser receives off open rates on anything they buy.
- Cover all possible products the advertiser can buy from the newspaper in the one contract, so it won’t have to be revisited if such requirements come up later. This is another good reason for a universal spending based discount approach.
- Include incentives for over-achievement, so that this is already in place in case the advertiser wants or needs to spend more down the road.
- Ditto for contract under-achievement – let the advertiser specifically know their exposure to a short rate.
- If a contract document becomes cluttered with hand-written notations and clauses, take it back to the shop and retype it. The people who put those in there may not be around later to tell you what they meant.
- For every draft agreement, calculate one number: the percentage discount that the deal is from list price, as would be obtained from a strict application of the published rate card. Have some idea in mind as to how far the newspaper is willing to go off rate card.
- Have Finance closely analyze the dollars and sense of contracts for the newspaper’s largest advertisers before final approval.
- Require all contracts to be approved by the board or the publisher. This gives the newspaper one last chance to scrutinize the terms before final contract acceptance, and sends an internal message that executive management is watching over the process.
- Ensure that the standard terms and general conditions that apply to all advertising with the newspaper are specifically referenced. Your lawyer may also advise that a copy of these conditions should be appended to the contract and initialed.
- Assign specific responsibility to a department like Finance, Legal or Administration to file and maintain contract originals. Sales and others should only work with photocopies.
- Hunt down “grandfathered” accounts and other advertisers getting “sweetheart” deals, and develop specific strategies to move each one up. It might take five years, so start now.

Is There Another Way?

The annual advertising contract replaced the earned rate approach a few decades ago. It was the “another way” of the times. The wide use of contracts today certainly demonstrates their value and success, which could not have been achieved without benefits and advantages to both parties involved, newspapers and advertisers.

The times have changed. Is there a next “another way”, an alternative to the annual advertising contract, a “Plan D” as it were? Well, there may be, and it’s called “Dynamic Discount”. It will be the subject of a future article.

Ed Strapagiel (eds@kubas.com) is Executive Vice President of Kubas Consultants, a firm specializing in newspaper pricing structures, revenue development, and publishing strategy. For more information, visit www.kubas.com.

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Epilogue 1: Try This Simple Test

How seriously does your organization treat contracts, the cornerstone of your advertising revenue? If you are the Publisher, General Manager, VP, or in a similar position, try this at your newspaper.

- Ask Sales if they have a list of all advertisers that are currently on contract, how much each is worth in dollars, and how much revenue each has generated so far, in case you need it for a meeting first thing tomorrow morning. First just see if such a list exists; if not, ask when you can have it.
- Go through yesterday’s paper, pick a cross-section of 25 or so regular advertisers of various types, and ask Sales to send up a copy of the contracts for your meeting. Calculate the percentage you get.
- To make the above a little more interesting, ask to see the newspaper’s *original* of those contracts, so they won’t have to spend time photocopying.
- Take whatever contracts arrive over to Legal or perhaps the CFO, and get a quick opinion on how well they would stand up in court. Calculate the percentage that are legally enforceable out of the number of contracts initially requested, and see how comfortable you are with that.

Epilogue 2: The Full Rate That Wasn’t

We were discussing rate cards and maintaining pricing integrity at a bull session with our newspaper client’s sales team. Everyone agreed that getting full rate was an important goal. At that point, a sales rep stood up and explained that she had just signed an advertiser to a contract to run full page ads at the full rate given in the published rate card. This was quite a coup for the newspaper, and everyone clapped and cheered!

Just 15 minutes later, the discussion turned to contract discounts and incentives, and the same rep got up and explained that the way she got the above advertiser on that contract was by giving them every fourth ad free. This time, there was dead silence. Of course, that is a fat 25% discount, and not at all full rate.

The moral of the story is that sales people can tell a good tale, and may even convince themselves of it, but they aren’t necessarily financial analysts. On the other hand, you wouldn’t want to send out accountants to do your sales for you either.