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Accountancy and the Advertising Agency

BY R. N. PRICE

Keeping pace with the development and growth of business is surely an essential task of accountancy. Yet accountants do not always fulfil that obligation. Some accountants are startled occasionally to discover, for the first time, business activities which are so closely related to and dependent upon accounting practices as to be, of themselves, almost in the nature of accounting bureaus. Such activities have often grown to tremendous proportions before it was realized that the accounting problem was one of the most important factors in the operation of those businesses.

The varied home-made accounting methods which have accompanied the growth of such activities, and the success of those organizations in spite of the haphazard accounting methods employed, only serve to emphasize the importance of the businesses in question as fields for intensive study and cultivation by the accounting profession.

This brings to mind the oft-repeated question, "Should accountants interest themselves in the technical nature of any particular type of business?" In the opinion of this writer the answer to that question is an unequivocal affirmative.

The interest of the accountant in the technical nature and the ramifications of every department of all types of business on which he can obtain accurate information is in direct proportion to his energy and willingness to serve. Some accountants are inclined to limit their vision to percentages, profit-and-loss statements and the usual accounting functions, believing that such problems as those of advertising, sales, merchandising, etc., are of no interest to them. Similarly they are sometimes inclined to overlook specialized lines of business with which they happen to have had no direct contact. But interest in what is happening on the other side of the fence is important to the accountant. It is as important as his interest in mechanical short cuts, automatic calculating machines, etc., knowledge of which enables him to recommend economical methods to his clients.

The need for such interest is indicated by the many questions the accountant is constantly called upon to answer, especially by smaller clients, which really have no direct bearing on accountancy matters.

While the accountant should refuse to give advice on many of these questions (see "Accountants' limitations," THE JOURNAL OF ACCOUNTANCY, October, 1927), he should nevertheless gain as much knowledge as possible on all such subjects.

Speaking at Springfield, before the Sales Managers' Club of Central Massachusetts recently, F. E. Barth, vice-president, Graton & Knight Co., chose the subject, "Why sales managers remain sales managers." He said, in part:

"The sales manager is so busy directing his salesmen, worrying about his customers, thinking up how to change prospects into customers and worrying generally about competition that he feels he has very little time in which to become well acquainted with details in his business other than those involving sales. In this age of terrific competition and craving for volume, we nearly forget that all the sales in the world are useless unless they are made on the basis of a fair profit. The sales manager will immediately become a bigger and broader-visioned man when he studies the balance-sheets and profit-and-loss statements of his company and, later, studies the costs that make up the profit-and-loss statement. Few men on the sales end know anything about bookkeeping and accounting. They feel that balance-sheets and profit-and-loss statements are highly technical and, therefore, they congratulate themselves that they do not have to bother with them. . . ."

Perhaps there is a reverse moral to Mr. Barth's remarks which accountants might advantageously analyze. And his statement, ". . . all the sales in the world are useless unless they are made on the basis of a fair profit," might well be remembered when accountants see opportunities to recommend to clients time-saving methods and appliances.

A case in point is that of the advertising agency. Here is an activity which is of unquestionable importance in the business structure. It is an established "industry" of a size sufficient to arrest the attention and awaken the interest of accountants as a potential field for service.

Up to the present time, however, the accountancy profession has shown little interest in this business, the very foundation of which rests upon a structure of accounting procedure.

Briefly and roughly, advertising-agency service consists of placing before prospective buyers, in the most economical and effective way possible, the advantages of a product or service. This service of the agency embraces many ramifications. Formulation and operation of an advertising campaign by an advertising agency usually necessitate most of the following activities: consumer investigations; trade investigations; analysis of markets; analysis of competition; study of product; study of production

facilities; analysis of potential use; analysis of potential markets; analysis of the part advertising can play in economical distribution; determining the percentage of the selling job represented by such aid in distribution, and fixing the advertising appropriation accordingly; preparation of copy for magazines, newspapers, trade journals, car cards, outdoor display boards, folders, house organs, news articles, etc.; preparation of sketches, drawings, paintings; mechanical details of engraving and printing; study and selection of proper media for national or localized advertising, considering respective circulations, class of readers, localities reached, etc; preparation of estimates based on space contract rates, etc.

This detail is distributed among the respective agency departments—planning, media, estimate, copy, publicity, art, production—and each step, including billing, is recorded and checked by the agency's accounting department.

The accounting department of an advertising agency is, among other things, a calculating division, for the agency's clients and the agency itself are always intensely interested in percentages. The client, of course, is interested in knowing the exact percentage of advertising expenditures to sales. In the case of "inquiry advertising," he must know the cost per inquiry and the percentage of inquiry sales to inquiries received. He wants to know the number of calls required by his sales force to close an order, and the effect of his advertising on this figure.

A new and highly successful method of control accounting has been developed for advertising agencies. This method consists of assigning definite percentage limitations on the costs of agency operation. The gross revenue of an advertising agency averages approximately 15 per cent. of billing or sales. In other words, the gross income which the advertising agency receives in the way of space commissions, service charges, etc., represents an average of 15 per cent. of the money expended for advertising (through the agency) by its clients. This 15 per cent. must cover the cost of service, overhead and profit. Through an exhaustive study of past experiences and costs, the operation of the agency, under the new method of accounting, has been split into three divisions:

1. Salaries of producers and assistants.
2. Overhead (which includes salaries of non-producing employees).
3. Profit.

By assigning definite percentage limitations to these divisions, in so far as their relation to revenue is concerned, a control is set up which reveals, at all times, any weak spot in the functioning of the organization. This is true for a particular agency within a group, and it is equally true for a particular individual within an agency. Such organization creates an additional amount of detail work, but the results are worth the effort. Incidentally, the problem of added detail has been solved to a great extent by the use of electrically operated, automatic calculating machines of the type which provides direct automatic subtraction and division, as well as multiplication and addition.

It is rather gratifying, to one who can remember the generous burning of midnight oil which was the accepted lot of the advertising-agency accounting department when the new method was first installed, to stroll into those departments now and see a clerk obtain the percentage of \$10,481.00 to \$39,875.65 by simply pressing a button, so to speak.

As a result of the new accounting plan, coupled with the speed of these machines, detailed control revenue cost and expense reports, and individual and departmental reports, as well as asset and liability statements, for five advertising agencies in the Hamman group are completed on the third of each month covering the entire preceding month's business.

The development of the electrically operated automatic calculating machine, by the way, is something with which every accountant can profitably familiarize himself. Of course, we have had calculating machines for a long time. But the modern, crankless, fully automatic machines are devices at which we may marvel without embarrassment. The small amount of desk space required, the electrical, automatic push-button operation, the unfailing accuracy and speed of these almost human products of mechanical genius are benefits for which the present-day accountant may well be thankful. For they simplify his problems as well as those of his clients. The great mass of detail in advertising-agency work has resulted in widespread use of these machines by progressive agencies.

There have been many interesting developments and improvements in office machinery during the past decade, but none means so much to the accountant as the perfection of the modern, electrically operated, automatic calculating machine and the modern bookkeeping machine.

Agency billing usually consists of service charges, publication or other space charges and production charges. Service charges are based on the amount of service rendered in the way of creative work, preparation and placing of advertisements, publicity, direct-mail material, etc., while production charges come from the art department and from work usually done by outside organizations such as engravers, typographers, electrotypers, etc.

The breakdown of statistical information resulting from preliminary research and analytical work in which all advertising agencies are constantly engaged is, in itself, an accounting problem, as is the work of the agency's estimate department, which must determine estimated costs on proposed campaigns. Space-purchase discounts and commissions offer additional problems of accounting peculiar to the advertising agency.

The advertising agency offers a definite field for the services of the accounting profession. Its every operation requires accounting of an exact and more or less complicated nature.

It is not a business which, like Topsy, "just grewed." On the contrary it has been with us a long time, making steady and tremendous strides. It has certainly reached a place of importance in American business life which makes it worthy of careful attention on the part of accountants.