TABLE OF CONTENTS

I. NATURE OF THE INDUSTRY

Primary Functions of Advertising Agency

The primary functions of advertising agencies are planning and creating advertising campaigns for clients and placing advertisements in various media. Planning consists of researching the market for a given product or service, assessing alternative methods of distribution and choosing the most effective way to reach the market. The agency then creates the advertising campaign and contracts for time and space with selected media. The ultimate objectives of advertising agencies include helping advertisers attain sales objectives, market share and long-term profitability (Outlook).

Size of the Advertising Industry

At present, there are approximately 9,600 advertising agencies in the United States, of which most are small businesses with less than six people. Nearly one-third (3,200) of them are one-person operations and still another third have fewer than five employees. The remaining third is a number of large organizations, some of which employ over 2,000 people.

Advertising industry growth has been, and is expected to continue, out pacing the gross national product (GNP). Future expenditures for the advertising industry are expected to be enhanced by the entry of new companies in to the marketplace and by the introduction of new products by existing firms (Outlook). Also because U.S. corporate profits continue to be strong, the number of product introductions has increased, and because deregulation of television has opened up airwaves to commercial time in several European countries, advertising spending is projected to exceed 1987 levels by 8-9 percent (Value Line, pp. 180-182).

A unique factor of the advertising industry is that all agencies are independently owned and operated; there are no franchises.

Economic Performance of the Advertising Industry

and Future Outlook

The historical performance of the industry over the past 16 years has shown great increases in advertising expenditures, agency billings, agency revenue and employment (Table 1). Both expenditures and billings have tripled, revenue has increased five times over and employment has nearly doubled. Using the historical performance of the industry, an assumption can be made stating that advertising expenditures, agency billings, agency revenue and number of employees will continue to increase. Furthermore, industry sales were predicted to peak for the 1988-89 year at $25.2 billion.

Current trends in the industry are important to future expectations. As of this last decade, a smorgasbord of super agencies has emerged, offering a menu of services ranging from the traditional ad creation and placement of advertisements, to market research and total campaign development and execution. All of these activities are being pursued on a national and global basis. In fact, many advertising agencies are on their way to becoming primarily "marketing agencies" (Outlook). Additionally, international (overseas) advertising has been increasing over the years and is expected to continue doing so. For the 1988 fiscal year, spending was expected to increase by 10.3-12 percent, bringing total sales to $223.4 billion.

Trends in Media Prices

Prices for buying advertising exposure in newspaper, magazines, network TV, spot TV, network radio, outdoor advertising and direct mail fliers have all increased over the past eight years. Newspapers make the largest jump, up by 75 percent. Sport TV is close behind, up 60 percent (Industry Surveys).

Increased media rates and rising demand for advertising time and space have driven this trend, which has even held true during sluggish economic growth. Several factors have fueled the demand for time and space: the entry of new companies into the marketplace, the introduction of new products and services, greater affluence, the growing number of women in the labor force and growth in numbers of people in their prime buying years (Industry Surveys).

Television ad expenditures are expected to rise 11 percent, to $26.8 billion. Radio ad expenditures are expected to rise 13 percent, to a total of 38.4 billion. Additionally, magazine ad expenditures should grow 6.5 percent, to $9 billion, and outdoor advertising should rise 5 percent to $1.4 billion.

Regulators of Advertising

The strict advertising controls are imposed by federal and state laws. The Federal Trade Commission (FTC) is the major regulator of national advertising, and its efforts are largely directed toward protecting consumers by policing the media. Federal regulation first developed with the passing of the Sherman Antitrust Act in 1890 and has continued to grow from other acts (Bovee, Appendix A).

Many cities and countries also enforce laws regulating local advertising practices through consumer protection agencies. Moreover, self-regulation within the industry has increased. Today regulation is widely conducted by industry trade associations, professional organizations, advertising agencies, media trade organizations, business organizations and the National Advertising Review Board. Ad agencies can best regulate themselves by being responsible. They can research and verify all product claims and comparative product data before using them in advertising.

Furthermore, the agency and the advertiser are both separately and equally responsible for advertising presented to the consumer. Each party is considered knowledgeable in its own areas of expertise. The agency on its part, is responsible for truthful photography of the product, documentation of demonstrations, and the substantiation of consumer testimonials (Gaedeke).

Many of the larger agencies now have legal departments. Other agencies check advertising with outside legal counsel. When reviewing advertising themselves, advertising managers must remember to perform two functions: (1) judge what is effective, and (2) judge what is truthful and socially responsible.

The American Association of Advertising Agencies

A key source of information for an advertising agency is the American Association of Advertising Agencies (AAAA). This organization is a membership, industry association that fosters standards of conduct and competency. A basic qualification of membership in the AAAA is that the agency must be an independent business organization; it cannot be owned by any advertising medium or supplier. The qualification is based on the premise that only an independent agency can provide the unbiased and objective counsel that the advertiser needs. AAAA member agencies handle approximately 70-80 percent of all the agency-placed advertising in the United States. More information on the AAAA, other industry associations, and related professional organizations can be found in the Standard Directory of Advertising Agencies available at most local libraries.

II. LIFE CYCLE OF SMALL ADVERTISING AGENCY

Initial Considerations

A good starting point when considering setting up one's own agency is to participate in a seminar on the fundamentals of owning and operating a small business sponsored by a variety of public and private organizations, including the U.S. Small Business Administration (SBA), local community colleges and universities and the American Management Association. Topics such as

TABLE 1 - Twelve-Year Performance, U.S. Advertising Industry
(SIC CODE 731)
(000)

Total Advertising
Expenditures
Ad Agency
Billings1
Ad Agency
Revenue1
Employment

1972
23210
10584
1690
121.5

1973
24980
10960
1750
122.7

1974
26620
11710
1870
123.8

1975
27900
12280
1960
122.2

1976
33300
14650
2340
124.9

1977
37440
16740
2650
131.5

1978
43330
19060
3050
139.9

1979

48780
20560
3310
145.9

1980
53550
23030
3680
153.0

1981
60430
25380
4090
156.0

1982
66580
27960
4470
160.7

1983
75850
31860
5090
170.7

1984
88100
36889
5890
183.5

1 Estimated by International Trade Administration, Trade Development
Source: U.S. Department of Commerce: U.S. Bureau of the Census. Intern
Department of Labor: Bureau of Labor Statistics; Advertising Age.

financing and tax planning, marketing techniques and management controls are covered in these seminars. In addition, the AAAA and Advertising Age magazine conduct a variety of short courses specifically designed for agency owners/managers. To be successful, it is necessary to develop proficiency both in advertising and its functions, and in the techniques of operating a small business. Some questions to ask when considering the challenge are:

- Do you want to be a manager?
- Will you be happy managing?
- Do you have the qualifications for management success?
- As part of your own experience in advertising, have you established management controls on your own accounts?

A more complete list of concerns may be found in such SBA publications as Thinking About Going into Business and Checklist for Starting a New Business. Some qualifications that are necessary for the potential ad agency manager/owner are good creative judgement and a full knowledge of steps required to produce most forms of advertising. Other related qualifications are an entrepreneurial instinct, the ability to lead and delegate and the ability to be at ease among a wide range of people (Gamble).

Starting an Advertising Agency

There are many risks involved with starting one's own agency. The main risk is financial. This risk is incurred initially when the main capital contribution is required. However, this risk also continues through the life of the company.

There are no franchise opportunities in the ad industry as it is much "to individualized." For example, an agency catering to a college town would operate under standards different from those in a large metropolitan city. The capital requirements for starting a small agency range from $50.000 to $60.000. These funds cover equipment purchases, furnishings, rent, materials and advertising for the agency itself. Excluded is salary for employees (Price).

Some common start-up pitfalls are undercapitalization, no knowledge or not enough knowledge of the industry and of management skills and lack of experience. This last pitfall encompasses both advertising and business perspectives.

Technological changes are an often overlooked factor in starting a business. A technology that is particularly influencing the advertising agency is desktop publishing. Computer-related innovations have led to programs and laser printers that are creating professional quality printed materials, and challenging ad agencies' control over production of camera-ready advertisements. As of now, the quality of printed materials that ad agencies provide is still a little better than that of a desktop publishing program, but the gap is closing rapidly. Agencies need to be aware of this competition for printed materials and be prepared to combat it head on.

Preparing a business plan helps a prospective advertising-agency owner to examine both the needs of the new agency and outside factors that may influence the agency's operations. Components of the business plan include:

1. Description of the industry, the business and its products/services.

2. Market research analysis.

3. Marketing plan.

4. Product design and development plan.

5. Purchasing and operating plan.

6. Management team.

7. Implementation of pre-operational tasks.

8. Critical risks and problems.

9. Financial plan, including any public stock offering.

Of course, there are no hard-and-fast format requirements for a business plan. However, the aforementioned guideline is effective in developing one. Generally, a business plan is developed by outside consultants and has two principal uses. One is to guide an owner's actions and those of the management team. The second is to help persuade prospective investors to invest in the agency.

The final element necessary for a start-up is a town/city business license. The cost of the license varies from city to city. For example, in Blacksburg, VA., the initial fee is $40. Once the business is in operation, this license must be renewed annually with payment a percentage of gross receipts.

Growing/Mature Model

Once the specifics involved in start-up are satisfied, the owner/manager must employ people with the various specialties needed to make the business a success. The first specialty is marketing. To help clients with both planning and supporting their marketing efforts, an agency has to have people capable of handling these tasks. In small agencies, this is usually top management's job. The second specialty is creativity. Creative people come up with the ideas for ads and shape those ideas to appear in the media. A creative staff usually includes specialists in print and television products. These people develop plans for using the different media to meet the clients' marketing and advertising objectives. They are also responsible for conducting an audience analysis, after an ad is run, to determine acceptance. The next specialty is accounting/administration, which ensures proper handling of finances and office procedures. Finally, account people are responsible for the liaison between agency and client. Account people are constantly torn between the demands of the client and the needs and objectives of the agency itself. Of course, the size of the agency determines the distribution of responsibilities among employees. In very small agencies, two people may be responsible for all of these functions (Berkman).

III. MARKETING

Advertising agencies do business with firms that range in size from one-person operations to large corporations. Clients, therefore, have many different needs and wants. Agencies can best handle their various clients by using a "custom-tailored approach," i.e., by treating each individual account as a new project that requires a fresh approach each time. Potential clients can best be targeted by using a segmentation process. For instance, clients can be classified by type of advertiser: industrial, retail, corporate, social, local business and international. The advertising agency then may choose to target a particular client category. Other segmentation criteria could be geographies, demographics and product type. Many times it is best to classify by more than one criterion; for example, retail advertisers may be grouped by the specific product type handled and by the specific region where they are located (Rothschild).

The size of an agency's market depends upon the type of service(s) the agency offers. A specialized agency, for example, one that concentrates on business-to-business advertising in the high technology field, is limited by the type of client served. On the other hand, if an agency offers a wide range of services to an undifferentiated set of clients, then the size of the market would be quite large. The latter may not be an appropriate strategy for small advertising firms with limited financial and personnel resources.

According to various industry sources, the market for agencies is not saturated. Since ad campaigns can sometimes take as long as six months to prepare and since many agencies are small in size, then many agencies are needed to meet the demand (Whiz). Furthermore, there are still some untapped niches that can be found that an agency could specialize in and be very successful (KSK).

Site Analysis and Selection Factors

Deciding on the location of your agency is another important consideration. It is important to locate where the agency has greatest access to needed resources. Also, it is important to locate where the overhead is affordable (KSK). Many agencies find it very convenient to be as close as they can to their clients. This is not only because of time and travel conveniences, but also so that the agency can monitor the business environment (Rothschild). Many agencies, therefore, locate in the city or in the main part of a town to be accessible to clients (Whitz). Furthermore, some agencies have located in areas that were predicted to grow and offer a large business potential within a couple of years (KSK). Many of the agencies that have taken advantage of this type of opportunity have grown to be well respected and successful.

Pricing

A pricing policy used by an advertising agency depends upon many other financial considerations, such as whether an agency wishes to use commissions or fees. These issues, along with pricing, are fully covered in Section V.

Export Trade Potential

In 1986, foreign operations represented 33 percent of total gross income and billings for the top 100 U.S. advertising agencies, according to advertising size. This percent represents an increase of 19 percent over 1985. This accomplishment resulted from three main factors: exchange rate shifts, increased advertising abroad by U.S. manufacturers and continued success in obtaining foreign clients (Outlook). Looking into the 1990s, continued solid growth in ad spending is likely to be found abroad, especially when the European Community lifts trade barriers. Other predictors that agencies will do well abroad are the anticipated steady operating margins and the greater income from auxiliary services (Value Line).

On the other hand, the U.S. advertising industry currently faces numerous barriers when conducting business abroad. One major obstacle includes outright prohibition from acquiring certain accounts. Other barriers include restrictions of the form and amount of investment in local offices, denied access to certain media, customs regulations that bar or exact heavy duties upon the import of advertising materials, obstacles to the repatriation of profits and regulations that bar or render ineffective the employment of non-nationals (Outlook). The good news is that the U.S. Government and private industry are working together to eliminate these barriers.

Government Sales Opportunities

There are some opportunities available from the U.S. Government, but these sales generally are made on a bid/proposal basis. Most government work, however, is done for another firm with the government only considered a third party (KS).

Competing with Large Firms

Large firms have the advantage of their pooling together and using their size to buy large blocks of media time for their clients at a discount. Fears of the small agencies are that these joint buying ventures may give these agencies the ability to control media prices and develop more clout. So far, though, only a few large firms have shown a real interest in these joint ventures, so it may be quite a while before this before becomes a problem for small agencies (Industry Surveys).

Advertising Strategies

Clients come to an agency by referral, in response to advertising, because they were solicited or because of an established reputation.

Most good agencies get their clients by referral (Whitz). In case of local advertisers, representatives of the media frequently refer clients to agencies with whom they have a nice healthy relationship. It's important, therefore, for agencies to maintain good relationships with their clients, the media and other agencies. It is a common practice for an agency to "put the word out" when looking for new business (Bovee).

Less-known agencies must take a more aggressive approach in seeking new business. An agency could openly solicit new business by advertising, writing solicitation letters, making "cold" calls on prospective clients or following up leads from inside sources (Bovee). Agencies do frequently find that their best source of business is simply their good reputation; however, a good reputation normally takes a long time to develop and can be lost in a short time. Most agencies participate in activities that help raise their profile in the business community. Some activities include assisting local politicians; working on charitable committees; being active in the arts, education or religious circles; giving seminars, and writing articles for magazines (Bovee).

Client-Agency Relationship

The best relationship between the client and agency is an extremely close one, similar to a true partnership. This "partnership" can only work if both client and agency clearly understand the objectives set for the product or service. Both parties should always keep each other informed of ongoing business issues. Furthermore, there should be a healthy environment for open communication and creativity.

IV. MANAGEMENT

Personnel Requirements

Before the personnel requirements are explained, the various types of agencies should be explained. A full service agency covers all the areas of creative media and research, except final production (Rothschild). A full service agency, as part of its complete service, also offers general marketing expertise and may offer public relations, sales promotion, trade shows and package design assistance (Bovee). At the other end of the spectrum, creative boutiques (described under Type of Advertising Agencies) concentrate on copy and art and seldom engage in activities such as research, marketing or media placement. In addition, it should be noted that a good boutique can do quite well without incurring the overhead of the other departments so this approach is especially appealing to the smaller firm (Rothschild).

The major functions of a small full service agency include research, planning, creating, production for print and broadcast, trafficking (meeting deadlines on time), media planning, account management and new business development. Personnel are required for each of these functions. Principal positions, with suggested educational requirements and extracurricular activities as well as average salaries, are presented in Appendix B. Additional jobs that need consideration are those of market researcher, office manager, treasurer, secretary, billing clerk, bookkeeper, sales promotion specialist, film and television commercial producer, personnel manager, art buyer, casting specialist, television business affairs manager and talent reuse specialist (Bovee).

Agency Structure

The way in which an ad agency organizes its functions, operations, and personnel varies greatly according to its size, the type of accounts is serves, and whether its scope is local, regional, national or international (Bovee).

In small agencies (See Figure 1), daily operations are usually supervised by the owner or president, who may be in charge of new business development as well (Price). Client contact is generally handled by account executives. Account executives also may produce creative concepts or even write copy. The account executives are generally led by an account supervisor, who is responsible for bringing in new business (KSK).

Usually an inside art director produces the necessary art work, but work may be purchased from an independent studio or freelance designer. Most small agencies have a production and traffic department or an employee who performs these functions. A small agency may also have a media buyer or the account executives may be in charge of this task (Bovee).

Types of Advertising Agencies

Advertising agencies can be grouped by size of receipts or billings. Small agencies send out billings that total $20 million or less per year. Medium-sized agencies have billings totaling between $20 million and $100 million. Large agencies total between $100 million and $1 billion while super agencies invoice over $1 billion per year (Berkman).

To expand, small agencies stress personal service as their hallmark. They employ around six people (excluding secretarial staff). In view of the multiplicity of job tasks, the key employees in a small firm must be flexible with regard to planning, account solicitation, creative contributions, administration and accounting. Hence, smaller agencies are not based on a standard organizational structure. On the other hand, larger agencies are more departmentalized. There is a greater need for specialization because of the increased size. Departmentalization only serves an agency's internal requirements; an informal structure still exists for the servicing of individual accounts. A method of structuring called the "group system" is often used where different people from each department form an interdisciplinary group to work on particular accounts (Berkman).

Agencies also can be categorized by their specialization. Creative boutiques are often operated by copywriters and art directors who left full service agencies. A creative boutique performs only the creative function, usually for a fixed fee percentage of media expenditure. An in-house agency is owned and operated by the advertiser and provides all of the functions of al full service agency. Additionally, an in-house agency operates at a lower cost than others because the advertiser can save all of the profits that usually go the advertising agency based on the 15 percent media commission. The advertiser also has greater control over agency activities.

Full service agencies provide a broad and complete range of marketing services. They are staffed to handle most marketing functions. In addition to providing for its own internal business functions (accounting, personnel, finance, etc), a full service agency also provides account service, creative services, traffic, media and marketing research.

Finally, modular agencies are full service agencies that sell their services on a piecemeal basis. Thus, a modular agency's creative department may be hired to develop a campaign while other agency services are being used elsewhere. In any case, a fee is charged for the service provided (Kaufman).

Compensation Methods

The kind of compensation method used by an advertiser depends upon the type of business and the size of its budget. Consumer goods advertisers are more likely to use the traditional 15 percent commission. Larger advertisers are more likely to use a variation of the commission system while small firms, including industrial firms, are more likely to use fee systems. The strict fee and combination fee systems are becoming more common than the 15 percent method. The strict fee is a negotiated amount based on services provided by the agency while the combination fee system blends commissions and fees to determine the agency's total compensation. A survey conducted in 1985 by the Association of National Advertisers showed that agencies usually earned more per transaction when smaller advertisers used the combination fee system compared to the customary 15 percent method (Berkman).

Ethical and Legal Considerations

An agency should only take on a product that directly competes with a current client's product with permission from that client (Gamble).

An agency should also be aware of the basic AAAA Standards of Practice. A key provision states that:

> ...this the advertising agency should not deprecate a competitor or his work, circulate harmful rumors...make unwarranted claims, offer credit extension or banking service, or seek to get an account by hiring an influential person away from the agency-in-charge in violation of that agency's employment agreements. The agency should compete positively and fairly, on merit.

As far as business liability is concerned, an agency should always understand every detail clearly when entering into a contract, either with a client or a production house. If art work is purchased, for example, the agency should understand whether it has bought limited rights or full rights. Limited rights entails using the art work purchased only for the explicitly stated reasons, while full rights gives the agency the ability to use the art over and over again. Furthermore, there is a kind of "silent" insurance within the advertising industry. This insurance simply is a high standard of ethics that exists between agencies so that they do not steal ideas from each other or use another agency's work without permission. These standards are held extremely high and are respected.

V. FINANCIAL PLANNING

A successful advertising agency not only requires capable management and a market in need of advertising services but also a strong financial foundation. Basically, it takes money to go into business, and proper management of that money to ensure that the venture researches is fullest potential. A thorough analysis of one's financial needs prior to starting the business will reduce the odds of confronting insurmountable financial problems and immediate business failure.

Consequently, the prospective small business owner must face up to the financial issues before starting the venture. Some questions must be answered at the beginning. How much money is needed to start the agency? Where will this money come from? How can this money be obtained? Where can additional funds be found in case of emergencies?

The owner of a new agency who answers those questions will be in a better position to both obtain the needed funding and use it effectively.

There is a wealth of information available, some from SBA, on financial planning and controls. Therefore, the Profile emphasizes the special requirements of advertising agencies.

Financial Requirements of Starting an Advertising Agency

Financial requirements of an advertising agency revolve around two interrelated needs: set-up capital and start-up capital.

The capital requirements needed for set-up, just to prepare the firm of operation, vary greatly, depending on agency size, location and other factors. Perhaps one of the largest initial capital expenditures will be for the lease deposit and renovation or remodeling of the office. The costs of renting or leasing a building that closely coincides with the needs of the agency versus the costs of remodeling a less suitable building at a lower rental fee must be analyzed.

Other set-up expenditures are for the basic equipment and minor fixtures necessary to run the agency. Specialized items such as a desktop publishing system, photo composition equipment and promotional materials are expensive but may provide a competitive advantage to the new agency. Funds needed for consulting fees, licenses and any necessary prepaid expenses are often neglected by entrepreneurs. Legal and accounting services needed to set up the venture also will vary depending on the type of ownership and the extent of the owner's knowledge of these areas. These preparatory expenses may be high but must be included in the initial capital planning phase.

The estimation of start-up costs is also very important when considering financial planning. The entrepreneur must develop a contingency plan for possible losses during the agency's early existence. By carefully identifying the expected operating costs and likely sales, supplemental capital needs can be determined. Just as with set-up costs, determination of start-up costs is also important to the establishment of a solid financial cornerstone. Here, the owner will need to identify the costs of supplies, insurance, utilities and labor.

After determining the initial capital needs for starting the agency, the owner must determine his/her equity position, i.e., how much money the owner will put in versus the funds needed for creditors and lenders.

If the entrepreneur's funds are insufficient, then borrowing from family, friends and lending institutions may become necessary. Borrowing is a significant milestone as it increases a business's risk by creating a debt liability that will have to repaid with either the assets of the firm or by the owner personally, including the owner's home, car and other possessions. Therefore, the owner should limit borrowing to precisely the amount that is needed. Extensive borrowing could affect the firm's ability to obtain additional capital later, at perhaps more critical times. However, too little borrowing results in undercapitalization and hinders business activity.

Attaining the desirable mix of personal equity and debt that will cover both set-up and start-up capital needs cannot be left to chance. These amounts can be calculated based on the guidelines in Table 2.

Once the entrepreneur has determined what capital will be necessary and how much if it is to be personally contributed, a base is set for identifying sources of financing and for initiating the borrowing process.

Sources and Types of Funding

The prospective agency owner/manager should identify potential sources of funding, even in the unlikely event that the owner has the personal resources necessary to start the agency as it is important to know of sources for emergencies.

Source:
Robert Morris & Associates, Annual Statement Studies, Philadelphia, PA: Robert Morris & Associates, 1987.

The task of identifying funding sources is complex because some lenders will provide almost all the capital needed, while others will lend money only on particular segments of the proposed business's activities. Consequently, sound financial planning demands that the owner identify not only the sources of funds but also the types of capital available.

Understanding the different types of capital available is a key to successful borrowing and overall financial management. Different types of lending institutions carry different time frames
for paying back borrowed money. Typically, short-term financing consists of loans paid back within one year, while long-term financing is paid back over a time period greater than one year.

The entrepreneur needs to give serious consideration to the time frame of the borrowing process. Short-term loans tend to be used most commonly during the start-up stage of the venture, while long-term loans are used for the set-up phase (with a major portion being allocated to fixed assets).

Short-Term Financing

Short-term financing includes loans for working capital derived from trade credit, short-term borrowing from commercial banks and financing accounts receivable. The latter is a likely source of capitalization for the advertising firm.

There are both advantages and disadvantages to using this type of borrowing effectively. Short-term borrowing helps the business meet its pressing obligations, such as unexpected expenses and slow sales. A primary disadvantage is that as an easily tapped source of funds, short-term borrowing may be used too quickly, too often or as a substitute for sound financial management. In addition, because the payback period is relatively brief, the entrepreneur must consider the revenue and expenses of the firm to ensure that the loan can be paid off in the short term.

Short-term loans are usually self-liquidating, that is, repaid when the receivables financed are converted to cash. The commercial loan, repaid in a lump sum after three to six months, is the basic short-term vehicle. It is normally unsecured, i.e., not backed by specific collateral. The bank relies on the firm's financial statement to determine the borrower's creditworthiness and draws on the business's assets if the loan obligation is not met.

When a major part of a company's working capital is tied up in unpaid accounts, which could easily and frequently occur with an advertising agency, accounts receivable financing may be the answer. Receivables financing gives the company a cash injection that grows along with its sales yet protects the banker with an asset that can be readily liquidated. Receivables loans form a revolving line of credit in which funds are continually advanced, repaid, and re-advanced. The cost of interest may be kept at a realizable level since it is levied only on outstanding balances.

Long-Term Financing

Long-term financing includes both intermediate borrowing, for two to five years, and longer term borrowing, for more than five years. Generally, long-term loans are used to finance the acquisition of land, buildings, fixtures and machinery or equipment.

The principal advantage of long-term financing is that it provides an extended period before the full loan must be paid back. This allows the agency more time to develop a profit base on which repayment can be made. Although definite provisions must be made for repayment, such borrowing is not subject to minor fluctuations in business activity. By using various types of long-term funding, considerable flexibility in payback can be achieved.

There are several disadvantages to long-term borrowing. First, since the risk of loss to the lender is higher, given that the longer time period is more difficult to predict, the interest rates for long-term loans tend to be higher than for short-term loans. Second, the debt is fixed and must be repaid. If the firm runs into a long period of slow sales, it might not be able to repay. However, this difficulty may be offset if a repayment schedule is built into the planning process. Third, very high levels of long-term debt may, on occasion, mean a dilution of the effective ownership and management of the firm. For example, lenders may require the firm to file special reports, not borrow additional funds, or subordinate particular interest.

Unsecured term loans are usually granted only to firms with profits histories. For a new business to be eligible, most banks require that the agency owner contribute at lest 50 percent of the venture's cost. This limits the company's other debts, dividends and the principals' salaries.

Medium- or long-term loans that are fully secured by equipment or real estate are separate loan vehicles. Equipment loans can enable an agency to purchase new equipment or provide funding when the agency cannot qualify for unsecured credit. With an unsecured term loan, the agency could cover 100 percent of its equipment costs: however, most banks limit their equipment loans to 60-80 percent of the equipment's value. The loan usually is repaid monthly over one to five years, or the length of the equipment's usable life.

Real estate financing is offered by most banks. The commercial mortgage is usually made for up to 75 percent of the property value and amortized over a set period, usually from 10-25 years.

Equipment leasing has become a frequently used financing tool for many banks. The bank generally writes equipment leases for a minimum of three years, stretching up to 80 percent of the equipment's useful economic life, possibly as long as 15 years. As equipment lessors, banks prefer to retain the income tax benefits and reduce the lease cost to the leasee.

Long-term borrowing can provide added profit potential for the agency owner who uses leverage wisely. Leverage is essentially the difference between the profit generated from borrowed money, and the interest rate of the loan. Through leverage, the agency owner can enhance profits or, at least, guard against borrowing with little hope of being able to repay.

Debt Financing

An alternative way of evaluating the types of capital available is to look at whether the ownership of the agency will be affected. The advantage of debt financing is that it seldom affects ownership. Since ownership is not involved, the earnings of the firm are reserved for the entrepreneur. In addition, the entrepreneur remains the sole owner and so has greater control over the actual management of the firm. The disadvantages of debt financing are quite similar to those already discussed for short- and long-term financing. Basically, debt must be repaid, and repaid on time. Also, the amount of the debt that can be incurred is limited because there are only so many assets that can be affected by the lender. Sources of debt financing for small advertising agencies include commercial banks, commercial and consumer finance companies and the SBA.

Commercial banks are the most common source of loans to advertising agencies. Under usual circumstances, commercial banks will make long-term loans, but generally banks make the short-term loans for start-up as well as set-up. Banks also require the personal signature of the owner as collateral.

Finding the ideal lender is a difficult task so the agency owner should discuss financing possibilities with a number of potential lenders. Through these contacts, the agency owner can examine the range of possibilities and find a satisfactory source of capital. In this search, the agency owner should find out whether the lender has experience in small business lending, acts as a business management counselor or provides other services, is reputable and is compatible with the agency owner.

The most desirable situation is one in which a reputable lender is impressed with the agency owner's proposed venture and is willing to make it a success. Therefore, it is necessary for the prospective borrower to prepare a loan package which fully describes the business's financing needs and addresses the following:

- The net earning power of the agency
- The capability of the owner to manage
- The long-range prospects of the agency
- The long-range prospects of the advertising agency industry.

While commercial banks tend to be quite conservative in their lending, commercial finance companies often are willing to loan funds to more risky prospects. It is not uncommon for an entrepreneur to be refused a loan by a commercial bank but be granted one by a commercial finance company. The types of loans offered by commercial finance companies are similar to those of commercial banks, i.e., loans for receivables, equipment and equipment leasing.

The main differences between these two types of lending institutions center on the availability, terms and costs of the loans. Generally, commercial finance company loans must be secured with collateral consisting of all or part of the firm's and/or entrepreneur's assets, although some unsecured term financing is becoming more common. While commercial banks take a hard look at a firm's track record and prospects, commercial finance companies often focus on the collateral offered. In addition, since finance companies may loan to more risky prospects, they tend to charge higher interest rates, which increase the cost of the loan.

Consumer finance companies do not make direct loans to businesses, but they do make personal shot- and long-term loans to business owners. These funds, generally up to $25,000.00, can be used to finance a new venture. Typically these loans must be secured by the personal assets of the borrower, although some are "signature" or unsecured loans. Collateral may be personal items for loans under $10,000 and second mortgages on the borrower's home for loans over $10,000. The advantage of this type of borrowing is flexibility in the use of the money. The disadvantage is that these loans tend to have high interest rates, often well above the rate of commercial banks.

Equity Financing

In addition to loans, another source of capital financing is equity financing. Equity financing involves "selling" part of the ownership to others. The "selling" vehicle for this type of financing is in the form of an executive summary. The executive summary should be a two- to five-page synopsis of the key elements of the business plan. In other words, it must be an overview intended principally to catch the interest of prospective investors. Often, the summary is all that the more sophisticated investors will read, so it must capture their attention.

While this "selling" cannot be done if the agency is a sole proprietorship, it can be done by converting to a partnership or a corporation. In the case of a partnership, the original owner can add new owners as general partners and/or limited partners. By incorporating the business, the agency owner can attempt to obtain equity financing through the sale of common stock, preferred stock, convertible debentures and/or debts with warrants.

Although it is possible for the agency to go public as a corporation, it is rare that it will be traded on the New York or American stock exchanges or even in the over-the-counter market. Rather, shares of an ad agency are more commonly sold to private investors, larger businesses or government-subsidized businesses that specialize in providing equity capital to small firms.

The primary advantage of equity financing is that there is no debt to repay at a particular point in time. Holders of common or preferred stock, for example, may not have to be paid a dividend on their investment if the firm experiences little or not profit. Therefore, the distribution of the corporation's funds can be deferred until the firm is in a more favorable position.

However, there are several drawbacks to equity financing. First, few ad agencies can expect to derive much funding in this manner. Most potential investors stay away from new small businesses because of their high failure rates and likelihood the of sparse profits during the initial stages. Second, the ownership of the agency is partially passed from the owner to others, thereby, reducing the owner's decision-making control. Third, the earnings of the business have to be divided among all shareholders. Finally, there is a limit on how many investors a business can realistically expect to attract.

Sources of equity include private investors, private venture capitalists and government-supported venture capitalists. Private investors, who become general or limited partners, or shareholders, are a limited source and are generally friends and relatives. While these two groups also are a source of debt financing, through equity financing, they are given part of the actual ownership of the agency.

Private venture capitalists are individuals and private companies who are in the business of providing capital to small-scale entrepreneurs. Closely paralleled with private investors, these individuals seek out new businesses that look promising but are considered too risky for commercial lenders. Hoping for large capital gains for their investments, these individuals make equity loans to help small businesses get off the ground. These venture capitalists represent a definite source of funding and often are not overly interested in direct participation in the management of the small business. Nevertheless, they are part owners and, in fact, may hold more than 50 percent of the ownership since they typically purchase common or convertible preferred stock in the business. As such, they have the potential to involve themselves actively in the daily operation of the business.

Although increasing in number, private venture capitalists have been unable to meet the needs for small business financing. To help meet these needs, government-sponsored venture capital firms called Small Business Investment Companies (SBICs) are established to invest in, or make long-term loans to, small businesses SBICs are themselves licensed and regulated by the federal government, and typically invest through the purchase of common or preferred stock, income-generating debentures or debt with warrants.

Finally, the issue of whether to use debt or equity financing, or some mix, has serious implications over the life of the enterprise. The ad agency owner must market a full evaluation of the advantages and disadvantages of each in terms of the risks, ownership and management, profits and goals involved.

Financing Growth

As the company expands, there comes a need for additional financing. One recommended way of financing this growth is through equity provided by venture capitalists. As would be expected, their participation in the company will vary depending on the projected value of the company, the state of development, the amount of financing requested and the negotiating strengths of the parties. The venture capitalist may offer only stage or lump-sum financing. Through stage financing, the investor agrees to advance money only as the company reaches a specific milestone. Lump-sum financing is provided in a single payment. With stage financing is provided in a multiple payments. With stage financing, the business owner must make accurate projections of the amount of money needed in the future. If this is done improperly, it can cause friction between the entrepreneur and venture capitalist.

VI. FINANCIAL CONTROL

An important management control in an ad agency, as in any other business, is the review of operating reports. An owner of a small advertising agency will find several types of reports helpful including daily reports of cash; weekly reports of overdue receivables, which are especially important for advertising agencies ad there exists a constant need to have a ready source of capital to service their accounts; weekly sales summaries; and product and process cost analyses, which are important barometers of agency efficiency.

These reports should be reviewed along with the agency's accounting records such as charts of accounts the general ledger, the sales and cash receipts journal, the purchase journal and payroll journals.

Bookkeeping

Due to significant advances in computer technology in recent years, the cost of automated accounting systems has come within reach of many small businesses. In the event that someone in the agency if familiar with basic accounting procedures, it is suggested that an in-house software package be integrated with the other bookkeeping operations of the agency.

On the other hand, in absence of a bookkeeper or the integration of a software package, outside service bureaus can become the link between manual and computer systems. Once data are collected and transferred onto input forms at the agency, they are sent to the service bureau for processing and returned to the company in report form. The use of outside bureaus serves as a fast and efficient means of preparing periodic payrolls, journals and tax reports. The disadvantage, of course, is that immediate access to data maybe needed for important decision making or updating financial reports. Another important application of computers for the advertising agency is tracking the various stages of a project from inception to completion, with careful attention being paid to the deadline.

Budgeting

Any review the agency owner makes is important; however, the most effective review compares results to a predetermined yardstick, i.e., a budget. The budgeting process provides a mechanism through which the owner can lay out the planned activities and attach dollar costs and revenues to their implementation and result.

Cash Flow Forecasting

Cash flow projections help estimate when, how much and how long financing is needed. Using projections, an owner can decide when to borrow, how much for how long and, where an equity investment is used, and estimate the amount and timing of dividend payments to investors. Additionally, the projections can help identify when idle funds could be temporarily invested.

Income Statement Ratios

Financial ratios serve as good indicators of a company's overall performance. The choice of the ratios that the owner of an advertising agency should examine depends on the type of financing the agency used to start and expand the business. However, under most circumstances, the ratios of importance include liquidity, coverage and leverage ratios. Liquidity ratios measure the quality and adequacy of current assets to meet current obligations as they come due. Ratios useful to owners of small advertising agencies have been compiled by Robert Morris Associates (RMA) in Annual Statement Studies. The ratios cited are based upon 117 small agencies having assets ranging up to $1 million.

The formulas and ratios are as follows:

Current ratio = Total current assets
       Total current liabilities

This ratio is a rough indication of a firm's ability to service its current obligations. Generally, the higher the ratio, the greater the "cushion" between current obligations and a firm's ability to pay them. Based of RMA, the median result for the current ratio for small advertising agencies was 1.2 in 1987, and remained constant in the past.

Quick ratio = Cash & equiv+accounts receivables

Total current liabilities

Also known as the "acid test" ratio, this is a refinement of the current ratio and is a more conservative measure of liquidity. It expresses the degree to which a company's current liabilities are covered by the more liquid current assets (RMA median - 1.0 for the five years since 1982; the values represent national averages of small advertising agencies).

Coverage ratio Earnings before interest and taxes
Annual interest expense

This ratio is a measure of a firm's ability to meet interest payments. A high ratio indicates that the borrower has little difficulty in meeting the interest obligations of a loan (RMA median ranges from 3.5 in 1981 to 4.1 in 1987).

Fixed/worth = Net fixed assets
Tangible net worth

This ratio measures the extent of which an owner's equity has been invested in fixed assets. A lower ratio indicates a better "cushion" for creditors in case of liquidation (RMA median = .6 for 1987 and remained consistent in the past five years).

Debt/worth = Total liabilities / Tangible net worth

This ratio expresses the relationship between capital contributed by creditors and that contributed by owners. It expressed the degree of protection provided by the owners creditors. The higher the ratio, the greater the risk being assumed by creditors (RMA median ranges from 3.2 in 1982 to 2.8 in 1987).

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APPENDIX A

Federal Regulators of Advertising

Agency	Function
Federal Trade Commission	Formed in 1914, regulates all regulatory agency for advertis advertising profession.
Federal Communications Commission	Formed by the Communicati telegraph industries. It the license of every broa
Food and Drug Administration	Has authority over the ad and therapeutic devices. words on packages, and ha hazardous products.
Patent and Trademark Office	Regulates registration of

Alcohol and Tobacco Tax Division	Has almost absolute or deny renewal of m to be in violation o
Office of Consumer Affairs	Established in 1971, is t It coordinates, maintains consumer protection. Publ guidelines, monthly newsl 4500 daily newspapers.
U.S. Postal Service	Has authority to halt mail del maintains control over false a guarantees which deceive or de
Library of Congress	Registers and protects copyrig computer software, and other c governing certain procedures.
Civil Aeronautics Board	Regulates air traffic and adve
Securities and Exchange Commission	Established in 1934, has interstate commerce. It r pertinent information on an informed buying decisi investment.
Department of Justice	Normally does not initiat federal laws governing ad
Department of Agriculture	Closely monitors the dist represents the federal go agencies. Its grain divis seeds and grain products
Consumer Product Safety Commission	Established in 1972 to de derives its power from fo Act (1960), The Children Sleepwear Act of 1972. It and other promotional mat products, toys, and hazar advertising and labeling Continued violations by p General.

Source: Contemporary Advertising. 2d Edition, Courtland L. Bovee & Wil

Principal Specialties in an Advertising Agency

Job Title
Educational
Requirement
Occupational
Experience
Extracurricular
Activities
Average Salary

Art Director
B.A. desirable but not
required. Degree from
a professional art
school preferred.
Visual arts courses
Retail store
advertising
Visual arts studio
(portfolio required*)
Art director club.
Communication
arts group.
Graphic arts
group
$40,000 (senior)
$18,500 (assistant)

Copywriter
B.A. with courses in
advertising and
marketing. English
literature, sociology,
psychology,
philosophy, language
Intern in ad agency.
Retail store sales.
Writing
advertisements for
newspaper,
magazines, or
broadcasters.
(portfolio required*)

Literary group
Press club
Public relations

club
$40,000 (senior)
$18,000 (junior)

Media Buyer
B.A. with emphasis on
marketing, economics,
English, mathematics,
statistics. M.B.A.
desirable
Advertising and/or
marketing
department of a
manufacturer or
large retailer
Participation in
campus and
community
business
organization
$38,000 (media
director)
$25,000 (media
supervisor)
$18,500 (buyer of time
and space)

Accountant
B.A. in business.
M.B.A. desirable
Advertising and/or
marketing
department of a
manufacturer or
large retailer
Participation in
campus and
community
business
organization
$30,500

Traffic
B.A. not required but
highly desirable for
promotional purposes
(commonly an entry-

level position in an
agency because it
provides exposure to
the agency's functions
and personnel)
Work experience in
company advertising
department. Media
advertising
departments.
Ad club.
Marketing
organizations
$18,000

Production
B.A. helpful but not
essential with
emphasis on graphic
arts courses, visual
arts courses,
typography, design,
layout
Work experience
with printers,
photoengravers,
paper merchants,
typesetters,
photostat houses, art
studios
Printing club
Graphic arts
group
Art directors club
$27,000 (production
manager)
$20,000 (production
assistant)

* A portfolio is a collection of your best work which you show during
Source: Contemporary Advertising, 2d Edition, Courtland L. Bovee & Wil
Homewood, IL.