Marketing Science Institute Working Paper Series 2012
Report No. 12-104

Conflict Policy and Advertising Agency-Client Relations: The Problem of Competing Clients Sharing a Common Agency

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Report Summary

Historically, advertising agencies in the U.S. and Europe did not simultaneously serve accounts and/or clients who were competitors. In recent decades, however, the advertising and marketing services industry has undergone a number of structural changes that have disrupted and modified traditional norms and policies emphasizing exclusivity in agency-client relationships.

Despite its history as a contentious issue in agency-client relations, conflicts of interest are a relatively undeveloped topic in professional and academic literature. Here, Alvin Silk examines the history of the advertising agency in the U.S. and Japan, analyzes press accounts of specific conflicts and policy guidelines, and reviews theoretical and empirical work to offer an integrated view of the issue.

He identifies two significant changes in conflict policies evident in the U.S. First, safeguards to preserve proprietary information that function as organizational, location, and personnel mobility barriers among quasi-autonomous units within a mega-agency or holding company have become an essential component of conflict policies. Subject to the protection against security breaches afforded by such safeguards, rival clients may be served by separate organizational units that are under common control and/or ownership.

Second, a family of hybrid conflict polices has evolved that feature elements of the split account system long practiced in Japan, augmented by safeguards that serve as partial substitutes for the umbrella prohibition on serving rivals imposed by exclusivity. By relying on safeguards and splitting account assignments among different organizational units within or across a mega-agency or holding company, clients exert a measure of control over those agencies' access to confidential information while also offering them incentives to avoid conflicts of interest.

This analysis also uncovers several avenues for further research: the substantive content of conflict policies and the policy-making process, the role of safeguards in addressing conflicts of interest, the conditions under which different policy options should be adopted, the evolution of agency-client relationships, and cross-national differences.

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Acknowledgments
I am indebted to Tim Ambler, Paul Michel, Brian Moeran and Tom Finneran and members of the American Association of Advertising Agencies' "New Business" Committee for helpful comments on an earlier draft of this paper. Thanks are due to Don Dillon, Herb Minkel, Jr., and Jiro Yoshino for discussions of conflict policies. The assistance of Earl Campbell, John Deighton, and Susan Keane and the support of the Division of Research, Harvard Business School are gratefully acknowledged.

CONFLICT POLICIES AND ADVERTISING AGENCY-CLIENT RELATIONS: THE PROBLEM OF COMPETING CLIENTS SHARING A COMMON AGENCY

"Conflicts in advertising are taboos as religious as any you would find in the Middle Ages."
Mary Wells Lawrence (2002), p. 231.

1.0 INTRODUCTION

It has long been recognized that historically, advertising agencies in the U.S. and Europe generally did not simultaneously serve accounts and/or clients who were competitors of one another. Seeking to avoid the risk of conflicts of interest with their agencies, clients were averse to sharing a common agency with a rival, a position that gradually was accepted by agencies. Thus, over the course of the first third of the twentieth century, "exclusivity" became the prevailing norm in the U.S. advertising industry. However, a 1979 position paper on conflicts issued by the American Association of Advertising Agencies (AAAA) forewarned that "Because of the proliferation of mergers, acquisitions, and new product introductions by clients, the potential for client-agency product conflicts has increased dramatically to the point it is of considerable concern to client and agency management alike" (p.1). In line with that assessment, disputes relating to the interpretation and violation of this longstanding prohibition have been reported with varying regularity in the U.S. trade press, along with discussions of their disruptive effects on agency-client relations, often culminating in agency dismissals or account resignations; sometimes accompanied by litigation. Two decades later, a subsequent AAAA's (2000) position paper began by noting that "Little has been published on conflict policies" and went on to suggest that: "The definition of conflict is becoming more liberal, i.e., less restrictive, due to current business trends" (p. 2), citing consolidation and globalization as developments

precipitating the change. These observations raise a fundamental question: what do we know about how and why conflict norms and policies have changed?

Despite its history as a contentious issue in agency-client relations, conflicts of interest remain a relatively undeveloped topic in both the professional and academic literature on advertising and marketing. As a step toward the development of a more complete understanding of the state of contemporary practices relating to conflict norms and policies and the undertaking of further research into policy issues and options, this paper reviews/surveys and integrates three somewhat disparate bodies of relevant material that are available. First, an examination of the history of the advertising industry in the U.S. and Japan serves to inform our understanding of the development and functioning of the principal contending policy options: the exclusivity norm and the "split account system," respectively. Second, analysis of press accounts of specific conflicts and policy guidelines issued by trade associations illustrates how the re-structuring the U.S. advertising industry over the past three decades has affected potential threats of conflicts and means for addressing them. Third, a handful of theoretical and empirical papers are available that offer valuable insights into issues relating to controversies about conflicts that have been raised in the trade literature.

The basic contribution of this paper is to call attention to what I characterize as a family of "hybrid conflict policies" (HCP's) that has gradually evolved in the wake of the discordant agency-client relations that surfaced in the mid-1980's when the effects of consolidation, diversification, and globalization began to sweep through the advertising and marketing services (A&MS) industry and exposed the limitations of the traditional norm of exclusivity. The policies are hybrid in that they adopt elements of the split account system practiced in Japan, augmented by safeguards that serve as substitutes for the traditional umbrella prohibition on serving rivals

imposed by exclusivity. The critical feature of hybrid policies is the establishment of distinct organizational units operated separately but in parallel while under common control and/or ownership. Competing accounts/clients can then be served by quasi-independent units, subject to the protection against security breaches afforded by safeguards that serve as organizational and personnel mobility barriers. The system's adaptive quality derives from flexibility in the manner assignments may be split across units and in the use of a variety of accompanying safeguards. This flexibility facilitates the selective relaxation of the demands of strict exclusivity and fosters the design of customized conflict policies to address the heterogeneity and dynamics of agency and client interests. In these respects, HCP's are responsive to repeated calls of industry leaders for "balanced" conflict policies, developed through accommodation on the part of both agencies and clients. HCP's may also be viewed as a further step in the realization of Marion Harper's vision of the holding company as an organizational form for circumventing the constraints placed on agency growth by exclusivity.

Viewed from a historical perspective, the recent evolution of conflict policy in the U.S. advertising and marketing services industry appears to have much in common with the changes that occurred in the first quarter of the twentieth century. During the latter era, the scope of functions performed by agencies expanded from media-related services as creative, research and strategic services were added to the mix and the full-service agency was born. With that diversification, the sharing of a common agency by rivals fell into disfavor with clients and the norm of exclusivity gained acceptance. It now appears that the latter trend has been at least partially reversed, with somewhat less restrictive policies being in the ascendency, particularly in relations between multiproduct clients and mega agencies or holding companies. What often goes unrecognized is that throughout both eras, a variety of conflict policies co-existed in the

advertising industry. Then as now, industry practice is distributed across a spectrum of conflict policies, ranging from acceptance by rivals of sharing a common agency to strict exclusivity. How conflict policies are distributed across the population of advertisers and how that distribution has changed over time are, in principle, observable quantities but currently remain unmeasured and unknown.

The remainder of the paper is organized as follow. Section 2 outlines a conceptual framework for analyzing the antecedents and consequences of conflicts of service encountered by professional service firms and discusses the role of safeguards in addressing threats of security breaches. Section 3 traces the evolution of the exclusivity in the U.S. and the split account system in Japan. Recent structural changes in the U.S. advertising industry are reviewed and areas where agency and client perspectives on conflict policy diverge. Section 4 examines the use of safeguard and contractual provisions in limiting agency-client conflicts. Section 5 presents a typology of conflicts along with policy guidelines issued by trade associations, followed by an analysis of a hybrid family of conflict policies that has emerged to accommodate the interests of large diversified, global corporate clients and holding companies and a discussion of the resolution of conflict disputes. Section 6 reviews the limited body of analytical and empirical research available on the economics of conflict policies. Section 7 considers directions and opportunities for further research. Section 8 provides an overview of the current state of knowledge about alternative conflict policies followed in practice, the economic rationale underlying their use, and the effects conflict policy has on the industry's efficiency and organization.

2.0 CONFLICTS OF INTEREST IN PROFESSIONAL SERVICES

Nanda (2003) proposes that "The defining characteristic of professionals is their commitment to manage the conflict between self-interest and client interest" (p. 1). Such conflicts arise when a professional serves two (or more) competing clients and favors one client to the detriment of another client. Nanda includes "confidentiality" along with "loyalty" as elements of the professional service firm's (PSF) fiduciary duty to a client. As will be discussed further in section 3.4, in advertising services, concerns about both "divided loyalties" and breaches of confidentiality are often mentioned as sources of conflicts of interest between agencies and clients. However, a sharp distinction tends to be drawn between acts of disloyalty and breakdowns of security in terms of the likelihood of their occurrence and the severity of their consequences.

Broadly speaking, conflicts of interest that arise in advertising and marketing services are managed in two ways. First, over time ***industry norms*** have evolved that identify conflicts of interest and practices. These industry norms find expression in ***policies*** adopted by agencies and clients, which are included in formal ***contracts*** that specify the terms and conditions governing the relationship to which both parties agree, including the definition of competition used in identifying the accounts and/or clients which the agency should avoid. Second, there are ***safeguards***, practices and procedures that may be employed to reduce the likelihood that conflicts of interest will occur and become provisions in contracts, such as prior consultation and various organizational, locational, and personnel policies. The historical development of industry norms on conflicts of interest is summarized in Section 3, alternative conflict policies are analyzed in Section 4 and 5, and contracts and safeguards are considered in Section 6.

Drawing on literature in economics, sociology, and ethics concerned with professions, Nanda (2003) presents a framework for understanding the antecedents and the consequences of

conflicts of interest that occur in a broad range of professional service fields (law, medicine, and business).[1] In Section 2.1 below, I summarize Nanda's framework and the insights it offers pertaining to the restrictiveness of conflict norms and policies and the economics and organization of the advertising services industry. Then in Section 2.2, I review Demski et al.'s (1999) agency-theoretic analysis of safeguard policies employed by information intermediaries to protect proprietary information and relate its conclusions to the issues involved in agency-client conflicts.

2.1 Conceptual Framework

A major recurring issue is whether conflict norms and policies are specified so as to be narrow or strict as opposed to being broad or lenient? Nanda suggests that conflict norms are contingent or context-dependent and variations in the restrictiveness of conflict norms and policies across and within professional services fields can be explained, at least in part, by two factors (a) the nature of the interrelationship existing among clients (competitive vs. complementary vs. independent); and (b) how the service rendered affects client performance ("strategic" or comparative performance vs. "generic" or overall performance). Thus, he postulates that when ***strategic*** (***generic)*** services are offered to ***competing (complementary or independent) clients***, conflict norms will tend to be ***restrictive*** (***unrestrictive).***

Nanda (2004a) distinguishes between two types of conflicts of interest; *conflicts of duty* (COD) and *conflicts of service* (COS). First, COD's come about when a professional service firm

[1] Nanda focuses on "professionals" and "professional service firms" rather than a "profession" in the more limited sense in which the latter term is often used (e.g., law or medicine). He defines "professionals" as those who "master complex inference skills that are valued by their clients" and identifies such personnel as a sub-category of service providers. Advertising agencies are included in his illustrative list of "professionals" along with investment brokers and management consultants, among others. See Nanda (2005). Von Nordenflycht (2010) argues that the distinguishing characteristics of PSF's are knowledge intensity, low capital intensity, and a professionalized workforce. In his taxonomy, advertising agencies are classified as "neo-PSF" on grounds of having a weakly professionalized work force.

(PSF) provides the *same service* to competing clients but in doing so, treats them differentially such that one rival is disadvantaged relative to the other. COS's occur when a PSF supplies a *varying mix* of services to competing clients but in so doing, provides superior service to one client as compared to another. The importance of this distinction between conflicts of duty and conflicts of service lies in how they are connected to size-related cost economies. The restrictiveness of COD policies affects the *scale* of PSF operations, the restrictiveness of COS policies affect the *scope* of PSF operations. Thus, the restrictiveness of conflict policies affect the extent to which available scale and scope economies can be realized by advertising service firms and influences the level of concentration (i.e., overall size distribution of firms) and the intensity of competition in the industry, and ultimately, the range of choices available to clients in choosing a service provider. Thus Nanda postulates that when ***unrestrictive*** (***restrictive***) ***conflict norms*** prevail, firms will (**not)** capture available scale economies and tend to be ***larger*** (***smaller***) ***in size***, and the industry will be ***oligopolistic or highly concentrated*** (***fragmented or un-concentrated***) and ***competition is intense*** (***attenuated***). Nanda does not discuss the effects of diversification and economies of scope on industry structure; however MacDonald and Slivinski (1987) have addressed this topic and the application of their analytic framework to the U.S. advertising agency business is considered in Section 3.4.

The potential for conflicts of services to occur and for norms and policies to become more or less restrictive may shift over time with structural changes relating to industry demand and supply conditions. In recent decades, advertisers have broadened their product lines and market coverage and demanded more diversified and globalized services from agencies, which, in turn, expanded their operations to meet those demands. Concomitantly, agencies unbundled their services, commission-based agency compensation was gradually replaced by fee-based

compensation related to labor costs, and holding companies were growing rapidly. Accordingly, Section 3 traces the history of conflict policy in the U.S.

2.2 Safeguard Policies

Demski, Lewis, Yao, and Yildirim (1999) have analyzed a set of practices and policies that PSFs may consider adopting in their role as information intermediaries ("firms that specialize in the collection and analysis of information," such financial, accounting, consulting, and legal firms) as means of avoiding the mismanagement of proprietary information.[2] Information abuses include leakages, betrayal of client confidentiality, and careless management of clients' commercial secrets. Using agency theory, they model the internal organization of a consulting firm and evaluate alternative strategies available to information intermediaries to guard against the threat of mismanagement of proprietary information: (1) control the mix of clients served to reduce conflicts of interest; (2) compensate employees so as to reduce their incentives to breach information security; and (3) construct organizational and physical barriers to limit employees' access to proprietary information.

Demski et al. (1999) show that in and of themselves, market forces are unlikely to effect efficient information management. They find that: "Absent legal and regulatory enforcement, firms are unable to credibly commit to safeguard their client's information. In a market equilibrium, clients will rationally infer that firms will under-invest in information security" (p.110). However, the authors go on to demonstrate that firms can signal their intention to control information breaches by adopting the three types of strategies noted above. We briefly highlight their major analytical results below.

[2] The safeguard policies examined by Demski et al.(1999) focus on the management of proprietary information and differ from the "relationship safeguards" discussed in the literature on transaction cost economics to address problems of ex post opportunism. See, e.g., Jap and Anderson (2003).

First, firms control the mix of clients served through the scope of services offered. Narrowing service scope decreases opportunities for employees to leak information but also limits the realization of scope economies that may be available by offering complimentary services. Service scope may also have implications for designing employee contracts and incentive compensation policies. Second, with respect to compensation, Demski et al. find that firms that are employee-owned and where employees are closely monitored are able to take advantage of information economies without compromising performance incentives.[3] Third, Demski et al. show that the imposition of legal and regulatory requirements relating to the assumption of liability for harmful information disclosures and the use of information walls have beneficial effects for information intermediaries by increasing the credibility of a firm's commitment to maintain security over clients' information and discouraging employees from breaching that security. Although the role of safeguards in obviating agency-client conflicts has long been acknowledged, research relating to design, costs, and effects of safeguards is conspicuously absent in the advertising literature. A classification of the types of safeguard policies that are employed in practice is presented in Section 5 and details relating to their use (with examples) are discussed in Section 6.

3.0 HISTORICAL BACKGROUND

This section begins by reviewing the early history of U.S. advertising when ***conflicts of interest*** between agencies and clients led to the development of an ***industry norm of exclusivity***. Over the first third of the twentieth century, acceptance that an agency would not ordinarily serve a competitor of an existing account grew and became a widely shared expectation throughout

[3] Census data for the period 1977-2007 shows that upwards of eighty percent of advertising agencies are corporations. However, they are overwhelmingly privately held and only a small number of agencies are publicly traded. See von Nordenflycht (2009).

much, if not all of the U.S. advertising industry.[4] Next, an alternative to the exclusivity norm is described, the split account system long practiced in Japan. Last, the period of strained agency-client relations in both the U.S. and Europe that began in the mid-1980's is considered when the combined forces of consolidation, diversification, and globalization ushered in a new round of complex conflicts that tested the generalizability of the established norm of exclusivity.

3.1 Evolution of the Norm of Exclusivity in the U.S.

Pope (1983) traces the emergence of the norm of exclusivity to the beginning of the twentieth century when it gradually gained acceptance as a limitation on agency independence that "reduced the perils of agency opportunism that had made many advertisers suspicious of advertising men" and "strengthened the allegiance of advertising men to their clients" (p. 163). In an earlier era when advertising "agents" functioned primarily as "space brokers" representing publishers, it was an accepted practice for them to serve competing advertisers. However, once agencies began to extend the scope of their offerings to address client demand for creative, research, strategic consulting and other services, the issue of conflict came to the fore.

Hower's (1939) history of the N.W. Ayer agency chronicles the changing nature of client conflicts and offers a revealing analysis of the dilemmas that agency faced in formulating policies for handling competing accounts over the period 1900-1925. For many years, Ayer's policy was "not to agree not to not take a competing line" but "would not do so if we felt that it

[4] The concept of a norm, defined as "expectations about behavior that are at least partially shared by a group of decision makers" (Heide and John 1992, p.34 and the references cited therein), has been used in other discussions of conflicts of interest in the advertising agency business (Nanda 2004, Pope 1983, and Silk and Berndt 1994). In the law and economics literature, a norm has been defined as "a rule that is neither promulgated by an official source, such as a court or a legislature, nor enforced by the threat of legal sanctions, yet is regularly complied with" (Posner 1997, p. 365).The prohibition against serving competing accounts has been characterized variously by practitioners as a "doctrine," (O'Toole 1980), a "convention" (Ogilvy 1983), an "unwritten rule," (Moeran 1996) and a "golden rule," (Lawrence 2002). Other observers have labeled it a "built-in brake" (Seligman 1956), and a "taboo" (Pope, 1983). Also see Ivens and Blois (2004) critical review of the use of norms from Macneil's theory of"relational contracting" in research on business to business marketing.

jeopardized…[the client's] interest" (p.350). Ayer maintained that serving competing accounts could benefit rival clients by building market or industry demand and by avoiding "knocking" campaigns. Over time, increasing numbers of advertisers objected to Ayer's policy of rivals sharing a common policy on grounds that the value of agency counsel and service rested in its exclusivity and the risk of leakage of confidential information was unacceptable.

The task of formulating a coherent policy on account conflicts became a recurring challenge for Ayer management as shifts occurred in the scope of clients' product lines and the markets they served, and as the agency sought to grow by soliciting new accounts. Reaching a consensus in defining markets and competition proved to be problematical. To address clients' concerns about the agency serving rival accounts, Ayer offered various safeguards in the form of organizationally separated account groups and security measures (storing strategic copy "under lock and key" and producing layouts in-house rather than through outside vendors).

Faced with clients' proposals to divide account assignments between two or more agencies as a means of encouraging inter-agency competition, Ayer adopted a general policy of opposing account splitting in the interest of integrating campaign development and execution. Although Hower (1939) found that Ayer's refusal to accept split accounts cost the agency substantial amounts of business, he also reports the agency made exceptions to its general policy and accepted split assignments, as when the various divisions of a single corporation were assigned to different agencies or when responsibility for different media employed in a particular account's campaign was divided among a set of agencies.

Pope argues that maintenance of the commission system of agency compensation served to protect the position of the independent full-service agency in the vertical structure of the

advertising industry. Despite opposition by national advertisers, compensation based on media commissions prevailed and become the cornerstone of the "recognition system," an interrelated set of trade practices that aligned the interests of agencies and media in what Pope characterized as an "alliance of convenience" (p. 153). That system drew scrutiny by antitrust authorizes as a conspiracy in restraint of trade and subsequently led to the signing of a consent decree in 1956 by the American Association of Advertising Agencies and several trade associations of publishers, thereby dismantling the administrative structure of the recognition system. Nonetheless, full-service agencies continued to pursue the twin policies of bundling and commission-based commissions for several decades and abandonment of these practices occurred only slowly (Arzaghi et al. 2010).

Well aware that the power of the purse resided with advertisers, agencies sought other means to improve relations with major advertisers. Among the "several standards of agency conduct" that by World War I had been generally accepted was the norm restricting an agency from serving competing accounts. That step illustrates one of the routes advertising agencies pursued to establish their "professionalism" in the eyes of the business world and the public at large and thereby offset the negative impression of advertising as a "game."[5] That aspiration was manifest in the "Standards of Practice of the American Association of Advertising Agencies" adopted in 1937. The preamble to that declaration stated: "We hold that advertising agencies have an obligation not only to their clients but to the media they employ, to the public, and to each other" (reproduced in Burt 1940, Figure 1, and p. 261).

[5] Marchand (1985, Chapter 2) points out that leaders of the advertising industry put forth two different and conflicting conceptions of "professionalism." One perspective stressed "educational standards, public service, and cultural uplift," while the other focused on a "narrower professionalism" involving loyalty and expertise.

Baker, Faulkner, and Fisher (1998, p. 151) describe markets as becoming institutionalized through the evolution of "rules of exchange" and identify exclusivity ("sole source relationships") as one of three important rules of exchange that developed over time in the market for advertising services; the other two being the commission-based method of agency compensation ("fixed prices") and loyalty ("infrequent switching" of agencies by clients). They note that these three rules of exchange also arose in other professional service markets but suggest that "The advertising market is unusual…because these rules are *informal* collective agreements, not *formal* rules imposed by laws and regulations" (footnote 5, p. 151, emphasis in the original). Hence, exclusivity in agency-client relations can be viewed as a "relational exchange norm" which Heide and John (1992) characterize as being "based on the expectation of mutuality of interest, essentially prescribing stewardship behavior, and designed to enhance the wellbeing of the relationship as a whole" (p.34).

3.2 The Japanese "Split Account System": An Alternative to Exclusivity

Numerous observers have noted that although exclusivity is widely recognized to be the norm on conflict in advertising markets across the world, there is a "single major exception," and that is Japan (Clark 1988, p. 47; European Association of Advertising Agencies 1994, p. 67; Jones 1998, p. 4; Moeran 2000, p. 186; O'Toole 1980, p. 217). Rather than exclusivity, the prevailing norm in Japan is "the split account system," wherein advertisers routinely employ two or more different agencies concurrently to serve the same account, regardless of whether those agencies may already be serving competing accounts. Multiproduct Japanese advertisers *split* their account assignments across agencies in various ways: by product or brand, by media, or by both product/brand and media.[6] Note that the splitting of accounts by media or by both

[6] Throughout the paper, the term, "multiproduct advertiser" is used to denote a *client* who markets two or more branded products or services and establishes separate *accounts* for each with one or more advertising agencies.

product/brand and media assumes that agencies *unbundle* their services. With the notable exception of the work of Moeran (1996, 2000), the split account system has received scant attention in the advertising literature since Hower's (1939) discussed its limited role in conflicts at the N. W. Ayer agency early in the twentieth century.

As background for his participant-observation study of a Japanese agency, Moeran (1996) summarized the history the advertising industry in Japan, paying particular attention to the development of the industry's "tripartite" institutional structure of advertisers, media, and agencies. The advertising industry developed later in Japan than it had in the U.S. and Europe, but as with the latter cases, the origins of modern Japanese advertising agencies can be traced back to the emergence of "agents" who sold space in newspapers and later in magazines to advertisers and were compensated by the publishers for doing so via commissions. Moeran (1996) points out an important difference in the path of development followed by Japanese agencies as compared to their Western counterparts: Japanese agencies invested in media organizations and the latter, in turn, invested in advertising agencies:

> As a result, there is a complex set of interlocking shareholdings among agencies, newspaper and magazine publishers, and radio and television stations, and it is these which enable some agencies to have special lines of "communication" to particular media organizations, thereby enabling their clients to receive preferential treatment of one sort or another (p.10).

Building on his participant-observation study of a Japanese agency (1996), Moeran (2000) argues that the split account system can be understood in terms of the economics of the Japanese advertising industry rather than by invoking explanations that are "specifically cultural and 'peculiarly Japanese' " (p.185) that others have sometimes been put forward.
Moeran stresses that both features of the Japanese system are critical elements of the split account system: i.e., not only do Japanese advertisers generally accept an agency serving a rival;

they also *divide* account assignments among two or more competing agencies, as opposed to assigning the entire account to a single agency, which was the customary practice historically followed in the U.S. and Europe. Splitting accounts enables advertisers to exercise a measure of control over the confidential information to which an agency may gain access; an aspect of the split account system that does not appear to be widely appreciated and as will be discussed below, one that has a far reaching influence on the organization of the Japanese advertising industry.

Moeran (1996) sees the split account system as serving the interests of advertisers in that it enables them to exert control over agencies so as to improve advertising by encouraging: (a) ongoing competition among agencies for additional assignments and revenues; and (b) close inter-organizational communication between clients and agencies (pp. 47-48). Both processes are vital to incumbent agencies seeking to expand their share of a client's business where their success in doing so depends on familiarity with the client's marketing strategy and personnel. Thus, the split account system can viewed as one that enables clients to "divide and rule" agencies by holding out to agencies the prospect of gaining additional business in the future as an incentive to align the behavior of agencies with that sought by the client. Morean (1996, p. 24) also notes that in Japan, "there is often no written contract between advertiser and agency" and that assignments can be terminated without notice.

Moeran (1996, Chapter 1) presents a thick description of the complex organization of account services in a large ("top 12") but unidentified Japanese agency that he observed for a twelve month period in 1990. That organization structure was intended to be sufficiently flexible to facilitate adaptation to differences in its clients' organizations, while also allowing the agency to address the problems of client conflicts that can arise under the split account system.

Safeguards in the form of organizational and locational barriers play a prominent role in obviating client conflicts. Care is taken to assure the physical separation of account teams serving competing clients and to avoid overlaps in their membership that might result in breaches in the maintenance of confidential client information to occur.

Moeran (2000) insightfully shows how the split account system influences the organization of the Japanese advertising industry and goes on to argue that the manner in which advertisers distribute their accounts across agencies is fundamental to understanding "the structure and operation of any advertising industry anywhere in the world" (p. 185). Comparing the exclusivity-based system in the U.S. with the split agency system practiced in Japan, he maintains that as a consequence of the splitting of accounts, there are "more accounts in circulation," and that major Japanese agencies tend to serve a larger number of accounts than their U.S. counterparts, but the size of the individual accounts comprising a Japanese agency's account portfolio is generally smaller than that of a major U.S. agency. Published studies comparing account turnover and agency scale and scope in Japan and the U.S. are presently lacking. However, the data available indicate that advertising agency business in Japan is more highly concentrated in than in the U.S. For the period 2005-2011, the four firm (CR4) and eight firm concentration (CR8) ratios calculated from data presented in Dentsu's annual reports for the largest advertising companies in Japan were approximately 40-41% and 45-47%, respectively.[7] The latter values are considerably greater than the comparable concentration levels in the U.S. for either advertising agencies or holding companies reported by Silk and King (2012) and discussed below in Section 7.2. Dentsu is the dominant advertising company in Japan and its

[7] See *Dentsu Annual Report 2011* (Section on "Market Data," p.4). The revenue data reported are for "net sales" which are roughly equivalent to "gross billings" in U.S. terminology. Agency compensation is customarily based on commissions from media companies for the sale of media space and time to advertisers. See *Dentsu Annual Report 2011* (Section on "Management's Discussion and Analysis of Financial Position and Operating Results," pp.1-2).

share of the Japanese market was in the range of 22-24% throughout the aforementioned period, Although as early as 1974, Dentsu was recognized as the world's largest advertising agency by *Advertising Age* and from 2005 to 2011, the firm continued to derive roughly 90% of its total revenue from its home market operations.

Moeran (2000) draws a further distinction between exclusivity and the split account system. Building on his (1996) study of a Japanese agency, Moeran (2000) suggests that under the split account system, agencies work closely with clients and this frequent interaction tends to limit the freedom agencies can exercise in developing campaigns. This leads agencies to focus more on the state of the agency-client relationship and less on the product of the account relationship, the advertising, and in particular, creativity. In contrast, when exclusivity prevails, "agencies are allowed to work in comparative isolation from their clients" (p.197), enabling them to enjoy greater freedom in preparing campaigns and to emphasize the creativity of their work. Hence, whereas the split account encourages agencies to be "account-driven," exclusivity enables agencies to be "creative-driven." [8] Moeran extends his analysis further to reach the following provocative conclusion:

> Creativity thus becomes the source of the agency's cultural capital and is used in part as an ideological tool to offset its clients' economic power….the competing account rule has permitted European and American advertising agencies to assert symbolic independence from the financial power of the clients upon whom they depend for their economic existence, and to make use of their cultural capital (that is, creativity) to transform that power into their own economic capital (by winning accounts) (p.197).

More recently, Kawashima (2006) investigated how the "peculiar " structure of the advertising industry in Japan contributed to concern about the "deterioration in the quality of television commercials" voiced by advertising professionals in Japan, beginning around 2000 .

[8] Jones (1999, p. 136) uses this terminology to characterize alternative agency cultures. Also relevant to this distinction is Kover's (1970) theoretical and empirical analysis of the relationship between an advertising agency's organizational structure and the creativity of its output conducted among a sample of U.S. agencies.

Drawing on interviews conducted in Tokyo and London with thirty-seven advertising and marketing professionals,, Kawashima compared the structure and practices of Japanese agencies with those of creative agencies in the U.K. emphasizing that whereas in Japan, agencies remained "full service" operations compensated by commissions on media purchases; in the U.K. (and the U.S.), those practices had been abandoned, facilitating the development of unbundled agencies specializing in creative services. The author went on to argue that "What happens with this business structure is that media buying power, rather than creativity, dictates the trade" (p. 400).

It bears noting that in a comprehensive study of account loyalty in the U.K. over the period 1976-85, Michel, Cataguet, and Mandry (1996) found that an agency's creative reputation (as measured by awards won in industry-wide prize competitions) was positively related to retention of accounts and clients.

3.3 Industry Growth, Structural Change and the Rise of Holding Companies

Clashes over conflict policy typically arise when the growth strategy of one party leads to policy demands that are viewed as thwarting or threatening the interests or opportunities of the other party. By the 1970's, both clients and agencies had begun to adopt growth strategies emphasizing the diversification and globalization of their operations.[9] Industry acceptance of the norm of exclusivity early in the 20th century was an outgrowth of the rise of full-service agencies but even then, that policy was an uneasy solution to the problem posed by conflicts of interest between agencies and clients, as documented in Hower's (1939) history of N.W. Ayer. The traditional norm of exclusivity had gained increased acceptance in an era of *"full service" agencies* and the prohibition on agencies serving competing accounts (typically brands) applied

[9] In some sectors, de-regulation, in conjunction with technological changes, also contributed to conflicts. See, for example, Gleason and Cleland (1995).

to rivals who were *direct competitors* in a defined and/or recognized *product category* and *market*. However, attempts to generalize that norm to address the new realities of competition proved to be fraught with problems and controversial conflict policies proliferated, unsettling agency-client relations. Conflicts now involved large multiproduct corporate clients advertising in a wide array of markets around the world who maintained relationships with a few diversified, global mega-agencies or holding companies, each of whom, in turn, operated duplicate agencies or networks in parallel.

Concomitantly, the advertising and marketing services industry underwent a number of major institutional and structural changes. First, pressured by clients, full-service agencies gradually unbundled their services and re-aligned their compensation, shifting from commissions related to client media outlay to fees based on labor rates (Arzaghi et al.2010). Second, consolidation occurred on both the demand-side (clients) and supply side (agencies) of the A&MS market. To a considerable degree, this was accomplished through ongoing waves of mergers and acquisitions (Prior 2001, Snyder and Petrecca 1999, Winski 1990). Rosenshine (2006) notes: "The standard rule of thumb in analyzing the profit potential of a merger was to assume that approximately ten percent of the combined revenue would be lost from departing clients (p. 231). [10] Michell et al.'s (1992) audits of agency-client relations in the U.K. and U.S. found increases in the incidence with which conflicts resulting from mergers and acquisitions were cited as a reason for the dissolution of relationships over the decade between the late 1970's and 1980's.

[10] See Siman (1989) for an analysis of the nature and resolution of conflicts that followed a set of mergers and acquisition initiated by three different major advertisers and a pair of holding companies in 1985-86. Also see, for example, Millman (1988) for a discussion of numerous client losses experienced by agencies during the wave of mergers occurring in the early 1980's.

Third, holding companies emerged as the preeminent organizational form in the global advertising and marketing services market (von Nordenflycht 2009).The acknowledged pioneer of the holding company in the advertising services industry was Marian Harper, Jr., who became CEO of McCann-Erickson in 1948. Harper recognized that exclusivity was a barrier to an agency's growth prospects via the dual strategy of diversification and internationalization. According to his colleague and biographer, Harper introduced the idea of the holding company in the 1950's after struggling with the problems of growth and client conflicts: "I don't see why it shouldn't be possible for us to own more than one agency and serve competing accounts, as long as we keep the two agencies completely separate" (Johnson 1982, p.96). Thus, Harper foresaw that by maintaining "complete separation" of duplicate or parallel agencies as a *safeguard* against the risk of conflicts of interest, clients would accept common ownership of the agencies and a holding company could serve as a means of circumventing the impediments to agency growth traditionally imposed by adherence to exclusivity. Interestingly, Johnson (1982) notes that Harper viewed General Motors' decentralized multidivisional structure as precedent for development of a holding company in the communications business.[11]

With McCann-Erickson's acquisition of a second agency, Marschalk & Pratt, in 1954 Harper took the first step in building "a group of agencies under common ownership, each one "free and independent" (Johnson 1982, p. 166), leading to the formation of the Interpublic Group IPG) in 1961. By then, IPG had completed ten acquisitions to advance its goals of growth through diversification and international expansion. IPG was privately held until 1971 when it went public. von Nordenflycht (2009) has noted that in order to avoid conflicts of interest between agencies and their clients, the American Association of Advertising Agencies (Four As)

[11] See Chandler (1977) for a discussion of the development of the multidivisional structure at General Motors, especially, Chapter 14.

had long imposed ownership restrictions on its members which effectively excluded outside investors. In 1963, the Four As amended its bylaws to permit agencies to issue public shares, with the proviso that control of the agency remained in the hands of active management (Business Week 1965). Soon thereafter, several prominent large agencies went public. The holding company concept initially drew criticism from both clients and competing agencies but gradually it was accepted and imitated (West 1996), culminating in the emergence of a handful of large, global, and publically-owned holding companies.[12] Each of these developments contributed to heightening the incidence and complexity of conflicts. As Wood (2003) aptly put it: "With all of the changes over the last decades, there are few industry norms remaining" (p. 189).

4.0 COMPLEX CONFLICTS

The onset and subsequent unfolding of the industry's re-structuring that began in the mid-1980's destabilized the prior equilibrium surrounding conflict policy in the U.S. Those developments were accompanied by numerous disputes reported in the trade press surrounding the formulation and interpretation of conflict policies. This section begins with a discussion of the basic differences underlying the discordant perspectives of agencies and clients. Then, a taxonomy of conflicts that have arisen is presented that attempts to capture the complexity and variety that of issues to be addressed in designing conflict policies.

4.1 Divergent Perspectives of Agencies and Clients

Examining discussions of conflicts by informed industry observers that have appeared in the trade literature over the years, one finds several recurring themes that indicate a deep division between the points of view held by agencies and clients on certain fundamental issues. On the

[12] See von Nordenflycht (2009) for an account of the evolution of holding companies in the advertising and marketing services business.

agency side, clients' conceptions of conflicts have often been criticized as arbitrary and their policy demands deemed excessive—views that reflect, in part, the power advantage held by clients over agencies. To illustrate, an early position paper on conflict policy warned that "experience indicates that the conflict problem is often more illusory than real "(AAAA, 1979, p.1) and agency executives have characterized conflicts as being "anything the client says it is" (O'Leary 1995 and Sellers 1995). Jones (1998) observed that "Clients are very restrictive about their agencies accepting competitive business— narrowness that often goes to extreme lengths" (p. 4). Industry leaders have repeatedly questioned why clients impose restrictions on advertising agencies serving competitors but do not make similar demands on other strategic professional service providers such as accountants, lawyers and management consultants (Editorial in Advertising Age 1986, p. 44; O'Toole 1980, p. 195; Rosenshine 2006, p.230).

On the other hand, many clients opposed agencies serving competing accounts more on grounds that it would create a problem of divided loyalties than out of concerns about breaches of confidentiality. Thus in a panel discussion of conflicts arising from agency mergers, General Motors' director of advertising services stated that: "I don't think it's so much an issue of sharing information. It's a question of resources and who is getting the best resources" (Advertising Age, 1986, p.44). Procter and Gamble's vice-president of advertising concurred: "It isn't just a matter of leaks of information; it's whose side are you on in a competitive struggle" (p. 44). Agency executives maintained that there was no history of security breaches in the industry (Marshall 1983). Nonetheless, some clients, such as RJR Nabisco, were not re-assured by safeguards such as the physical separation of agency personnel working on competing accounts within the same agency: "…as someone who has battled competition his whole career, I don't

want them on the same block, let alone living in the same house. And please don't tell me it's all right because they are quartered in a separate wing" (Wilson 1986).

Overall, that the normative positions held by agencies and clients with respect to conflicts do not coincide comes as no surprise; given divergent interests, it is to be expected that agencies will favor unrestrictive policies while clients will seek more restrictive policies. At the same time, it is doubtless the case that among agencies as well as among clients, there is substantial variance in the conflict policies advocated and practiced that goes unobserved. Press reports tend to cover disputed cases where large budgets are at stake while harmonious relations receive little or no attention.[13] Only occasionally do conflict norms and policies appear to have been singled out for attention in the otherwise abundant literature on the auditing of agency-client relations (Michell 1986-1987, 1992; Prince and Davies 2006).

4.2 Taxonomy of Agency-Client Conflicts

The industry's history indicates that the restrictiveness of conflict policies has been a recurring source of disharmony in agency-client relations. The core of exclusivity as a conflict policy is the prohibition imposed on agencies against serving "competing" accounts so as to avoid and/or resolve conflicts of interest between clients and advertising agencies.[14] But reaching a consensus on a working definition of "competition" that satisfies the current and future interests of both a client and its agency has repeatedly proven to be a major stumbling block.[15] If rivals are served by the same (focal) agency, there is the potential for the focal agency to treat the rivals differentially such that one rival is disadvantaged relative to another. Conflicts of interest

[13] See "Lesson 4" in Wood (2003, p. 195).
[14] Advertisers sometimes grant exclusivity to agencies in the sense of agreeing that one agency will be the sole provider of specified services. See Lehv (2001, p. 18) and Stone (1989, p. 17) Exclusivity can also be an issue in contracting for other advertising services such as jointly sponsored promotions, celebrity endorsements, and home shopping broadcasts. See Wood (2003).
[15] The issues encountered in defining competitors in connection with conflict policy are somewhat analagous to the problems surrounding the assessment of anti-competitive effects arising from horizontal mergers. See e.g., Baker and Bresnahan (2008).

typically arise when an incumbent client objects to the focal agency simultaneously serving a rival. Incumbent opposition can be triggered by various events such as a merger or acquisition or new account solicitations. Analyses of such conflicts require that two sets of basic questions be answered. First, what *unit of the focal agency* would provide what *services* to the rival? Second, how and where do the rival and incumbent *compete*? Dichotomizing answers to these questions results in the delineation of sixteen types of conflicts, each one represented by a cell in Table 1.

Conflicts are classified along dimensions relating to (a) the ownership and scope of services supplied by the *focal agency* to an incumbent client (vertical classification), and (b) the nature and scope of *competition* existing between the incumbent client and some rival advertiser (horizontal classification), who would be denied service by the focal agency under the exclusivity norm on grounds that such would constitute a competitive conflict for the incumbent client.[16] Combining these dichotomized dimensions (2^4) results in a set of sixteen complex conflicts.

The *traditional exclusivity conflict* occurs when two competing advertisers are served by the same agency and falls into Cell #1. Proceeding downward and/or to the right across cells of the matrix, the combination of conditions that establish a conflict (indicated by the row and column categories) are successively broadened; thereby defining conflicts of increasing scope or breadth; and concomitantly, implying conflict policies of increasing restrictiveness to satisfy them. Table 1 is intended to serve as a template to array the variety of conflicts that have arisen and to capture the principal differences among them. Drawing on reports appearing in the trade press, I cite examples of conflicts representing various cells of Table 1.

[16] These distinctions are consistent with those drawn by others, e.g., Weilbacher (1991) and the European Association of Advertising Agencies (1994).

Focal Agency: Shared Unit vs. Separate Units with Common Ownership

Consider the first level of the vertical dimension in Table 1. The focal agency may be either a *single independent* agency or *separate agencies* within a *holding company* (e.g., "agency brand" or "*network"*). An instance of a Cell #9 conflict arose when two rival brewers (Miller-Coors and Anheuser-Busch) were served by a pair of agencies (Draft FCB and Deutsch) owned by the same holding company (Interpublic Group). Although Deutsch's assignment with Anheuser-Busch was limited and confidential, when Miller-Coors learned of its competitive nature, the firm complained to IPG and Deutsch resigned from the Anheuser-Busch roster (Mullman 2009b).

Scope of Agency Service: Full vs. Partial

As shown in the second level of the vertical dimension of Table 1 agency units may supply accounts with either the *traditional "full" range of services* (or approximately so, e.g., strategy and creative) or just "*partial"* or limited services, as when an account is *split* with the creative assignment given to one agency and media planning and buying to another. Note that under the Japanese "split account system," cases falling in cells along the second (#5-#8) and fourth (#13-#16) rows of Table 1 would not be conflicts.

A conflict involving partial service (Cell #13) arose following the merger in 1999 of the Leo Burnett and MacManus Groups to form a holding company, BComm3. Each group had its own media services agency, Starcom (Burnett) and Mediavest (MacManus), and each handled the media planning and buying for a major accounting services firm (Arthur Anderson and Ernst & Young). Following the merger, one of the clients expressed concern about the potential for a conflict in media buying: "if those units must serve two masters, who's to say which client…would secure the best commercial times on television" (Kranhold 1999). A holding

company executive indicated that the two media units would not be merged, but would be "linked to give them more buying power."

Scope of Competitive Conflict: Accounts (Intra-Category) vs. Corporations (Inter-Category)

The first level of the horizontal dimension in Table 1 distinguishes *direct competition* between products or brands within a product category (*intra-category competition*) from *indirect competition* between multiproduct or multiservice corporations or firms whose rivalry transcends or extends across the boundaries of two or more conventional product/service categories (*inter-category competition*). An oft-cited example of the latter type of conflict (Cell #11) occurred in 1988 when RJR Nabisco, whose product lines included tobacco products, dismissed Saatchi & Saatchi DFS Compton after the agency had produced commercials for another client, Northwest Airlines, announcing a smoking ban on its flights (Sit 1988). Another somewhat similar case (Cell #3) occurred when Hallmark dropped Young & Rubicam after that agency accepted an assignment with AT&T, on grounds that long-distance calls and greeting cards were substitutes (O'Leary 1995).

Scope of Market Coverage: Common Markets vs. Open Markets

Conflicts are defined not only in terms of competition but also with reference to market coverage, i.e., the market areas or segments where competition arises. The second level of the horizontal classification in Table 1 addresses the issue of specifying the scope of market coverage where the focal competitive conflict is present. The distinction drawn is between *Common Markets* where the incumbent client is served by the focal agency and *Open Markets* where the incumbent client is served by another agency or alternatively, has no presence.[17] Market boundaries may be delineated with reference to geographical areas (country or region),

[17] See European Association of Advertising Agencies (1994, p. 59).

market segments, or distribution channels (American Association of Advertising Agencies 1979, European Association of Advertising Agencies 1994).

An example of a conflict involving inter-category competition between global rivals was that encountered by Young and Rubicam as a result of that agency handling Jello desserts for Kraft in the U.S. and dairy products, including yogurt, for Danone on a global basis. A conflict developed when Danone's new product development became focused on positioning yogurt as a dessert and it was contemplating marketing its line of European desserts in the U.S., thereby raising the prospect of a Cell #4 conflict (Pollack 1998).

5.0 DESIGNING POLICIES FOR COMPLEX CONFLICTS

Has there been any industry-wide response to reconciling the divergent views of agencies and clients on conflict policies discussed above in Section 4.1 and to addressing the array of complex conflicts summarized in Table 1? This section begins by reviewing guidelines proposed by trade associations as an aid in formulating conflict policies. Comparison of the guidelines with the taxonomy of conflicts introduced above in Sections 4.2 underscores the substantial differences in restrictiveness between the policies advocated in the guidelines and those implied in order to address the range of complex conflicts represented in Table 1. However, in advocating the relaxation of restrictive policy demands, the guidelines also propose placing greater reliance on the use of a variety of safeguard policies that are outlined below in Section 5.2. In Section 5.3, it is suggested that a new form of hybrid conflict policy has emerged and begun to gain acceptance by combining features of the split account system and the use of safeguards. Finally, in Section 5.4 contrasts alternative modes of resolving complex conflicts; litigation and accommodation.

5.1 Policy Guidelines

To aid management in addressing the disruptive conflicts that accompanied the continuing consolidation affecting the industry, the American Association of Advertising Agencies (AAAA) issued a set of guidelines for defining and resolving conflicts in 1979, and again in 2000. Similarly, the European Association of Advertising Agencies (EAAA) released guidelines in 1994, updated in 2002 by the latter's successor organization, the European Association of Communication Agencies (EACA). [18] A similar statement was recently endorsed by five trade associations in the U.K. (Chartered Institute of Purchasing and Supply et al., 2009). It is instructive to compare these guidelines with the taxonomy of conflicts presented in Table 2.

The AAAA (2000) guidelines recommended: (i) the unit of analysis for assessing conflicts should be "the agency brand, not the holding company;" (ii) the relevant scope of competition should be "brand vs. brand" or "category vs. category," rather than the "divisional or corporate" level, and should address "real business issues" on "product by product and country by country basis." The report also noted that "an agency office" (with its own staff) and "unbundled services" can be "valid separations." Note that endorsement of the latter organizational partitions as "valid" implies reliance on safeguard policies to protect against breaches of security.

The EACA (2002) advocated "principles" that were similar to AAAA's guidelines in recommending that "Definitions of conflicts should <u>not</u> go above the agency brand level (i.e., to sister agencies within the same global communications group)," <u>nor</u> should they extend "across promotional disciplines," or "subsidiaries," "<u>if</u> separately housed or managed" (emphasis added). Moreover, the EACA urged that "Agencies must not be prevented from handling business in

[18]The guidelines on conflicts developed by the Council of Public Relations Firms (2001) are very similar to those issued by the AAAA and EACA and discussed above.

countries, or in market sectors, where they are not used by the client." Exclusivity should be restricted to "key named competitors" and should not be extended to "complete sectors."

The EACA's recommendations differed from the AAAA's position in one noteworthy respect, namely the EACA emphasized that "The degree of exclusivity demanded by a client must be reflected in the remuneration terms offered to the agency," and went to propose that:

> Only in exceptional circumstances should global exclusivity be requested. In line with other sectors like PR, a base level of $10 million agency income is suggested as a starting point for consideration of exclusivity on more than a local or regional basis (p. 4).[19]

The distinctions drawn in the AAAA and EACA guidelines are captured by the four dichotomous categories employed in Table 1 to classify conflicts reported in the trade literature, i.e., the "Focal Agency" and "Scope of Agency" categories that define the horizontal classifications and the "Scope of Focal Competitive Conflict" and "Market Coverage" categories that define the vertical classifications. When applied to the typology presented in Table 1, both the AAAA and EACA guidelines would effectively rule out as conflicts all but Cell #1, the traditional definition of a conflict. Moreover, none of the conflicts captured in Table 1, including those represented by Cell #1, would arise under the Japanese split account system as described by Morean (2000). Thus, by sanctioning safeguards, the position on conflict policy implied by the trade association guidelines is one that ends up being in close accord with that of that of the Japanese split account system which emphasizes the division of assignments among different agencies. Nonetheless, it is also apparent that the normative perspective on conflicts embraced by agencies is much less restrictive than that reflected in the broad range of conflicts represented in Table 1 and that, on occasion, have been pursued by at least some clients. As will be discussed

[19] Wood (2003) notes that compensation arrangements can be an issue when a client employs an agency on a "non-exclusive basis, depending on the particular method of agency compensation employed (pp.192-193). For example, were agency compensation to be based on fixed commission rate related to media billings, one agency might provide a particular service while another handled media placement and thus the former agency's compensation would be ambiguous. Of course, under fee-based compensation, this problem is unlikely to arise.

below in Section 5.3, there is reason to believe that this gap between agency and client points of view on conflicts and conflict policy has diminished over time through acceptance of the splitting of accounts and the use of safeguards to design and customize conflict policies.

5.2 Types of Safeguards

Safeguards are defenses, intended to prevent or discourage conflicts of interest. The traditional form of exclusivity in agency-client relations can be viewed as a safeguard in the sense that denying a competitor the services of the incumbent client's agency removes direct or immediate threats of conflicts, such as the leakage of commercial secrets or proprietary information. An in-house agency offers maximum exclusivity. Designing safeguards involves the creation of barriers to inhibit or thwart threats of conflicts. The use of targeted safeguards has been advocated in the advertising trade literature for some time (e.g., AAAA, 1979). The guidelines for conducting agency searches recently issued jointly by the AAAA and ANA (2011) recommends that agencies emphasize safeguards as a basis for resolving conflicts and mentions "firewalling" the accounts of rivals "by using an entirely separate account team, on a separate floor or even in a separate office or city" (p. 10). A variety of safeguards are available that may serve as partial or imperfect substitutes for exclusivity by addressing particular threats of breaches of obligations and are classified into the three categories shown in Table 2. For each, the threat addressed by the safeguard is identified, along with the instruments employed to control that threat.

The first safeguard listed in Table 2 is *Separation of Agency Units* serving the incumbent client and a rival. Independent ownership is the fundamental rationale underlying exclusivity and spatial separation is presumed to accompany distinct ownership. To assure separation, several

instruments to control access and avoid mismanagement of confidential client information may be employed: (1) the organizational placement and physical location of agency personnel so as to minimize interactions between agency personnel working on the accounts of a rival client; (2) procedures for assigning agency personnel to client accounts that preserve separation in the face of promotions, transfers, and other staffing decisions; and (3) the maintenance of secure information systems

Safeguards to effect separation are internal controls that apply to an agency's current clients and employees. But the high rate of turnover of both accounts/clients and employees in the advertising agency business is legendary (Broschak 1994) and thus the exit of clients and/or personnel creates a channel through which breaches of security may flow and where internal agency safeguards are no longer operable. Thus, there is need for *Provisions in Agency Employment Contracts* and *Agency-Client Contracts* to head off conflicts of interest that may develop in the wake of terminations of prior relationships. Such provisions are listed in the third column of Table 2 and are discussed and illustrated in greater detail later in Section 6.0.

5.3 Hybrid Conflict Policies: Adaptive Split Assignments with Safeguards

In the concluding section of his 2000 paper, Moeran (p. 197) raised the question: "Can or should [the split account system] be adopted in advertising industries elsewhere in the world?" At that time, he noted that a small number of large U.S. corporations were splitting their accounts by product or brand. That development has continued and been extended in the U.S., facilitated by the unbundling of agency services (Arzaghi et al. 2010) and by the increasing, but less than universal acceptance by clients of an array of safeguards that address their concerns about conflicts (Sampey 2005).

The major holding companies all structure their organizations around a set of global or consolidated networks that operate quasi-independently. Each network consists of a lead agency and a set of supporting units representing various "disciplines." Networks within a holding company often compete with one another for new accounts. With the protection against conflicts offered by various safeguards, holding companies position themselves as able to serve rival clients by assigning each to a different network. In addition to multiple global or consolidated networks, holding companies also operate multiple **media agency** networks, each offering unbundled media services and collectively able to accommodate rivals just as the global networks do. Media agencies are sometimes formed de novo within holding companies as "conflict shops" to handle accounts that none of a holding company's existing media networks can accept because of they already serve a rival (Sternberg 2011). Coping with conflicts is one of the reasons for the proliferation of media agencies within holding companies (McClennan 2011). In 2010, each of the four largest holding companies was comprised of at least three global consolidated networks plus three or more media services units. Thus, the traditional "full-service" agency has given way to the widespread unbundling of creative services and media services with each service being assigned to different units, located either within a single holding company or in different holding companies (Horsky 2006).

Two other practices have affected account splitting: the assignment of creative duties for a given brand/product to two (or more) agencies (Gleason and Petrecca 1996) and the consolidation of media planning and buying for several brands/products at one or more media services agencies (Jaffe 2005). In splitting creative assignments for a particular brand/product among different agencies, clients may be pursuing the policy of parallel development of alternative creative treatments advocated by Gross (1972) rather than as a matter of conflict

policy. Nonetheless, doing so may add a layer of complexity to the design of account splits to avoid conflicts. On the other hand, consolidation of media services offers large multi-product advertisers a means of realizing cost economies and other benefits available from specialized media units of holding companies (Fine et al.2005, pp. 60-63).

The splitting of account assignments across different agency units accompanied by the use of safeguards to protect against breaches of security has resulted in the emergence over time of what can be construed as an adaptive family of hybrid conflict polices (HCP's). These policies are *emergent* in the sense they evolved from practice with the accumulation of experience gained in addressing conflicts and embody the guidelines on conflict policies proposed by trade associations discussed in Section 5.1. The control policies are *hybrid* in that the concept of splitting accounts resembles the system practiced in Japan and reliance is placed on safeguards to substitute for the norm of exclusivity, traditionally emphasized in Europe and the U.S. The policies are *adaptive* in that accounts can be split in several different ways (brand/product line/service/market or combinations thereof) and a variety of accompanying safeguards may be employed. Such adaptability allows conflict policies to be customized so as to satisfy the diverse and changing demands of agencies and clients. The problem of formulating a conflict policy becomes a problem in the design of organizations, incentives, and contracts so as to align the interests of an agency and its clients. Clients and agencies are confronted with complex tradeoffs in assessing the benefits and costs of abandoning exclusivity for an alternative policy involving splitting accounts and substituting safeguards for the strict separation traditionally required by exclusivity. Splitting accounts expands a client's set of agency options but also increases its search and coordination costs and increases the risk of security breaches, depending on the substitutability of safeguards for exclusivity in protecting proprietary information. Under account

splitting, an agency will sacrifice some revenue from the incumbent client but gain revenue from the rival; the net change must be evaluated in light in the investment in safeguards that accompanies the change from exclusivity to a split account system. Since at least some components of investments in safeguards are likely to be client-specific, the problems of designing and enforcing incomplete contracts can be expected to accompany use of HCPs (Hart 2008, Salanie 1998).

As depicted in Figure 1, conflict policies can be arrayed along a continuum of *restrictiveness* with unfettered sharing of a common agency by rival clients and san exclusive in-house agency as the polar extremes. Less restrictive than an in-house agency dedicated to a single client is the traditional exclusivity policy which permits agency sharing among non-rival clients. The Japanese split account system is distinctly less restrictive than traditional exclusivity in that rivals may employ a common agency—an option positioned to the left of the mid-point of the restrictiveness continuum in Figure 1. As an adaptive family of hybrid conflict policies (HCP's), split accounts enhanced with safeguards represent policies positioned at different points in the mid-range of the restrictiveness continuum shown. Hence, the availability of hybrid policies permits the selective relaxation of the requirements imposed by strict exclusivity and thereby encourages resolution of agency-client conflicts through accommodation, rather than litigation and/or termination of the relationship. This topic is explored further below in Section 5.4.

S.C. Johnson (SCJ) provides a recent example of a major global advertiser relinquishing exclusivity and adopting account splitting. Following an extensive agency review in 2011, SCJ decided to withdraw its business from its incumbent agency, DraftFCB, a unit of IPG,

terminating a relationship that had begun more than half a century earlier when SCJ first appointed Foote Cone & Belding (FCB) to its roster (Neff 2011). IPG acquired Draft in 1995 and FCB in 2000 and then merged the two units in 2006. DraftFCB served as SCJ's lead creative agency globally and SCJ was the major client served by several of its international offices. Other IPG units handled SCJ's media planning and buying as well as various other marketing services (Neff 2010). SCJ's total global spending was estimated to be in the vicinity of $1 billion, including outlays of $400 million for measured media in the U.S.

In initiating its search, SCJ announced: "The review will focus on agencies that have a global knowledge and network, align with the company's values and have a track record of building successful global brands" (Neff 2010). SCJ was described as having long held "a rigid anti-conflict stance with holding companies" (Morrison 2011). Since the other major holding companies already served SCJ's major competitors (Neff 2010), in seeking a replacement for DraftFCB/IPG, SCJ options appeared limited: either divide the assignment among independent agencies that were free of conflicts *or* relax its conflict policy with respect to holding companies and work with conflict-free networks within holding companies that already were serving SCG's competitors (Morrison 2011). Given the scale and scope of SCJ's businesses (multinational market coverage for a broad product line), few independent agencies were viewed as suitably staffed to handle the workload and SCG\J included several holding companies in the review, although many networks within holding companies were eliminated from consideration because of their ongoing relationships with SCJ competitors. In the end, SCJ awarded its business two holding companies, splitting the assignments primarily according to product line (Morrison 2011). WPP received SCJ's home fragrance (e.g., Glade) and cleaning brands (e.g., Pledge); the creative assignment going to Ogilvy & Mather, media planning to Maxus, and media buying to

GroupM. Omnicom was awarded SCJ's home storage (e.g., Ziploc) and pest control brands (e.g., Raid); creative and media planning duties were assigned to BBD&O and media buying to OMD.

5.4 Resolving Complex Agency-Client Conflicts

Agency-client conflicts often result in termination of a relationship, either by the client dismissing the agency or by the agency resigning from the account. Alternatively, disputes about conflicts may be resolved through accommodation and the relationship continues, a perspective stressed in statements of guidelines on conflict policy (AAAA 1979). The distinction between "exit' and "voice" developed by Hirschman (1970) suggest that the path to resolution should matter here. In this section, two conflict of interest cases are summarized. Both were triggered by mergers/acquisitions and involved clients concerned about rivals being served by separate agencies, owned and operated by the same holding company. However, the processes leading to resolution were quite different, as were the outcomes. In the first case, safeguards were rejected and prolonged litigation ensued, ending in dissolution of the relationship. In the second case, safeguards enabled the parties to reach an accommodation and the relationships continued.

5.4. Litigation

A case where the threat of a breach of confidentiality led to several rounds of litigation began after IPG's 2001 acquisition of another holding company, True North (TN). One of TN's agencies, Foote Cone Belding (hereafter FCB), handled several brands of fruit juices, sports beverages, and bottled water for Quaker Oats, owned by PepsiCo. McCann-Erickson, part of IPG, was Coca-Cola's major agency and served a number of their brands in the aforementioned beverage categories. Within a few days of the announcement of IPG's acquisition of TN, FCB entered into a confidentiality agreement with PepsiCo whereby no FCB employee would be transferred to a Coca-Cola account or that of its affiliate for a minimum of two years after

serving PepsiCo accounts. The agreement further specified that FCB would pay PepsiCo a penalty of $20 million if FCB resigned PepsiCo accounts (Vranica 2001). An *Advertising Age* (2001) editorial suggested that in making such "remarkable promises," FCB had "fought too hard" to retain PepsiCo's business.

Despite these safeguards, PepsiCo subsequently concluded that IPG's ownership of FCB created a conflict with Coca-Cola (Cell #9) and withdrew $400 million of billings for Quaker brands from FCB. PepsiCo moved the Quaker business to the holding company Omnicom with whom it had a longstanding relationship. Omnicom formed a new unit to handle that business and hired a number of former FCB staff with experience on Quaker and PepsiCo brands (Cappo 2003, p.22; Hatfield 2001). Shortly thereafter, Coca-Cola moved several of its beverage accounts to FCB to offset the loss of the Quaker brands. However, PepsiCo sought to block FCB from serving these accounts by initiating litigation on grounds that by accepting the Coca Cola account, FCB would violate its confidentiality agreement with PepsiCo. FCB contended that the confidential agreement only addressed the circumstance wherein FCB resigned PepsiCo business and did not apply to the situation at hand, in that PepsiCo had dismissed FCB, rather than the reverse. The court ruled in favor of PepsiCo and issued a temporary restraining order that prohibited certain FCB employees from working on the Coca Cola accounts (Elliot 2001).

In what was described as a "startling about face," Coca Cola withdrew assignments for two brands from FCB and returned them to the agencies where they had previously been assigned (Vranica 2001). The court's ruling came as an unsettling surprise to many in the advertising industry (Hatfield 2001). Rarely had clients been known to sue their former agencies after terminating the relationship (Elliott 2001) and it had been a longstanding industry practice for agencies to seek to replace lost business with new accounts from the same product category

(Vranica 2001). *Advertising Age's* editorial page (2001) called for "a more balanced remedy:" "What PepsiCo wants from FCB seems to give too much control to the former client in the name of protecting trade secrets and confidential information." The lawsuit was settled privately on terms that allowed FCB to accept Coca-Cola business ninety days after the exit of the Quaker brands but prohibited several FCB personnel from working on Coca-Cola brands for six months (MacDonough 2002).

5.4.2 Accommodation

In September, 2005, the Federal Trade Commission approved Procter and Gamble's $57 billion acquisition of Gillette. Prior to the merger, Gillette expended an estimated $566 million n measured media in 2004 and employed Mindshare as its media buying agency, one of three global media service networks operated by WPP, the other two being Mediaedgecia, and Mediacom. Mindshare also served Unilever, a major worldwide competitor of P&G. Thus, P&G's acquisition of Gillette created a conflict for P&G whose longstanding policy prohibited the same agency unit from handling both P&G and Unilever accounts (Neff 2005). In particular, P&G's Chief Global Marketing Officer expressed concern over Mindshare serving both P&G and Unilever due to the use of proprietary software and sensitive data in media buying. This case is akin to those falling within Cell 7 of Table 2, where two multi-brand corporations who compete in several categories and numerous geographical markets would be sharing a common media services agency, except the media agency was owned by a holding company, rather than an independent agency.

At the time of the Gillette acquisition, about seventy percent of P&G's global media buying was handled by Publicis' Starcom Mediavest Group (SMG). Publicis also owns another global media services network, Zenith Optimedia. To resolved the conflict, P&G withdrew $800

million of media billings from WPP's Mindshare, moving the domestic media account to Publicis' SMG and dividing its overseas accounts among two of Publicis' media agencies (SMG and Zenith Optimedia) and WPP's Mediacom (Mandese 2005). The latter had been the media buying agency of the Grey Global Group which WPP had acquired in 2004. P&G had been a major Grey client for many years. When WPP acquired Grey, Martin Sorrell, WPP's Chairman and CEO, had stated that "very little integration will take place" and a P&G spokesmen was quoted as saying: "We value the asset of the Grey network and we are going to operate the business as usual. As long as Grey remains a separate agency network, we have no issue" (Johnson 2004, p.14). In line with those commitments, Mediacom became a separate media network within WPP and P&G continued to employ Mediacom as one of its several media agencies.

Comparing these two disputes, several features deserve further consideration. The first relates to the role of safeguards. In the IPG-PepsiCo case, mobility barriers in the form of contractual provisions for conflict insurance and restrictions on agency employee assignments failed to allay the client's concerns and themselves became the subjects of courtroom disputes. However, in the WPP-P&G case, organizational separation of media buying agencies within the holding company was accepted by client. The second noteworthy aspect of the cases is how the effects of the conflict spread beyond the original conflicted agency and client to other adjacent industry participants. Especially in the case of large multiproduct firms with global operations, termination of agency-client relationships may touch off movements of several accounts to realign relationships. Third, the resolution of conflicts appears highly idiosyncratic. Prior history of the parties may play a role. PepsiCo and Coca Cola are long-time competitors across numerous product categories and markets ("Cola Wars"), as are P&G and Unilever ("Soap

Wars"). All four advertisers had reputation for being demanding clients and advocates of restrictive conflict policies. Finally, while safeguards and hybrid conflict policies appear to have gained acceptance and contributed to the diminution of demand for exclusivity suggested by the AAAA's (2000) position paper, suggested; far from disappearing, conflicts remain a recurring facet of agency-client relations (Fitzgerald 2004, Bruell 2011).

6.0 SAFEGUARDS AND CONTRACTS

Conflicts are costly and disruptive to both agencies and clients and the scope and duration of their effects vary widely. Contracts and safeguards are means of reducing the likelihood of conflicts occurring, containing their adverse effects, and facilitating their resolution when they arise. The governance of agency-client relations is generally formalized in a written contract or letter of agreement which expresses, among other things, the fiduciary duties of the agency to act in the best interests of the client (Lehv 2001, Wood 2003), i.e., the duties of "loyalty and care" (Frankel 1998).[20] Guidelines for agency-client contracts published by the AAAA (Lehv 2001) and the ANA (Stone 1989, Flink 2001, and Wood 2003) discuss provisions for exclusivity and confidentiality, emphasizing the importance of addressing the issues discussed above in Section 4. Guidelines on conflict policies also draw attention to various safeguards that contribute to preserving the confidentiality of proprietary information and recommend recognition of these responsibilities and related policies in agency-client contracts (AAAA 1979, 2000; EACA 1994; EAAAA 2002). For example, the EACA has called for more use of safeguards to demonstrate "provisions for greater secrecy," urging among other steps, "greater use of non-disclosure agreements" (that place restrictions on individual agency staff

[20] Surveys conducted over time by Association of National Advertisers show that the percentage of its membership (large U.S. national advertisers) having a formal contract with their agencies grew from 58 in 1979 to over 90 by the mid-1990's. See, e.g. Lundin and Jones 1998 (p. 54). However, evidence bearing on the utilization of contracts by small and/or local advertisers appears to be lacking.

members for a specified period after being employed by an agency) and making "Chinese" walls "more tangible."

6.1 Threats to Confidentiality

On occasion, agency representatives have maintained that the incidence of security breaches is minimal (Marshall 1983, EACA 2002); however, the absence of longitudinal compilations of archival records or other comprehensive data sources precludes any concrete assessment of how frequently *breaches of confidentiality* have actually occurred over time. Nonetheless, acts that pose *threats of breaches of confidentiality* have been reported in the trade press; some *opportunistic* in the sense of fitting Williamson's (1993) concept of "self-interest with guile." He advises addressing the "hazards of opportunism": "Transactions that are subject to *ex post* opportunism will benefit if cost-effective safeguards can be devised *ex ante*" (p.105). Other threats appear *inadvertent*. In practice, these distinctions are generally difficult to draw and are not necessarily compelling considerations in diagnosing and resolving conflicts. Brief accounts of two cases will illustrate the complexity and varying contexts and outcomes of conflicts that have arisen in advertising-client relations and serve as background for examining the role of safeguards and contracts in addressing them.

One widely publicized case of a direct threat arose in 1987 when a small Boston agency (Rossin Greenberg Seronick & Hill, hereafter, RGSH) attempted to solicit Microsoft as a client (Smith 1989). As part of that effort, RGSH mailed a "flier" to Microsoft bearing the headline: "But, Since We Know Your Competitor's Plans, Isn't It Worth Taking a Flier?" The flier went on to explain that the basis for this claim was that "some of our newest employees just spent the past year and a half working on the Lotus business at another agency." RGSH had earlier added two employees to its creative staff who had previously worked for the agency employed by

Lotus, a major competitor of Microsoft. Microsoft forwarded the RGSH material to Lotus, who then filed a lawsuit against RGSH and the two employees. The suit charged the defendants with offering to sell Lotus's trade secrets and confidential information and sought injunctive relief and damages. RGSH filed a countersuit against Lotus; denying the charges and claiming that the agency had the right to market its past experience.

The lawsuits were resolved by RGSH issuing a public apology to Lotus and pledging continued protection of Lotus' confidential information. The agency also volunteered not to solicit or undertake projects involving software products for ten months without Lotus' permission. RSGH did not attribute any account losses to this episode but did recognize that its reputation had been damaged and its account acquisition and growth had been adversely affected.

A quite different threat to confidentiality surfaced during the course of an agency review conducted by Levi Strauss in 2008 for the media planning and buying accounts of two brands, Levi and Dockers (Bush 2008). The RFP sent to candidates for the assignment asked for "supporting documentation" in the form of vendor invoice data to be used in analyzing agencies' capabilities. Despite the explicit warning included in the RFP against submitting information that could be used to identify the specific clients involved, many media professionals indicated that relating the information requested to other available databases would be sufficient to infer the identity of the brands to which the invoices applied, thereby revealing highly sensitive client-specific media price data. Thus by complying with this request, agencies risked breaching confidentiality agreements with their clients. The AAAA's executive vice-president for agency management services, John Finneran, was quoted as saying that such a request was inconsistent with best-practice guidelines for confidentiality agreements between agencies and clients (Bush

2008). To the best of the present author's knowledge, no breach or litigation relating to this case was reported in the trade press,

6.2 Internal Agency Organizational and Locational Barriers

In the early 1980's, large agencies occasionally used subsidiaries to resolve conflicts by offering to assign an account to a unit whose organization and location remained separated from the parent agency (Klingman 1983). Client reaction was mixed. Even those willing to accept working with a subsidiary of an agency who served a rival insisted on specific safeguards, such as complete separation of the subsidiary's creative staff from the parent organization. Others were concerned about the risk of security breaches arising from employee transfers or at higher organizational levels such as agency planning reviews and remained skeptical. One client characterized such separations as "just a sleight of hand" (Klingman 1983). For their part, agencies maintained that the subsidiaries were acquisitions that had been made primarily as part of their diversification and globalization strategies rather than as means of addressing client conflicts.

As consolidation and globalization on both the demand and supply sides of the market for advertising and marketing services gained momentum, the choices open to major clients diminished.[21] In this changed environment, clients became more willing to relax their demands for exclusivity at the holding company level, given the protection offered by organizational and locational separation , including "Chinese walls" (Fitzgerald 2004). Rosenshine (2006) describes the safeguards offered to Chrysler when BBDO, Doyle Dane Bernbach (DDB) and Needham-Harper merged to form Omnicom in 1986. Each of the three

[21] Rothenberg (1994) notes that at the outset of Subaru's 1990 agency search, the firm developed a consideration set consisting of approximately 150 agencies but "three dozen or more had to be eliminated because they already had car accounts, or were parts of agency networks that had them" (p. 24).

agencies had a major automotive account, creating the potential for a Cell #11 conflict (Table 2). The safeguards promised "completely different managements and staffs, each located in their own, unshared offices" and provided specific contractual stipulations against breaches of confidentiality, including a provision that former BBDO employees would not be permitted to join DDB immediately after leaving BBDO since DDB held the Volkswagen account (pp. 230-232).

Realizing that assurances of separation gave them a flexible tool to circumvent conflicts, holding companies introduced additional modes of organization designed to foster client acceptance, such as several networks operated in parallel with one another but each one internally conflict-free and occasionally even dedicated to serving a specific client. The challenge for holding company management was to develop control and incentive systems that allowed the networks to operate in a relatively autonomous but coordinated manner while at the same time crediting revenues and allocating costs to agency brands and specialized units so as to attract and retain talent and encourage efficient operations. Holding companies were able to gain particular advantage from these organizational arrangements by unbundling their media planning and buying services and attracting large multi-brand advertisers who were willing to consolidate their media accounts in order to capture the size-related cost economies offered by holding companies (Arzaghi et al. 2010). As a result, client demands for exclusivity became more fragmented as described by Chura and Wentz (2004):

> Some marketers will share an agency with a competitor as long as they are in different offices, while others will share the same office given sufficient Chinese walls. Some companies, however, so rabidly distrust their competitors they won't share a holding company with them. In the middle is the vast majority satisfied with regional exclusivity (p.16).[22]

[22] Michell et al. (1992) also noted variations in clients' sensitivity to account conflicts from comments made by advertisers in audits of agency-client relations.

The preceding discussion of security breaches and related safeguards is quite narrow in that it focuses on threats to the confidentiality of strategic client information. Virtually absent from the advertising and marketing literature are discussions of the nature and use of organization design and information systems to control access to sensitive information, much less the issues surrounding their design, implementation, and effectiveness. By contrast, a substantial literature has developed in the fields of accounting, finance, and information systems that address a similar set of issues in those domains which are subject to regulatory requirements (e.g., Bolton, Freizas, and Shapiro 2007; Bolster, Pantalone, Trahan 2010). A number of major security breaches have occurred recently where hackers have compromised proprietary customer databases (*Economist* 2011); one involved Epsilon, which ranked was the world's eleventh largest advertising services company in *Advertising Age's* 2010 ranking.

6.3 Mobility Barriers

6.3.1 Jilting and Conflict Insurance

Silk and Berndt (1994) suggested that exclusivity functioned as a form of "mobility barrier" (Caves and Porter 1977) in the sense that it is a prohibition that denies an agency the freedom to serve competitors of an existing client. From time to time, agencies have reacted to this restriction proactively by withdrawing their services from an incumbent client in order to take on the account of a rival of the incumbent, an action sometime referred to as "jilting." Such resignations are uncommon but when an agency does abandon an incumbent client for a rival, it typically does so with the expectation that the rival represents a more lucrative opportunity than the incumbent.[23] Thus jilting represents a means of circumventing the constraint exclusivity places on an agency's ability to leverage its industry-specific expertise by replacing an

[23] Conversely, agencies have been known to adopt a policy of never resigning one account to accept a larger conflicting account (Taylor 1990).

incumbent with a more attractive rival. An early example was McCann-Erickson's resignation in 1958 of its Chrysler account in order to accept the smaller Buick account, soon followed by award of GM's Truck and Coach Division account. Chrysler management reacted negatively and proceeded to dismiss McCann immediately, refusing to accept the agency's resignation with the usual ninety days advance notice (Geier 2009, pp. 34-36).

In 1994 when IBM was reported to have dismissed forty agencies after consolidating its advertising business at Ogilvy & Mather (O&M), the agency resigned the accounts of two incumbent clients, Compaq and Microsoft, who were viewed as competing directly with IBM. O&M also handled AT&T's overseas corporate advertising but O&M did not regard IBM as being in direct competition with AT&T. However, AT&T concluded that IBM's presence at O&M did pose a conflict (Cell#11) since previously IBM had entered into alliances with other long-distance telephone carriers (Levin 1994, p. D4). O&M's offer to establish a separate subsidiary within WPP to serve AT&T was declined and AT&T transferred its accounts to four other agencies. Thus, in acquiring IBM as a client, O&M gained an estimated $400-500 million in billings, but gave up billings totaling more than $200 million from the three clients that it lost by doing so (Landler and Berry 1994).

In June, 2009, Crown Imports announced that it was shifting the creative assignment for its Corona Light brand to Publicis New York. That agency that did not have a beer account at that time but had previously served Heineken. Only a month later, there was a further announcement that Publicis and Corona Light had "jointly decided not to engage in a relationship" at that time due to other conversations Publicis was having with another brewer "that would have an impact on any long-term relationship with Corona" (Mullman 2009a).

Shortly thereafter, Anheuser-Busch InBev awarded Publicis the global account for Beck's Beer (Mullman 2009c).

Not surprisingly, clients tend to regard agency resignation of an incumbent account to serve a rival as a disruptive and opportunistic act of disloyalty. As a safeguard against unwanted agency account resignations, some clients have sought a provision for "conflict insurance" in agency-client contracts in the form of an indemnification clause that requires an agency to pay a substantial penalty in the event the agency resigns the account following a merger or acquisition. Conflict insurance appears to have been introduced in late 1980's as reaction by clients to conflicts and account resignations that accompanied agency mergers. The most publicized cases involved the Shulton Division of American Cyanamid, Nissan Motors, and Scott Paper, all clients of the search consulting firm, Canter, Achenbaum Associates (CAA). CAA's chairman explained that clients sought protection "from being forced to switch agencies, which can be disruptive, costly, and time consuming" (Lafayette 1987, p. 1). The amount of the penalty was not disclosed but was rumored to be "in seven figures." In the case of contract between Nissan Motors and its agency, Hill, Holliday, Connors, Cosmopulos (HHCC), the protection was for five years. Notably absent from the discussions of conflict insurance appearing in the trade press were explicit references to the threat of breaches of confidentiality following account resignations.

In response to a senior HHC executive's characterization of the Nissan agreement as "balanced and fair," (Horton and Lafayette 1988, p.1), an *Advertising* Age editorial rhetorically asked: "Does Nissan guarantee it won't fire Hill Holiday for five years?" (1988). Conflict insurance seeks to limit an agency's freedom to select which client among a set of competitors (however defined) it can serve and in so doing, raises the mobility barrier imposed on agencies

beyond the level represented by adherence to client demands for exclusivity. That is, whereas exclusivity requires that only one of a set of rivals can be served by a single agency, conflict insurance attempts to dictate that an incumbent client cannot be dropped by an agency in order to serve a rival of the incumbent without payment of an economic penalty. Put differently, conflict insurance puts teeth in exclusivity as a conflict policy, but at a cost born by agencies.

6.3.2 Poaching and Agency Employment Contractual Provisions

Conflicts of interest may arise between agencies as a result of alleged efforts by one agency to recruit employees and/or attract clients from another agency, a practice labeled as "poaching." Inter-agency conflicts of interest may also involve actions that threaten the interests of an agency's present or former clients when ex-agency employees possess proprietary information that clients supplied to their agencies. Whereas *non-compete* provisions specify restrictions placed on a former employee with respect to working for a competitor, *non-solicitation* provisions deter ex-employee from recruiting current clients and/or employees of his/her former employer.

In 2006, the former President and CEO of Agency.com (a unit of Omnicom) entered into a separation agreement with his former employer under which he would be compensated and remain an employee for six months while seeking non-conflicting employment. He subsequently joined iCrossing, first as Chief Operating Officer and later President and CEO (Parekh 2008). Agency.com claimed that in violation of the separation agreement, their former employee had "raided" Agency.com's employees and clients and brought a suit against iCrossing and its ex-employee. In July, 2006, that action culminated in the signing of a settlement agreement prohibited iCrossing from soliciting Agency.com employees and clients for specified periods. Despite the agreement, Agency.com alleged the solicitation of employees and clients continued,

leading to the closing of Agency.com's Dallas office and the "decimation" of its Chicago office. Another round of litigation ensued in November, 2008 when Agency.com and Omnicom alleged breach of contract, and conspiring to misappropriate proprietary information and trade secrets and sought $19.5 million in damages from iCrossing for poaching (Vranica 2008). The dispute was finally resolved with iCrossing paying Agency.com and Omnicom an undisclosed sum (Parekh 2010a).

A somewhat similar case of alleged poaching of employees and clients was brought by McCann Erickson against Kirshenbaum Bond Senecal & Partners (KBS) following the hiring of a former McCann president by KBS as president and CEO of the latter firm. In this instance, the lawsuit was quickly settled, apparently at the urging of a common client, with no admission of wrongdoing or payment of damages. Interestingly, a lawyer not involved in the case observed that lawsuits of this kind can be "'used as a tool to emphasize and reinforce the notion of 'You can't interfere with our business'" (Parekh 2010b).

Although seemingly rare, charges of poaching have sometimes been raised when an agency hires an employee of an incumbent client to work on the account of a rival of the incumbent client. Such an incident arose in 2003 when the general manager of General Motors' (GM) Pontiac and Buick division, who had worked at GM's Chevrolet division for more than thirty years, was hired by Saatchi & Saatchi to oversee its Toyota USA account. Saatchi & Saatchi is owned by the Publicis Groupe, as are Leo Burnett and Chemistri who served GM's Oldsmobile, Cadillac, and Pontiac brands. GM's billings with Publicis were estimated to be $350 million while Toyota Motors USA's advertising outlays exceeded $600 million (Elliot 2003). According to press reports, neither Publicis nor Saatchi & Saatchi had given advance warning to GM of their intention to employ the GM executive (Halliday 2003). Upon learning of the hiring,

GM's executive director of corporate advertising publically expressed GM's "extreme displeasure" at Publicis' action, labeling it "unacceptable and inappropriate" (Halliday 2003). Within a month, it was announced that the former GM executive was leaving Saatchi & Saatchi. No allegations of breaches of confidentiality or contractual obligations were mentioned in press coverage of this episode.

The use of non-compete covenants in employment contracts has long been controversial: within the advertising and marketing services industry and beyond; in the U.S. and abroad. [24] While non-compete provisions may serve to protect the intellectual property rights of an employer against the unauthorized transfer of proprietary knowledge, such provisions may also adversely affect an individual's freedom of employment, firm competition, and economic growth. Given that non-compete provisions can be a two-edged sword, enforcement in the U.S. is uncertain and varies across states. Bishara and Orozco (2011) describe the current state of enforcement in the U.S. as follows:

> Although the majority of states will enforce noncompetes to some extent, there a few high-profile instances where, on the margins, states essentially ban the use of employee noncompetes. In those states the courts consistently uphold the ban based on public policy grounds. However those do allow some sort of post-employment noncompetet enforcement will apply a reasonableness test coupled with an evaluation of the stakeholder's interests. Thus, consensus among enforcing states centers on the reasonableness test to balance the rights of several stakeholders: the parties to the contract …. as well as considering the policy impact and the public interest" (pp. 12-13).

These uncertainties surrounding enforcement are among the reasons that the less restrictive non-solicitation provisions are favored over the more restrictive non-compete covenants in the advertising and marketing services industry (Morrison 2012).

[24] See Bishara and Orozco (2011) for s recent review of the relevant economic, legal, and management literature.

7.0 ECONOMIC ANALYSIS OF AGENCY-CLIENT CONFLICTS OF INTEREST

In this section, I review the available body of theoretical and empirical research that addresses various issues relating to conflict policy and its economic effects. The first sub-section discusses research on the effect switching agencies may have on the market valuation of a client firm while the second sub-section examines concentrations levels and the size structure of firms in the U.S. A&MS industry. The third sub-section considers how exclusivity functions as a mobility barrier and affects the diversification of agencies and holding companies. The final sub-section is concerned with how competition in a oligopolistic market affects a firm's choice of conflict policy.

7.1 Event Studies of the Effect of Changing Agencies

Turnover is a familiar but generally unwelcome element of agency-client relations. The movement of accounts among agencies is a costly and disruptive event for both clients and agencies. However, clients ordinarily expect changing agencies will lead to more effective advertising and improve their firms' performance**.** Does changing agencies affect the value of the client firm? This question has been investigated in a handful of papers reporting applications of the event study methodology widely employed in economics and finance (Campbell, Lo, and MacKinlay 1997, Chapter 4). The method assumes that stock markets are efficient and current share prices reflect currently available information. The revelation of new information may alter investors' expectations about the firm's future value and will be reflected in changes in the share price. Hence, assessment of the impact of an event that discloses new information bearing on a firm's future performance requires measurement of the *abnormal* return of the security which is defined as the difference of the actual or observed return and the *normal* return expected in the absence of the event. The latter is estimated from a model that relates the return on the firm's

security to the market return for a portfolio of securities and assumes a stable linear relation between the two over time.

Use of the event study methodology to assess the effect of changing agencies on the valuation of client firms call for careful consideration of the method's core requirements. The first is that the firms must be publicly traded. Since most publicly traded corporations are multiproduct firms, the question arises as to whether the agency assignment of interest is of sufficient scope to have a material effect on the firm's overall performance? For example, one might argue that a change in agency is likely to have a greater effect on firm value if the firm is a "single branded house" than if it is a "house of many brands" (Aaker and Joachimsthaler 2000).

A second requirement involves identifying the event and pinpointing the date of its occurrence. A change in agencies is generally the outcome of a multistage process that begins when a client discloses that an account in "under review." The client may (or may not) invite the incumbent agency to participate in the competition and retain the account and the incumbent may (or may not) choose to do so. Disclosure that an account is under review is followed by a prolonged period of uncertainty as to how the client's advertising may change. It is not uncommon for the agency search and screening process to consume several months before the appointee is announced. Information might be disclosed or leaked at different points in this process that could affect the market value of the client firm. Changes in agency-client affiliations occur for many reasons and conflicts of interest are only one of several possible factors contributing to the dissolution of agency-client relationships. Nonetheless, it is of interest to review this body of research and assess what insights it offers into the economic impact a client faces by terminating an agency relationship, the option of last resort available to settle a dispute over conflict policy.

Table 3 summarizes key details relating to the methodology and results from four studies that have investigated the effects on the market valuations of client firms of public announcements relating to various aspects of changes in agency-client relationships, using the event study methodology. The ordering of the studies in Table 3 is chronological, based on their publication date. The sizes of the samples of announcements studied varied from a minimum of 26 (#3) to a maximum of 173 (#2) and covered periods of varying duration, ranging from 6 to 9 years in the 1980's and 1990's. The source of the announcements for #1 was the weekly magazine, *ADWEEK,* while the other three studies relied on daily issues of the *Wall Street Journal*.[25] The estimation windows employed in modeling normal returns ranged from 125 to 255 days. The length of the event windows for which the average abnormal returns (AAR) were reported tended to be non-uniform, making comparisons of the results across the four studies difficult.

Of particular interest here are the differences in the information content of the announcements that was disclosed in the public announcements selected for inclusion in each study. Whereas #1, #3, and #4 focused on announcements relating to stages or steps in the aforementioned process that culminated in an existing account being switched from one agency to another, #2 considered announcements disclosing that a corporation had established a "new account" for an activity that the client had not previously assigned to an agency. In the latter study, the only statistically significant effect found for the total sample of 173 events was a CAR

[25] Table 3 highlights differences in important details of the four studies which also shared a number of common features. All the studies utilized daily returns obtained from the Center for Research on Security Prices (CRSP), University of Chicago and estimated normal returns from a market model with an equally weighted market portfolio also drawn from CRSP. Announcements were excluded where confounding events had occurred and the estimation windows did not overlap with the event windows.

of -0.50% ($p<.05$) for the two day event window encompassing the day "new" account assignments were announced and the preceding day (i.e., t to t-1).[26] Most of the announcements (123 of the 173) were cases where a "regular" or ongoing activity of the firm had been assigned to an agency for the first time and for that sub-sample, the pattern of results was similar to those obtained for the total sample shown in Table 3. When the announcements of agency assignments related to "new" activities being undertaken by the firm, there were indications of delayed positive effects, the detection of which was limited by the small size of the new announcement sub-sample.

Turning to the results from #1, #3, ands #4 where the focal announcement events all related to agency changes, one notes from Table 1 that no statistically significant effect on abnormal returns (AAR's) was detected on the day of the announcement (t=0) in any of these three studies. However, there is evidence from both #3 and #4 that a small, negative effect occurred two days prior to the announcement (t-2); sign tests indicate that each of the effects was statistically significant at the .01 level. These results suggest that some "leakage" of information relating to the dismissal of agencies preceded the public announcements.

In #4, Kulkarni et al. (2003) followed up the 41 case where clients had dismissed their agencies by investigating the effects of changing agencies on the market evaluations of both the agencies dismissed and their replacements. Only a minority of agencies are publicly traded and for the 41 cases of agency dismissals, the stock price required was available for 18 agencies that had been dismissed and 10 agencies that had been appointed as replacements. As Kulkarni et al. (2003) put it, the results indicated that "investors view being hired as a replacement as good news and being fired as bad news for an agency" (p.83). Despite the small sample sizes, the

[26] Daily average abnormal returns (AAR) were not reported for Study #2.

AAR on the day of the announcement was found to be significantly negative (0.84%, $p<.05$) for dismissed agencies but significantly positive (3.71%, $p<.001$) for replacement agencies.

Overall, these results suggest that if present, the effects of information pertaining to various types of changes in agency-client relations on the market valuations of client firms are likely to be small and heterogeneous. For example, the samples of daily abnormal returns rarely departed from being equally split between positive and negative effects in the pre and post event periods. The event sample size was less than one hundred in three of the four studies and none reported an analysis of the power of the statistical tests employed.

Perhaps the most important lesson to be drawn from the four studies reviewed here is that if the event study methodology is to be successfully applied to the study of agency changes, then more attention should be given to satisfying the methodology's basic data requirements discussed above. The first requirement calls for identifying the specific brand/product/ activity that is the referent for the information content in the announcements included in the study. Such identification is necessary to establish a plausible rationale for expecting that the information content of the announcements will affect a firm's overall performance as measured by its stock price when the firm is a multiproduct corporation and is likely to employ a roster of several agencies that serve its various lines of business. Hypotheses about how characteristics of the announcement events are related to the firm level measure of abnormal returns could be investigated using a cross-sectional regression model, as discussed in Campbell, Lo, and MacKinlay (1997, pp.173-175). Variables that could be used to characterize the announcement might include indicators from Aaker and Joachimsthaler's (2000) typology of brand architecture to capture firm differences in product line branding strategy and measures of the scale and scope

of the focal agency accounts. Mathur and Mathur (1996) found that account size was associated with the client firm's abnormal returns.

To cope with the problem of the leakage of information at different points in time when the appointment of an agency is the outcome of a multistage process, one might adopt the technique sometimes utilized in event studies where the event is partitioned into a sequence of sub-events. The latter are included in the market model as a series of dummy variables as a means of capturing the gradual release or flow of information over time (Lafontaine and Slater 2008, pp. 402-403).

7.2 Concentration Levels and the Size Structure of the U.S. Advertising and Marketing Services Industry

At a micro level, the restrictiveness of conflict polices affects the options available to clients in selecting agencies and those of agencies in acquiring and retaining clients and accounts. Aggregating these micro level effects, the question becomes: how does the restrictiveness of conflict policies affect the size distribution of firms in the industry as a whole? Recall from Section 2.1 that Nanda (2004a) hypothesized how conflict policies affect the size structure of firms comprising an industry: the more restrictive of conflict norms, the smaller the size of firms, and the more fragmented or less concentrated will be the organization of the industry. We postpone discussion of conflict policy and scale economies until Section 7.2 and focus here on industry's size structure and concentration.

In the case of the U.S., Silk and King (2012) have analyzed concentration levels in A&MS industry using data from the Census Bureau's quinquennial Economic Census and its Service Annual Survey. The U.S. A&MS industry was defined in terms of nine sectors, each of which was represented by a separate 5 digit NAICS category. Their study yielded three major

findings. First, in the case of the core and largest sector, Advertising Agencies, firm level concentration as measured by Herfindahl-Hirschman Index (HHI) increased slightly from 1977 to 2002 but then declined in 2007. All of the HHI estimates readily satisfy the standard used by the Department of Justice and the Federal Trade Commission to characterize an industry as "unconcentrated." [27] Second, concentration levels in 1997, 2002, and 2007 varied across the nine sectors comprising the A&MS industry, but all were within the range generally considered as indicative of a competitive industry.[28] Third, Silk and King found that the four largest holding companies captured between a fifth and a quarter of total revenue from the U.S. A&MS industry, and exhibited no discernible trend over the period, 2002-2009. These shares are approximately one-half the magnitude of comparable estimates often cited in the trade press. The persistence of a diverse and relatively unconcentrated size structure appears quite consistent with a small but growing body of research that has investigated the underlying economics of the A&MS business and provides a theoretical and empirical foundation for understanding the organization of this industry. See Silk and King (2012) and the references cited therein.

In line with Nanda's hypotheses, at the level of individual firms operating in different sectors among which exclusivity polices can vary, low levels of concentration are to be expected and were found to have been maintained over time. At the holding company level, where presumably restrictive exclusivity has been circumvented if not entirely avoided, the level of concentration is surprisingly modest in the U.S. A&MS market. It would be valuable to undertake cross national comparisons of concentration levels in the U.S. with those in Japan and

[27] See: U.S. Department of Justice and the Federal Trade Commission," Horizontal Merger Guidelines," Revised April 8, 1997 and "Horizontal Merger Guidelines," Issued August 19, 2010. Markets with HHF's below 1,000 were classified as "unconcentrated" in the *1997 Guidelines* but that cutoff level was raised to 1,500 in the *2010 Guidelines*. Both Guidelines are available at: http://www.usdoj.org.

[28] The nine sectors included: advertising agencies, public relations, media buying, display, direct mail, advertising materials, other advertising services, marketing research and polling, and marketing consulting.

Europe where it has been suggested that the contrasting conflict norms present in those markets have affected the size structure of firms in different ways (Morean 2000, EACA 2002).

7.3 Exclusivity as an Institutional Mobility Barrier: Diversification by Agencies and Holding Companies

What accounts for the diversity and limited concentrated that has long characterized the U.S. advertising agency business? Silk and Berndt (1995) investigated this question by relating the economics of the advertising agency business to MacDonald and Slivinski's (1987) analysis of the nature of the equilibrium that arises in an industry with multiproduct firms. An agency's output consists of the mix of services it supplies clients in the course of creating and implementing advertising campaigns. Drawing on a body of relevant empirical evidence, Silk and Berndt (1995) show that the advertising agency business possesses the essential demand and cost characteristics singled out by MacDonald and Slivinski (1987) as factors that give rise to a competitive equilibrium such that the industry structure consists of diversified agencies serving national advertisers and small agencies playing a fringe role by serving regional and local advertisers. The key features are free entry, low fixed costs, and demand unevenly distributed across the portfolio of services or disciplines agencies supply.

Silk and Berndt also argued that industry practices with respect to the prohibition against an agency from serving competing accounts and the bundling of services provide additional incentives for agencies to diversify and as a consequence, affect the industry's structure. Given that the skewness in demand for agency services varies across product categories or sectors, rivals of an agency's existing accounts or clients are likely to demand a mix of services similar to that which it already offers. On the other hand, accounts in product categories or markets currently unserved by the agency are likely to demand a different mix of services. As a result, the industry norm of exclusivity restricts an agency seeking to grow from doing so by simply

expanding the scale of its existing operations; instead, the agency's growth opportunities are more likely to be found among accounts in other un-served categories or markets and require the agency to extend the scope of its service offerings to satisfy their demands. Thus, the industry norm prohibiting agencies from serving competing accounts constitute an institutional mobility barrier (in the sense of Caves and Porter 1977) that leads individual agencies to grow by diversifying their lines of services rather than by expanding existing ones.

Traditionally, "full-service" agencies "bundled" the mix of services supplied to a client and were compensated by commissions earned on purchases of media time and space made on a behalf of the client (Arzaghi et al. 2010). In the face of client demand for an ever expanding array of services to support their marketing programs, these allied practices of bundling and compensation via media commissions also served to encourage agencies to extend the scope of their service offerings. Based on these considerations, Silk and Berndt (1995) proposed and tested the hypothesis of "excessive" diversification: "the joint presence of media bundling on the demand side and conflict policy on the supply side constitute institutional constraints that induce agencies to diversify more extensively than might otherwise be cost justified" (p.439).

Utilizing the multiproduct agency cost function developed by Silk and Berndt (1993), Silk and Berndt (1995) estimated measures of product-specific scale and scope economies from the 1987 domestic operating results for a cross-section of 401 U.S. advertising agencies that varied widely in size. An agency's product line or service mix was operationally defined in terms of the shares of its income derived from a set of eight categories of media which had been employed in the campaigns created for clients plus a composite ninth category covering income from other non-media related services. The measure of media-specific scope economies represents the percent cost savings realized by *jointly* producing advertising services involving a

particular medium j along with advertising in the other (n-j) media, as opposed to producing advertising for medium j *separately*. If joint production is less costly than separate production, then *economies of scope* are realized from producing services for advertising in medium j. However, if joint production is more costly than separate production, *diseconomies of scope* are present. Note that the cost comparison underlying the measure of medium-specific scope economies addresses the question that is relevant when an agency considers adding an additional service to its mix of offerings: is it more cost-effective to produce that service within the existing agency or to produce it in a separate unit?

Silk and Berndt (1995) results provide a revealing picture of the role of scope economies in agency diversification. First, the pattern of diversification varied considerably across agencies. The number of media-related categories from which agencies reported non-zero level of income varied from two to all nine, with 86 percent of the sample agencies active in six or more categories. Second, within each of the nine service categories, the sign and magnitude of scope economies varied markedly across agencies. Some agencies were able to capture economies of scope and realize cost savings from joint production while other agencies experienced some measure of diseconomies of scope and suffered a cost disadvantage through joint production. The percentage of agencies operating in each service category for whom joint production of that output is more efficient than producing it separately ranged from a low of approximately 50 percent in the cases to network and spot television to 78 percent and 85 percent for direct response and display advertising, respectively. Finally, when the measure of medium-specific scale economies was regressed on agency size (gross income), the relation was found to be negative for each of the nine media-related service categories. These results are consistent with the "excessive diversification" hypothesis that large agencies may experience diseconomies of

scope as a result of excessive diversification induced by institutional mobility barriers in the form of conflict policy and bundling.

The preceding discussion was focused on the U.S. operations of individual advertising agencies. A major motivation for the original formation of holding companies was to obviate the strictures imposed by the industry norm of exclusivity. To accomplish that goal, holding companies adopted a decentralized organization structure wherein a set of affiliated agencies or networks that offer more or less similar mixes of service operate in parallel but independently of one another, and indeed routinely compete with one another for clients and accounts. Over the period 1990-2001, the nominal annual growth rate in worldwide gross incomes of the ten largest holding companies averaged almost 13 percent, approximately three times greater than the rate of growth in global expenditures for advertising and marketing services (Silk and Berndt 2004). The holding companies played a major role in the consolidation that has occurred in the advertising and marketing services over the past three decades, having initiated hundreds of mergers and acquisitions around the world. As a result of their rapid growth via diversification, globalization, and consolidation, holding companies, the scale and scope of holding companies is vastly different than that of domestic advertising agencies. The question naturally arises as to whether holding companies have escaped the tendency for large U.S. agencies to be "excessively diversified" and attributed to bundling and the exclusivity norm functioning as institutional mobility barriers.

Silk and Berndt (2004) investigated the cost economies of the eight largest holding companies over the period 1989-2001. They obtained measures of scale and scope economies by estimating a translog cost function which captured two dimension of holding company scope: (a) lines of business (advertising-related vs. other marketing services), and (b) market served (U.S.

vs. overseas markets. The results showed that all the holding companies had realized economies of scope in each of the years covered by the study for both dimensions of scope. The cost savings obtained from joint as opposed to separate production were small (median of approximately 2 percent) but uniformly positive. Moreover, the form of the relationship between holding company size (worldwide gross income) and cost savings was found to be J-shaped (convex from below). Thus in contrast to Silk and Berndt's(1994) earlier study of individual advertising agencies, they found no evidence of excessive diversification by large holding companies. To the contrary, at low levels of holding company size, scope economies appeared to decrease with increases in HC size and hence small HCs may have under-diversified in the sense that greater scope economies were realized by those HCs able to achieve gross incomes above the inflexion point in the J-shaped relationship between size and scope economies.

7.4 Oligopolistic Rivalry and Advertiser's Choice of Exclusive vs. Shared Agency

As discussed in Section 3.1, whereas the norm of exclusivity gained acceptance early in the history of the advertising industry in the U.S. and Europe, sharing a common agency has long been accepted in Japan. The question that naturally arises is: under what conditions would competing advertisers opt for one policy rather than the other? Villas-Boas (1991, 1994) has addressed this question. Drawing upon the theory of information sharing in oligopoly (Raith 1996), Villas-Boas developed a multi-stage model of the decisions faced by a pair of rivals competing in the same market when choosing whether to share a common agency or to employ separate agencies.

Villas-Boas treats a conflict of interest as arising when, in the language of game theory, each rival has "private information" about his/her "type" (i.e., simply put, any information relevant to decision-making that is not "common knowledge" to all players) and the agency

serving the rival becomes privy to that private information. Consistent with the norm of exclusivity, Villas-Boas sets up the model such that if the rivals employ different agencies, no information sharing occurs and private information remains confidential. However, if the rivals share a common agency, information transfers can take place and the agency will earn additional compensation for doing so. By virtue of its relationship with the rivals, a common agency represents a credible communication channel for transferring private information between rivals. The issue then becomes: What effects might such information transfers have on the two rival's strategies and payoffs?

To facilitate the discussion, denote the rivals as U (Us) and T (Them). In the course of working together, U and T reveal their private information to their common agency, who may then exploit that information by revealing one rival's private information to the other. The common agency may decide to transfer information to neither, one, or both of the two rivals. The information transmitted by U's agency about U to T is an imperfect signal (s_u) about U's true "type" (p_u) and the quality of the signal is represented by q_t, an index of the degree to which T is well informed about U by s_u. That is, q_t is the probability that s_u is correct and T is "completely informed" about U's true type (p_u) by the signal (s_u): if q_t=1, T is completely informed about U, while if q_t=0, T is completely "uninformed" about U. The information upon which T bases it action (a_t) consists of two components: its own "type" (p_t) and the imperfect signal relating to its rival's type (s_u). Similarly, U's action (a_u) reflect its type (p_u) and the information about its rival's type obtained via the imperfect signal it received (s_t), such that T is completely informed about U with probability, p_u. To illustrate these constructs, Villas-Boas suggests "repositioning" as an example of an action taken by U (a_u) where its intrinsic type (p_u) could represent the cost or

difficulty of repositioning and the imperfect signal it receives about its rival's type (s_t), bears on T's positioning capabilities.

When the rivals share a common agency, several alternative information structures may exist, depending on how the actions and the expected payoffs of the two rivals vary according to what U knows about T and what T knows about U which, in turn, depend up the "informativeness" (q) of the rival's signal (s) and the distribution of the possible types (p) each might select, which are assumed to be continuously and independently distributed as $F_u(p_u)$ and $F_t(p_t)$ for U and T, respectively. Villas-Boas further assumes that the payoff for an advertiser's strategy is a quadratic function of its own action (a_u) and type (p_u), and the rival's action (a_t) and their pairwise interactions. The influence of changes in the rivals' actions and types on their payoffs is given by the first and second order partial derivatives of the quadratic function with respect to the action and type variables. Using this model, Villas-Boas derives the equilibrium strategies for the two rivals and characterize the conditions under which two "common beliefs" about information transfers are satisfied: (1) a firm (U) is better off when it has more information about a competitor (T); and (2) a firm (U) is worse off when a competitor (T) has more information about U.[29] The conditions turn out to depend upon the sign and magnitudes of the second order partial derivatives of the quadratic equilibrium strategy function, some of which reflect the sensitivity of a competitor's reaction to changes in its rival's actions.

Villas-Boas uses these conditions to evaluate the implications of changes in information structure on equilibrium payoffs so as to identify when a competitor would opt to share a common agency with its rival rather than each employing a separate agency. More specifically, he shows that three types of complex effects enter into the shared vs. separate agency decision. First, the choice is influenced by the "**decision-making framework effect**" wherein more

[29] See Propositions 1 and 2 in Villas-Boas (1994, pp. 196-198).

information is preferred because such permits actions to be better adjusted to the current state of the environment. That effect favors *always* sharing the same agency. Critically however, the other two effects can be such to *reverse* that outcome. The second component is the "**strategic effect**" that arises from the interaction between the competitor's reaction and the firm's private information. This effect can be positive or negative and manifests itself only when the rival has more information. Interestingly, under Common Belief #2 (above), the strategic effect is assumed to be negative and dominant, discouraging use of a common agency. The third element entering into the shared vs. separate agency decision is the "**uncertainty effect**" that results from a competitor's reactions becoming more variable with increases in information. The uncertainty effect may also be positive or negative, depending on how damaging the competitor's reactions are to the firm's equilibrium payoff.

Whereas writings on conflict are overwhelming concerned with issues of loyalty and the protection of confidential information, Villas-Boas addresses the possibility that for strategic reasons, an advertiser may wish to disclose confidential information to a rival and a shared agency could serve as an advantageous means for doing so. The EACA (2002) guidelines on conflicts recognized that such disclosure could occur but viewed that prospect dismissively:

> Agencies know that their own clients rarely if ever alter their own plans to counter what they hear of competitive intentions, although the practice is not completely unknown. They also know that most clients stake a very dim view of information which may be offered to them from agency sources, casting doubt as it inevitably would on the security of their own plans (p. 2).

No case where such behavior has occurred or is alleged to have occurred has been reported in any of the trade literature known to the present author. That said, the significance of Villas-Boas' paper lies in providing a theoretical foundation for analyzing the choice of a conflict policy by a client operating in a oligopolistic market who recognizes that it may be advantageous to share private information with rivals. An advertiser's decision to employ the same agency as a rival

rather than a separate agency carries implications for how changes in the information structure of the firm and its rival will affect the firm's payoff in equilibrium. Normatively, three distinct but complex effects should be considered to assess the net outcome and guide this policy decision. Villas-Boas' results demonstrate that exclusivity should not be expected to be adopted universally as a policy that will necessarily serve the interests of agencies and their rival clients. In and of themselves, "common beliefs" about the effects that the possession of more private information has on a firm and its rival do not justify either exclusivity or sharing; rather, conflict policy is a contingent matter.

Villas-Boas also explores how his results may explain the difference between the U.S. and Japanese advertising markets in prevailing norms with respect to account conflicts.[30] Of particular interest is the comparison he draws about the nature of competitive responses observed in consumer markets in Japan and the U.S. when information indicating a change in a rival's strategy comes to the fore, i.e., the "strategic effect." Villas-Boas (1994, p. 198) cites evidence indicating that when a rival launches a new product or repositions an existing product, Japanese firms are *less* likely than U.S. firms to respond with price promotions and advertising campaigns. However, Japanese firms are *more* likely than U.S. firms to respond by undertaking development of a competitive new product.

Acknowledging that there may be alternative explanations for such cross-national variation in defensive marketing strategies, Villas-Boas suggests that differences in competitive response may be related to whether the aforementioned *strategic effect* is positive or negative which, in turn, influences a firm's predilection to employ a common agency as a means of transmitting consequential information to a rival. If retaliation via price-oriented advertising and

[30] It should be noted that Villas-Boas' (1994) paper was published prior to the appearance of Moeran's work on Japan's split account system (1996, 2000).

promotional campaigns are particularly effective in disrupting a rival's launch of a new product or repositioning program, then all else being equal, U.S. firms will prefer agency exclusivity to reduce the risks of leakage of proprietary information. On the other hand, if the effects of accelerating the development of a new product are more distant than immediate, then Japanese firms may be indifferent to, or perhaps prefer that rivals be aware of their product development activities and therefore are willing to share a common agency. Villas-Boas further suggests that differences among markets with respect to "deep market parameters" may underlay differences in competitive response that, in turn, influence information sharing among rivals and preferences for exclusive vs. shared agency services. Ultimately then, these factors help shape the size structure and concentration level of an advertising agency industry in the market under consideration.

In light of Moeran's position that under the split account system, Japanese agencies tend to have more but smaller accounts than U.S. agencies, an interesting issue for future research is to compare the minimum efficient size of agencies in the Japan and the U.S.

8.0 DIRECTIONS FOR FURTHER RESEARCH

The preceding review has indicated that the formulation and administration of conflict policies have undergone considerable change in recent decades. Further, it is evident that much remains to be learned in order to close the substantial gap between the current state of practice in this domain and our understanding of the rationale underlying the nature and variety of policies being pursued. Below, I briefly outline a few of the directions that future research might productively follow.

First, research is needed on the substantive content of conflict policies and policy-making process. How are policies formulated within client firms, independent agencies, and holding companies? What options are considered, and what is the locus of organizational participation in policy design and decision-making? In what forms are conflict policies likely to find expression: as formal contractual provisions, as organizational guidelines, or as ad hoc responses to address particular issues? Has conflict policy become globalized, or do systematic cross-national differences exist? Has there been widespread replacement of exclusivity by hybrid conflict policies that combine split account assignments with enhanced safeguards? A variety of research designs (e.g., case studies based on interviews and participant-observation and cross-sectional surveys of informants) could be employed to investigate the above questions.

A different approach would be to gain access to a sample of written agency-client contracts and analyze their content, focusing on the terms of the agreement such as the scope of services, the specification of safeguards, and the definition of competition. The results of such studies would advance understanding of conflict policy and could also inform further theoretical analyses and model-building undertaken to address normative questions.

Second, the underdeveloped state of knowledge about the role of safeguards in addressing conflicts of interest deserves attention. What safeguards are employed to address what threats to security breaches? Do safeguards represent a major or minor expense? To what extent are safeguards client-specific or product-market specific? Are safeguards viewed as a credible substitute for exclusivity and an essential component of an agency's reputation?

Third, analyses bearing on the choice of a conflict policy and the design of agency-client contracts are needed to establish a theoretical foundation for understanding the conditions under which different policy options should be adopted and formulating normative guidelines. Perhaps

the most basic open question for economic modeling to address is: Are there conditions under which hybrid policies with account splitting and safeguards dominate strict exclusivity or free sharing of a common agency by rivals? Such analyses might also stimulate the development of decision-support systems to guide practice in formulating and evaluating policies.

Fourth, it would be desirable to examine disputes over conflict policy within the larger framework of the evolution of agency-client relationships. A growing body of research on customer-supplier relationships has investigated the erosion of relationships over time, a tendency referred to as the "dark side of close relationships" (Anderson and Jap 2005). Grayson and Ambler (1999) have shown how long term relationship between agencies and their clients can foster relationship dynamics that undermine the positive effects of trust, commitment, and involvement and Duhan and Sandvik (2009) have recently proposed and tested an extended model that links the interplay among commitment, trust, and cooperation to agency performance and client retention.

A fifth area worthy of further study is how conflict policies differ cross-nationally and what effects such differences have on agency switching and the longevity of agency-client relationships as well as concentration levels within national markets.[31]

Finally, in light of the changes in the use of traditional and new media in marketing communications now underway, it is well to ask how vertical relations among advertisers, agencies, and media supplies may be re-structured in the future and what conflict of interest issues may emerge in that environment.

[31] Interesting, the *Dentsu Annual Report 2011*suggests that whereas agency-client relations in Europe and the Americas are "usually exclusive," in Japan, they are "typically less exclusive" (Section on "Management's Discussion and Analysis of Financial Position and Operating Results," p. 10).

9.0 CONCLUSION

This paper set out to take a fresh look at a recurring and often contentious issue in agency-client relations: should an advertising agency simultaneously serve competing accounts or should an agency be restricted from doing so? Toward that end, I have attempted to: (1) trace the evolution and current state of industry practice with respect to conflict norms and policies; (2) review the body of conceptual and empirical research that is available about the sources and consequences of conflicts; and (3) outline some directions for future research to address unresolved policy issues.

Over the past three decades, the advertising and marketing services (A&MS) industry has undergone a number of major structural changes as both advertisers and service providers have pursued growth strategies emphasizing diversification and globalization and fueled ongoing waves of mergers and acquisitions on both sides of this market. Those developments were accompanied by changes in other longstanding industry practices: the unbundling of agency services; the related shift in agency compensation from commissions to cost-based methods; and the expanding role and influence of mega-agencies and holding companies. In the face of all these structural and policy changes, conflicts became more intricate and disruptive, especially those involving multiproduct corporate clients and mega-agencies/holding companies, which can have spillover effects that spread well beyond the original adversaries and unsettle other agency-client relationships. A typology of conflicts was introduced that reflects the principal dimensions of complexity and variety underlying contemporary conflicts.

Together, those development exposed the limitations of the traditional norm of exclusivity and set the stage for a more adaptive and less restrictive family of what I characterize as hybrid conflict policies (HCP's). The latter appear to have evolved from practice and feature split account assignments and substitute safeguards against security beaches for the traditional

and more restrictive forms of exclusivity. HCP's allow rival clients to be served by separate units that are under common control or ownership and offer a basis for accommodating the interests of agencies and clients and permit partial relaxation of strict exclusivity. Whereas in the not too distant past, the split account system was viewed as the anomaly found only in Japan, now it can be seen as forerunner of HCP's that holding companies have embraced and developed in ways that address the heterogeneous and dynamic demands of multiproduct and/or global clients for protection against breaches of security. The adaptability of this approach is achieved through flexibility in the ways a client splits accounts among quasi-independent units under common ownership and reliance on a variety of safeguards against security breaches in the form of internal organizational and locational barriers as well as contractual provisions that affect the mobility of accounts and personnel. The emergence of TCP's may also be taken as a further realization of Marian Harper's original vision of the holding company as an organizational form that would permit the "complete separation" of duplicate agencies under common ownership and thereby obviate the strictures of exclusivity on serving competing accounts.

Turning to the available body of empirical research on the effects of conflict policy, at the level of individual agencies operating in the U.S., there is support for the hypothesis that bundling in combination with the constraints imposed by exclusivity induces agencies to diversify the mix of services offered more extensively than could be otherwise cost-justified. However, no evidence of excessive diversification was found for holding companies which presumably face less restrictive conflict policies than do individual agencies. Over the past four decades, the size distribution of firms in U.S. advertising agency business has remained diverse and relatively unconcentrated. There is also reason to believe that the position of holding companies in the U.S. A&MS's market has been often been considerably overstated. Over the

most recent periods (2002-2009) for which consistent measures are available, the four largest holding companies have captured only 20-25 percent of U.S. total industry revenue — representing a four firm concentration level roughly one-half of that implied by flawed estimates that appear in the trade press.

Opportunities are abundant for a wide variety of studies to advance the underdeveloped state of present knowledge about conflict policies. If this paper stimulates renewed attention to discussing and investigating conflicts of interest in agency-client relations, it will have served its intended purpose.

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Figure 1

RESTRICTIVENESS OF CONFLICT POLICIES

Free Sharing of Common Agency by Rivals			**Complete Exclusivity**
	Split Account System	***Traditional Exclusivity***	***In-House Agency***
Low	**???**	**???**	**High**

Restrictiveness

Table 1

TYPOLOGY OF AGENCY-CLIENT CONFLICTS

Focal Agency	Scope of Agency Service	Scope of Focal Competitive Conflict [a]			
		Products: Intra-Category		*Firms: Inter-Categories*	
		Market Coverage		Market Coverage	
		Common Markets[b]	*Open Markets*[c]	*Common Markets*[b]	*Open Markets*[c]
Independent Agency Serves Both Incumbent Client & Rival	*"Full" or Extensive*	(1) Traditional Conflict	(2)	(3)	(4)
	Unbundled/ Partial (Split Acct.)	(5)	(6)	(7)	(8)
Separate Agencies within a Holding Company Serve Incumbent Client & Rival	*"Full" or Extensive*	(9)	(10)	(11)	(12)
	Unbundled/ Partial (Split Acct.)	(13)	(14)	(15)	(16)

[a] A competitive conflict arises when the focal agency serves a rival of an incumbent client.

[b] Common markets are markets where both the focal agency's incumbent client and a rival of that incumbent are active participants.

[c] Open markets are markets where the focal agency does not represent an existing client whom it serves elsewhere, either because that client employs different agencies in various markets where it is an active seller or because the existing client is not active in the market(s) under consideration.

Table 2

TYPES OF SAFEGUARDS

Safeguard	Threat of Breach	Instruments of Control Policy
Organizational and Locational Barriers: Separation of Agency Units	Unauthorized Access to Confidential Information	• Organization Design & Location • Assignment of Personnel to Accounts • Information Storage & Access • Chinese Walls
Mobility Barriers: Agency Employment Contractual Provisions	Turnover of Personnel & Accounts/Clients	• Non-Disclosure • Non-Compete • Non-Solicitation
Mobility Barriers: Agency-Client Contractual Provisions	Turnover of Accounts/Clients	• One vs. Two Sided Exclusivity • Conflict Insurance

Table 3

SUMMARY OF EVENT STUDIES OF THE EFFECTS OF ADVERTISING AGENCY CHANGES ON VALUE OF CLIENT FIRMS

	#1 (Rutherford, Thompson & Stone 1992)	**#2 (Mathur & Mathur 1996)**	**#3 (Hozier & Schatzberg 2000)**	**#4 (Kulkarni, Vora & Brown 2003)**
Subject of Announcement	Change in Agency	Establishment of New Account	Agency Termination &/or Review	Agency Termination
Size of Event Sample	88	173	26	41
Period Covered	1980-86	1989-94	1986-94	1981-99
Estimation Window for Market Model (No. of Days)	160 (T-191 to T-31)	125 (T-150 to T-25)	125 (T-135 to T-11)	255 (T-300 to T-46)
Event Window:				
Pre	T-30 to T-1	T-10 to T-1	T-10 to T-1	T-5 to T-1
Event	T	T	T	T
Post	T+1 to T+30	T+1 to T+10	T+1 to T+10	T+1
Results (Day)	AAR (%)	CAR (%)	AAR (%)	AAR (%)
-10	0.24	-0.30	-0.1	NA
.	.	[T-10 to T-6]	.	.
.	.		.	.
-5	0.13	0.32	0.1	-018
-4	-0.03	[T-5 to T-2]	0.4	0.17
-3	0.10		0.9	-0.31
-2	0.24	-0.50**	-0.3***	-0.38*
-1	-0.17	[T-1 to 0]	-0.1	-0.19
0=T	0.00		-0.1	0.22
+1	0.20		-0.1	0.19
+2	0.21	0.44	-0.1	NA
+3	0.04	[T+1 to T+5]	-0.2	NA
+4	0.19		-0.2	NA
+5	-0.18		1.1	NA
.	.	0.19	.	
.	.	[T+6 to T+10]	.	
+10	0.34		1.1	NA

***p< .10 **p < .05 ***p < .01**