

“The Advertising Agency Selection Contest: A Competitive Auction with Partially Reimbursed Participation Costs”

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ABSTRACT

In this work, we elaborate on how an advertiser ought to conduct a contest among full-service advertising agencies to select the best combination of creative quality and media cost. This contest is different from the traditional auction, in which the bidder that offers to perform the required tasks for the least money wins the contract. Instead, each participating agency can have a different creative quality and face a different cost of media buying, which our proposed auction combines into a single score. In contrast to the traditional procurement auction where only the winning bidder incurs a cost, in the advertising agencies' case, the bidders also face a cost of entering the auction. An upfront contest participation cost arising mostly from the need to develop a customized creative is borne by all participants except the incumbent agency currently servicing the account. In contrast, the subsequent cost of servicing the account, mainly related to media buying, is only borne by the winning agency. We show that it is optimal for the advertiser to reimburse the contest's losing agencies by a certain fraction of their upfront creative development expenses. Such a partial reimbursement policy attracts new outside agencies into participation, and the advertiser gains from the incumbent facing more competition. Without an incumbent, reimbursements are not profitable for the advertiser. In addition to providing a rationale for reimbursements, we also present evidence that about half the contests in this industry practice such reimbursement.