Promethean Research

Digital Agency Industry Report

2023 Edition

Contents

SECTION 01

Introduction

Digital agencies have been able to generate above-average returns and grow rapidly at an average rate of 16% per year since 2015. The sector has few, if any, barriers to entry, and thus the market as a whole is expanding at a rapid pace. This makes the industry incredibly attractive for many participants.

However, a closer look at the industry reveals an intriguing paradox. Despite its appeal, the industry's best practices remain inconsistently defined and disseminated. Over the past five years, there's been a tangible shift: agency owners are driving up the level of sophistication of their operations and becoming more strategic in their decision-making.

This report offers an in-depth analysis of this dynamic sector, identifying key trends, drivers, and standard structures of digital agencies. Our research encompasses over 45,000 digital agencies across more than 20 countries since 2015, utilizing online surveys, interviews, and secondary research sources. The insights we present are based on our proprietary data and other secondary sources.

This research, combined with additional data we've gathered, enables us to guide our digital agency clients more effectively. We strive to uncover opportunities, refine strategies, and design new pathways to success in an ever-changing environment. Join us as we delve into the heart of this rapidly evolving industry.

About The Author

Nicholas Petroski is the founder of Promethean Research.

Since 2015, he has helped over 100 digital agency owners better understand their industry and chart more effective paths to success.

Prior to cofounding Promethean, Nick worked as an equity analyst at a Wall Street firm where he covered the enterprise software and semiconductor industries.

When he's not in the office, you can find him backpacking around the Midwest or making elaborate firewood in his woodshop.

Disclaimer

This report is provided by Promethean Research LLC. It is for informational and educational purposes only as of the date of writing, and may not be appropriate for other purposes. The views and opinions expressed may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as business advice or recommendations, does not constitute a solicitation to buy or sell securities, and should not be considered specific business, legal, investment, or tax advice. The information contained in this report has been drawn from sources believed to be reliable, but is not guaranteed to be accurate or complete. This report may contain market and/or economic analysis and views, including about future economic and financial markets performance. These are based on certain assumptions and other factors, and are subject to inherent risks and uncertainties. The actual outcome may be materially different. Promethean Research LLC and its affiliates are not liable for any errors or omissions in the information, analysis, or views contained in this report, or for any loss or damage suffered.

SECTION 02

Top 10 Key Themes & Drivers

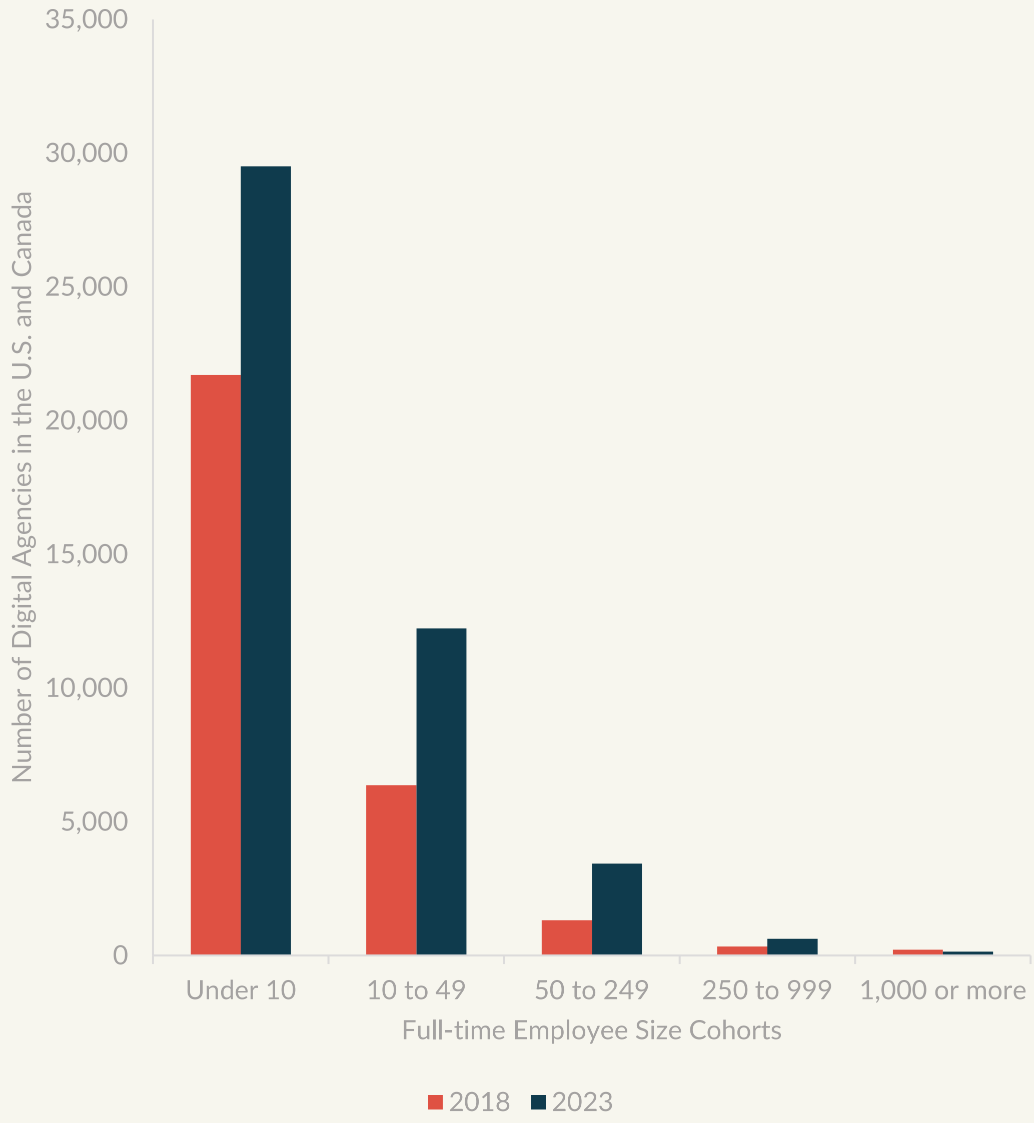
Top 10 Key Themes & Drivers

Digital agencies are driven by the needs of their clients. At large organizations, digital strategy will be directed by C-level executives and/or Vice Presidents of various functional groups. At smaller firms, owners, CEOs, or presidents will direct the strategy, with VPs and/or directors influencing them. These needs have evolved as various industries become more competitive, especially as digital capabilities have moved to the top of priority lists.

01. A growing market
02. Digital spend growth
03. The advent of artificial intelligence
04. Unequal agency maturing
05. Shifting agency margins
06. Talent Retention & Acquisition
07. Remote workforce, offshoring, and nearshoring
08. The start of the 4-day workweek
09. In-housing of marketing spend
10. A shifting fragmented marketplace

01. A Growing Market

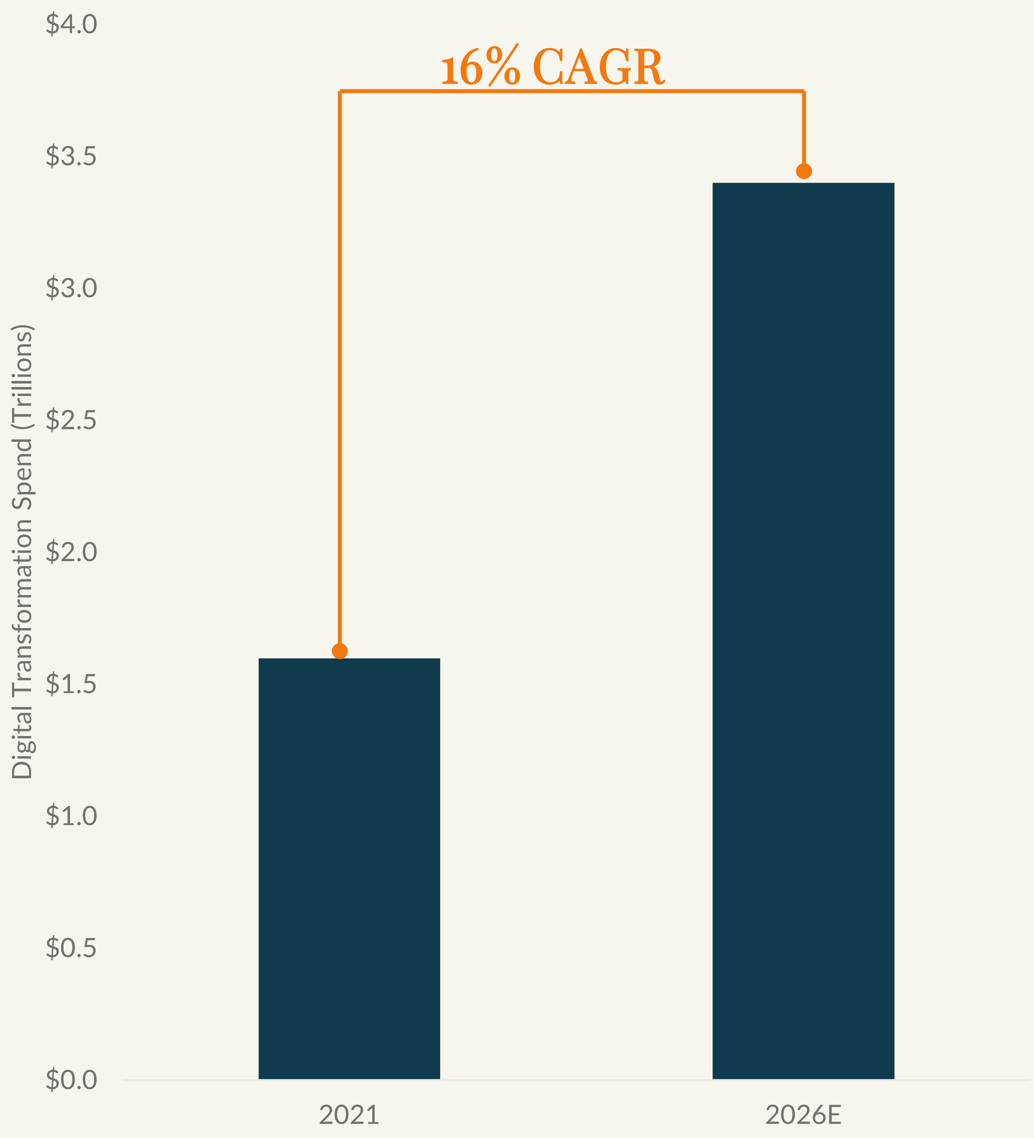
The number of digital agencies in the U.S. and Canada has **grown 54% from 2018 to 2023**. The average size of an agency has also increased. We're seeing a shift from 73% of the market in the 0-10 FTE range in 2018 to 64% in 2023. Most of them have grown to the 11-50 FTE cohort that now makes up 27% of the market, up from 21% in 2018.



Source: Promethean Research – Digital Agency Industry Report, 2018 and 2023.

02. Digital Spend Growth

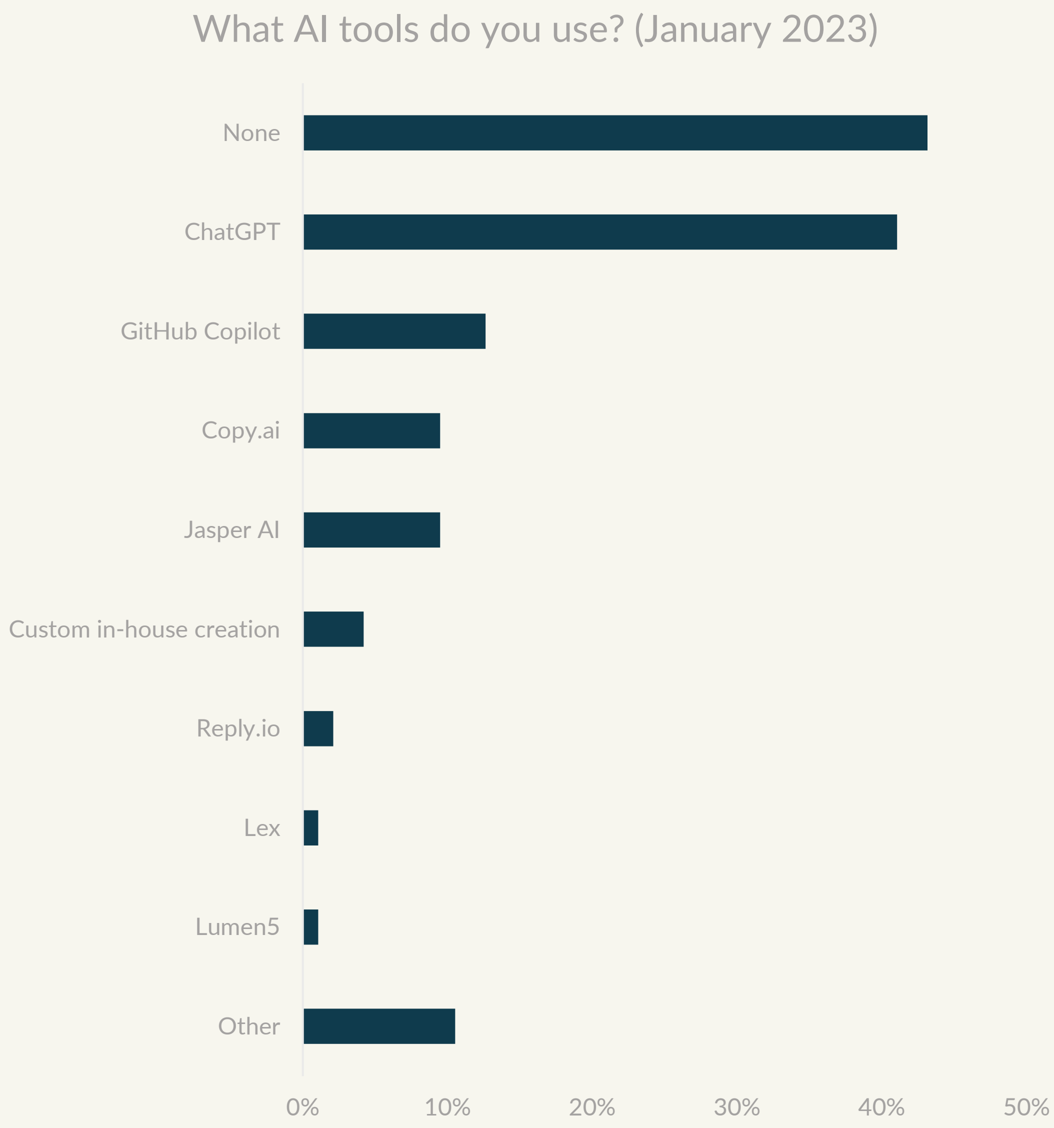
As the broad umbrella that is "Digital Transformation" continues to expand, opportunities for agencies offering digital solutions grows with it. Companies are investing significant portions of their budgets across digital transformation initiatives. Digital investments are no longer relegated to websites, IT enablement, and some digital marketing spend. They're now found organization-wide. Things like customer experience (CX), business process automation (BPA), data enhancement, cloud enablement, business model transformation, and cultural/organizational transformation are all areas firms are investing in. This provides a general uplift to the entire digital agency industry, and we expect it to continue for the foreseeable future.



Source: Promethean Research and IDC Worldwide Digital Transformation Spending Guide (V2 2022)

03. The Advent of Artificial Intelligence

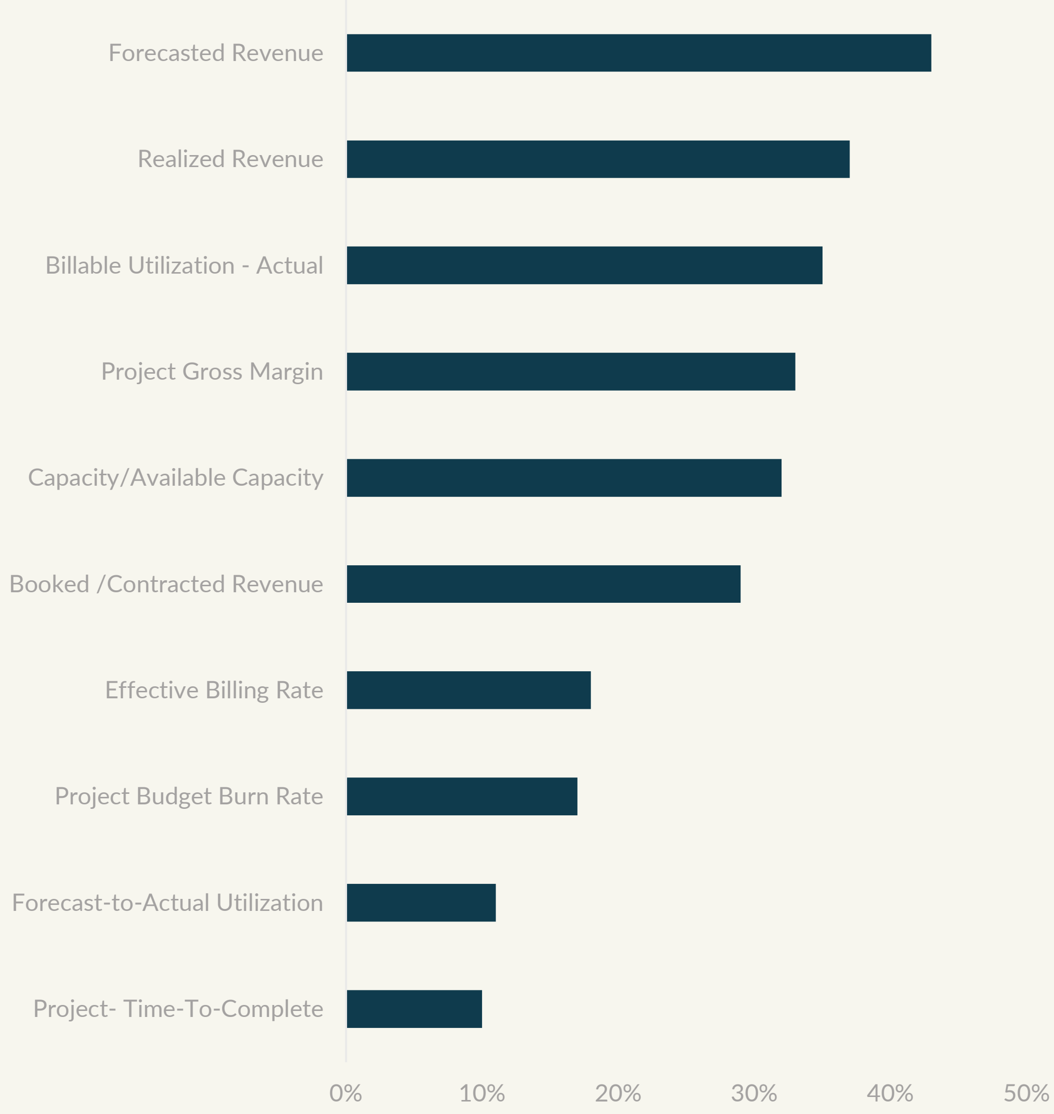
After OpenAI released its GPT-3 model in 2020, a flood of natural language content tools hit the market. Based on our survey data, **over half of digital agencies were using some kind of AI assistance by the end of 2022**. Everything from coding to content creation is being affected. It's too soon to tell just how this will play out, but it has the trimmings of a sizable industry shift.



Source: Promethean Research – 2023 Digital Tools Survey

04. Unequal Agency Maturing

Fragmentation and high employee turnover in the digital agency industry lead to sizable opportunities. Best practices aren't easily created or disseminated throughout the industry. This lack of industry cohesion allows an individual organization to significantly outperform its peers by simply implementing a few key best practices. This is most evident in the types of metrics tracked and managed to.



Source: Promethean Research and SODA: Global Agency Landscape Study, February 2022

05. Shifting Agency Margins

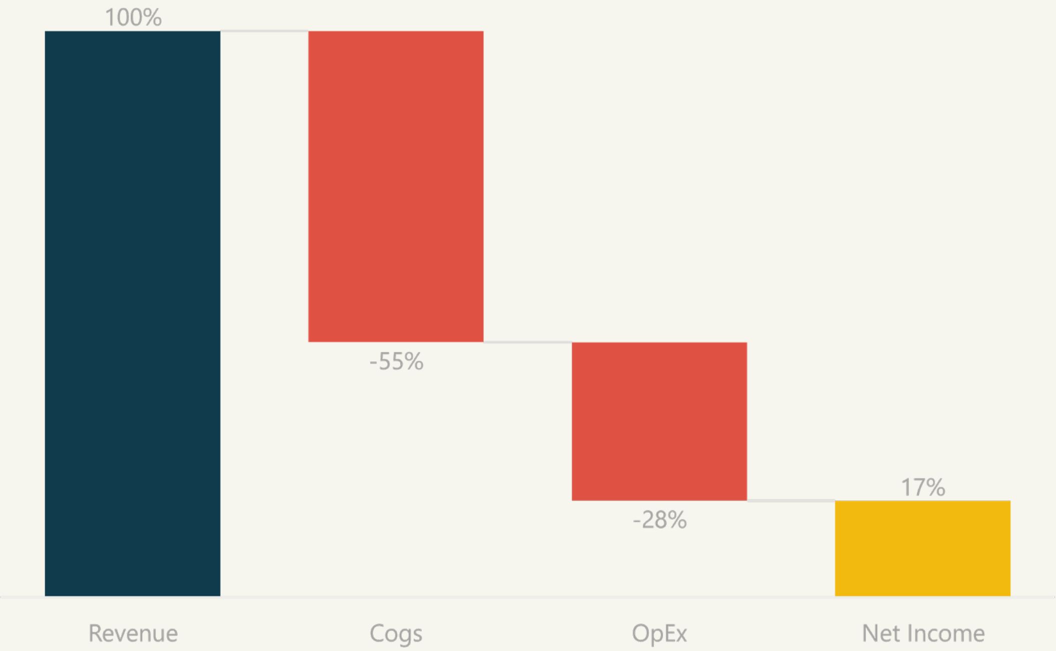
UPDATE: Our recent research into how artificial intelligence impacts digital agencies has shown the potential for significant margin expansion.

Learn more here: AI is Disrupting Digital Agencies.

The economics of running a digital agency have shifted over the last few years. This has been due to two significant shifts: inflationary and demand pressure on service pricing and margin pressure from historically high salary shifts. The general guidelines for digital agencies used to be: 45-50% of revenue spent on cost of goods sold, 20-25% of revenue on operating expenses, and then a pre-tax net income of 25-35%.

The two shifts above have slightly offset one another, but for now, it appears that the salary pressure has had a slightly greater impact. We now see the following breakdown as standard for a digital shop: 55% of revenue spent on COGS, 25-30% of revenue spent on Operating Expenses, and **17% pre-tax Net Income**.

We believe the growing competition has also played a role in the downward pressure on margins. This means that shops will have to increase their level of sophistication to compete successfully. Things like time tracking, managing utilization rates, service mix optimization, and targeted industry focuses are becoming table stakes.

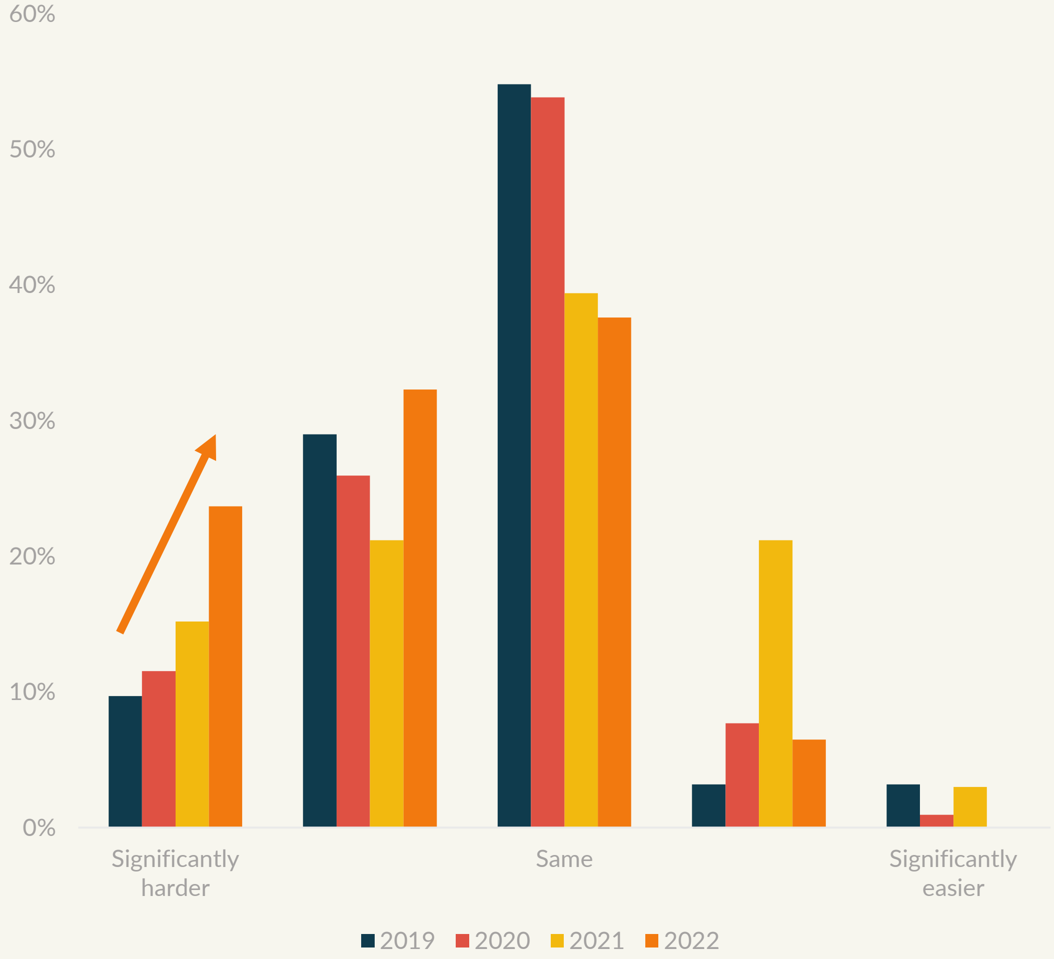


Source: Promethean Research – Digital Services Outlook 2022

06. Talent Retention & Acquisition

Agencies life is typically characterized as "work hard, play hard," but if you ask the average employee, they'll say it leans more towards the former than the latter. This, along with average agency salaries just above the U.S. median salaries, makes employee retention a challenge. Some shops have moved to the "churn-n-burn" approach, which has serious negative long-term consequences.

Talent acquisition is a difficult challenge, as evidenced by the consistently large number of job openings at U.S. agencies. The high industry fragmentation makes building a good reputation difficult, which in turn makes it harder to attract applicants. Once they are attracted though, work-life balance, compensation packages, promotion potential, etc., all play a part in the ability of an agency to retain a candidate. Unfortunately, at a large number of agencies, these are not robust enough and work against the firm during the hiring process.



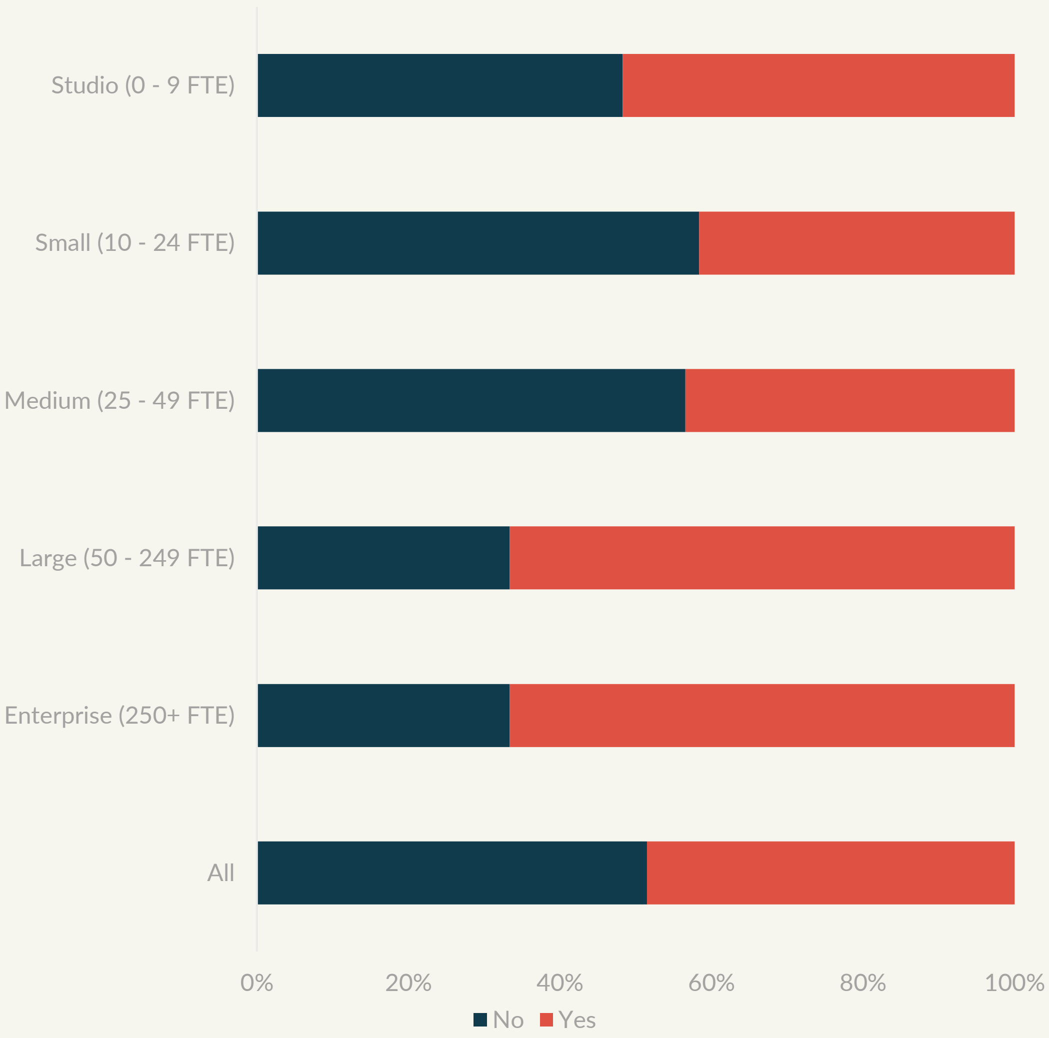
Source: Promethean Research – Digital Services Outlook 2019 - 2022

07. Remote Workforces, Offshoring, & Nearshoring

Digital agencies have always been at the forefront of remote work. Many have been mostly or fully remote for years before 2020. This gave many of them an advantage when the forced global remote work experiment happened that summer. For those that didn't have those processes in place, remote work was a struggle at first. After a few years of this, most shops have their processes worked out to support a semi-asynchronous workforce.

This crash course in async work exposed many shops to new workforces they didn't have access to before. Offshoring and nearshoring are now used by a large percentage of the industry. This is helping offset some of the salary pressure many shops have been under, but it comes with unique costs. Getting the async communication and processes right is critical to being successful here.

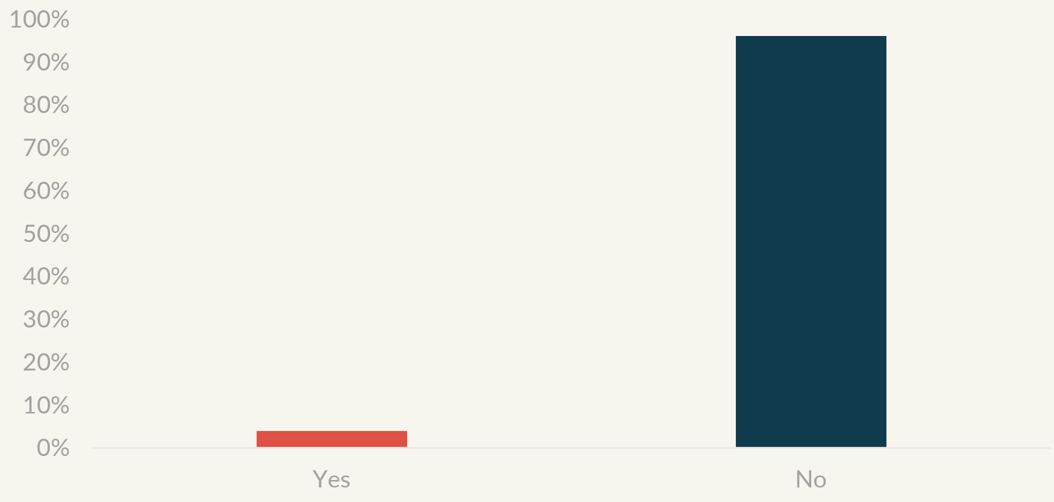
Percent Employing Offshore or Nearshore Talent



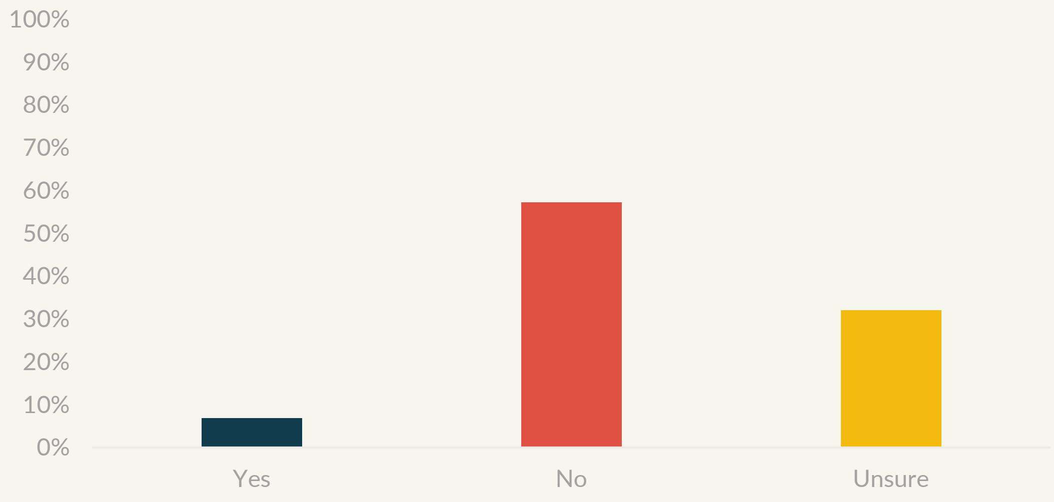
Source: Promethean Research – State of Digital Services 2023

08. The Start of the 4-day Workweek

While not as drastic as the remote work shift, we expect to see a gradual transition towards a 4-day work week for digital agencies over the coming years. Agencies have typically been towards the front of employee benefits, and this seems like a significant win for both employees and management. Our survey in the first quarter of 2023 shows that even forward-thinking digital agencies are still very new to the practice. Still, many owners expressed interest in using it as a recruitment / retention technique.



“Are you currently running a 4-day workweek?”



“Will you experiment with a 4-day workweek in 2023?”

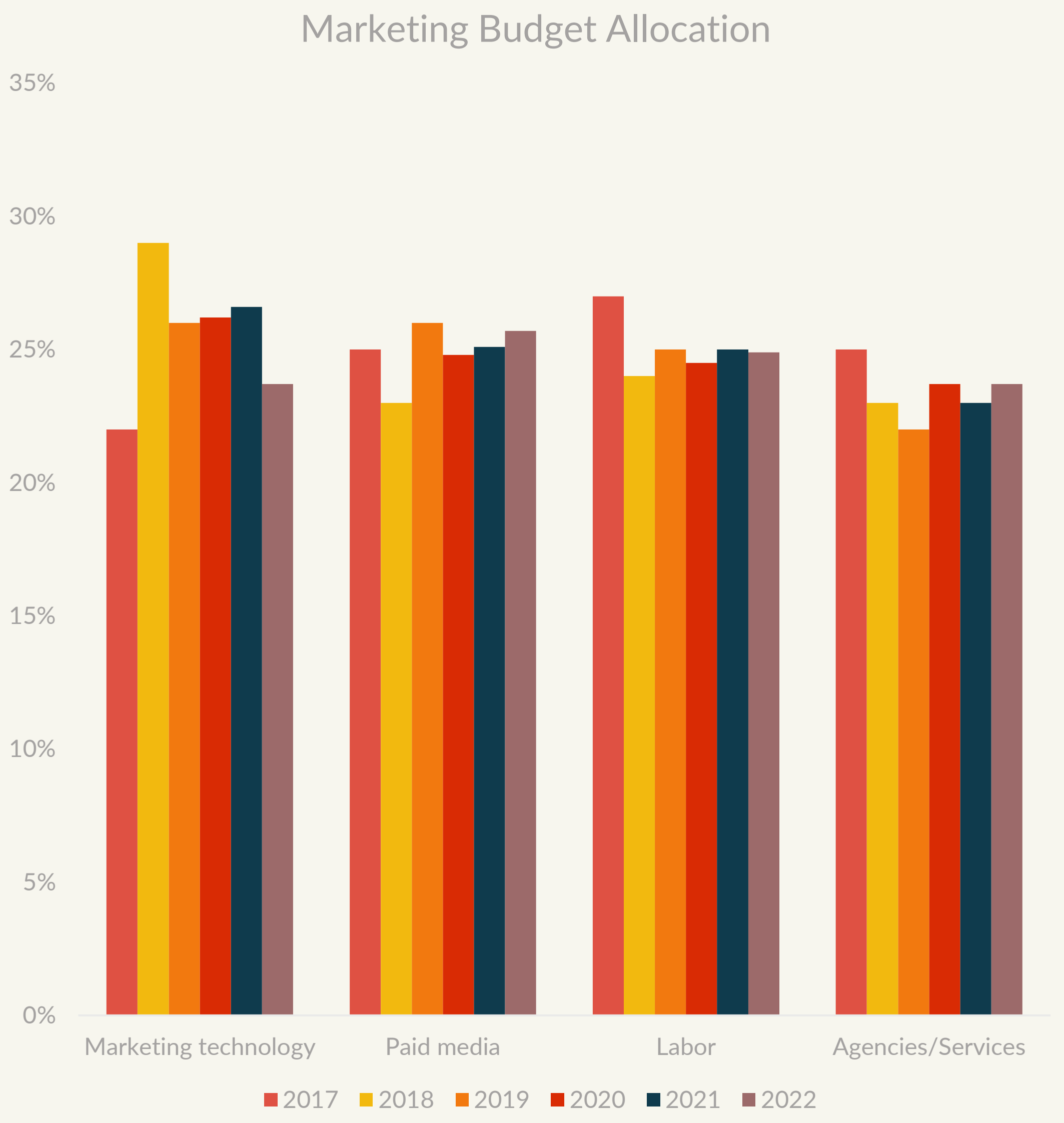
Source: Promethean Research – State of Digital Services 2023

09. In-housing of Marketing Spend

CMOs are constantly working to strike a balance between their internal capabilities and the value they gain from agency help. Lately, brands seem to be placing a greater emphasis on building their internal talent pools, which is placing downward pressure on agency growth.

The main force opposing this in-housing is the advent of new capabilities. Brands pay for capabilities. Did a new social media company explode on the scene? If so, brands will soon hire outside help specialized in navigating that new area. The same thing can happen in AI/ML areas, or ad targeting, etc. As these capabilities become commoditized (think general social media posting), they get in-housed or outsourced to the cheapest alternative.

The rate of change of new capabilities dictates how strong this in-housing force plays against agency growth. For now, it seems like new tech is enabling new capabilities faster than companies can create capable in-house teams.



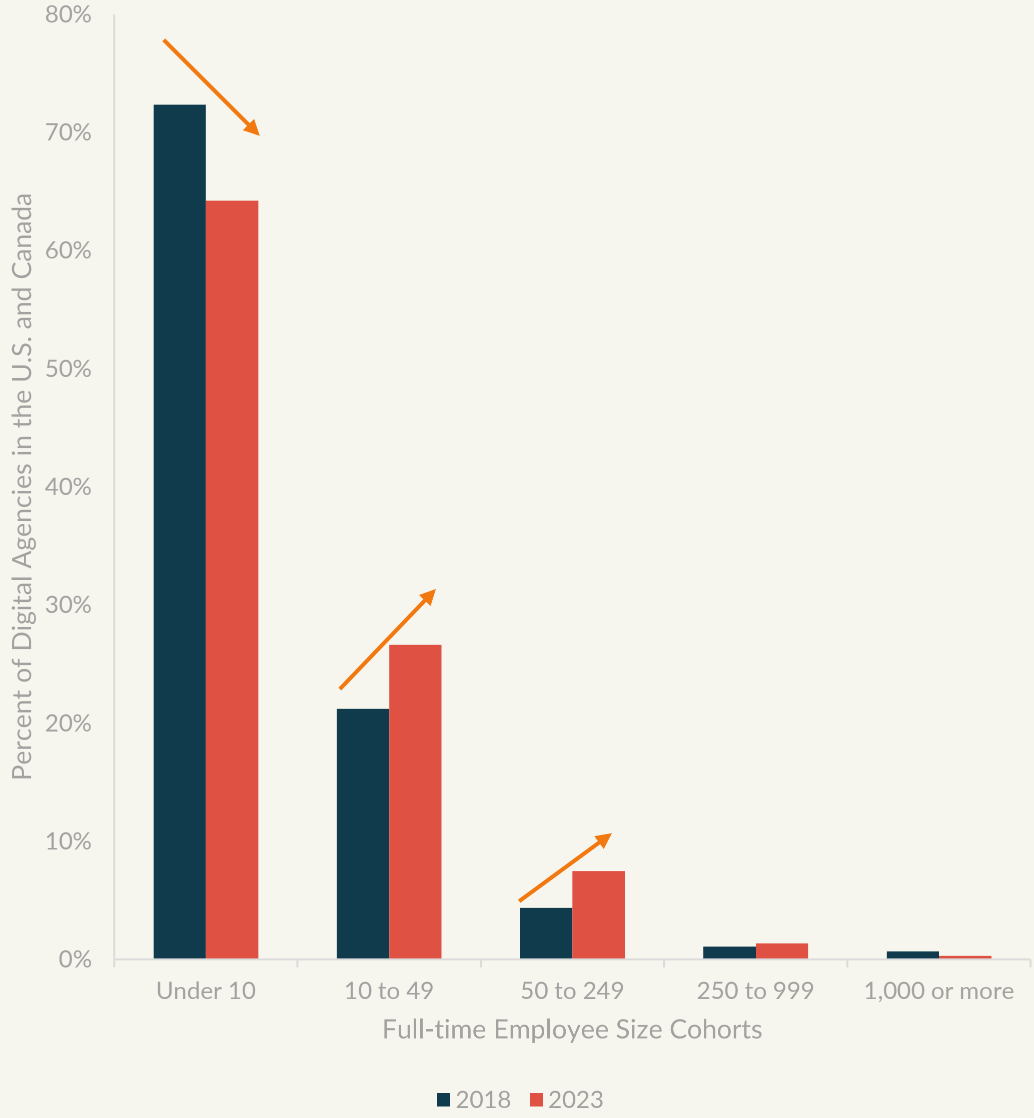
Source: Promethean Research and Gartner CMO Spend Survey 2017 - 2022

10. A Shifting Fragmented Market

There are very low barriers to entry to set up a digital marketing firm. The demand for specialists ensures that top-tier talent will always have the option of setting out on their own. This option, coupled with the challenging working environment at many agencies, makes "working for yourself" an attractive option to many.

M&A activity in this industry has remained steady over the last few years. We believe that this is due in part to the third force, limited benefits to scale. M&A in this industry tends to favor strategic capability additions rather than scale benefits.

There are limited benefits to scale for the digital marketer. After an early point, cost reduction opportunities become negligible, and the perception of working with a large monolith can actually be seen as a negative by brands. Low employee tenure also plays a factor in lower retained agency knowledge. It is difficult to benefit from employee learnings when they aren't around long enough to pass them on to others.



Source: Promethean Research – Digital Agency Industry Report, 2018 and 2023.

www.PrometheanResearch.com

"Working with Promethean was the most impactful decision we've made in the ten years since I started RocketBike."

Max Greenhood
Founder & CEO, RocketBike

More info on services for digital agencies

SECTION 03

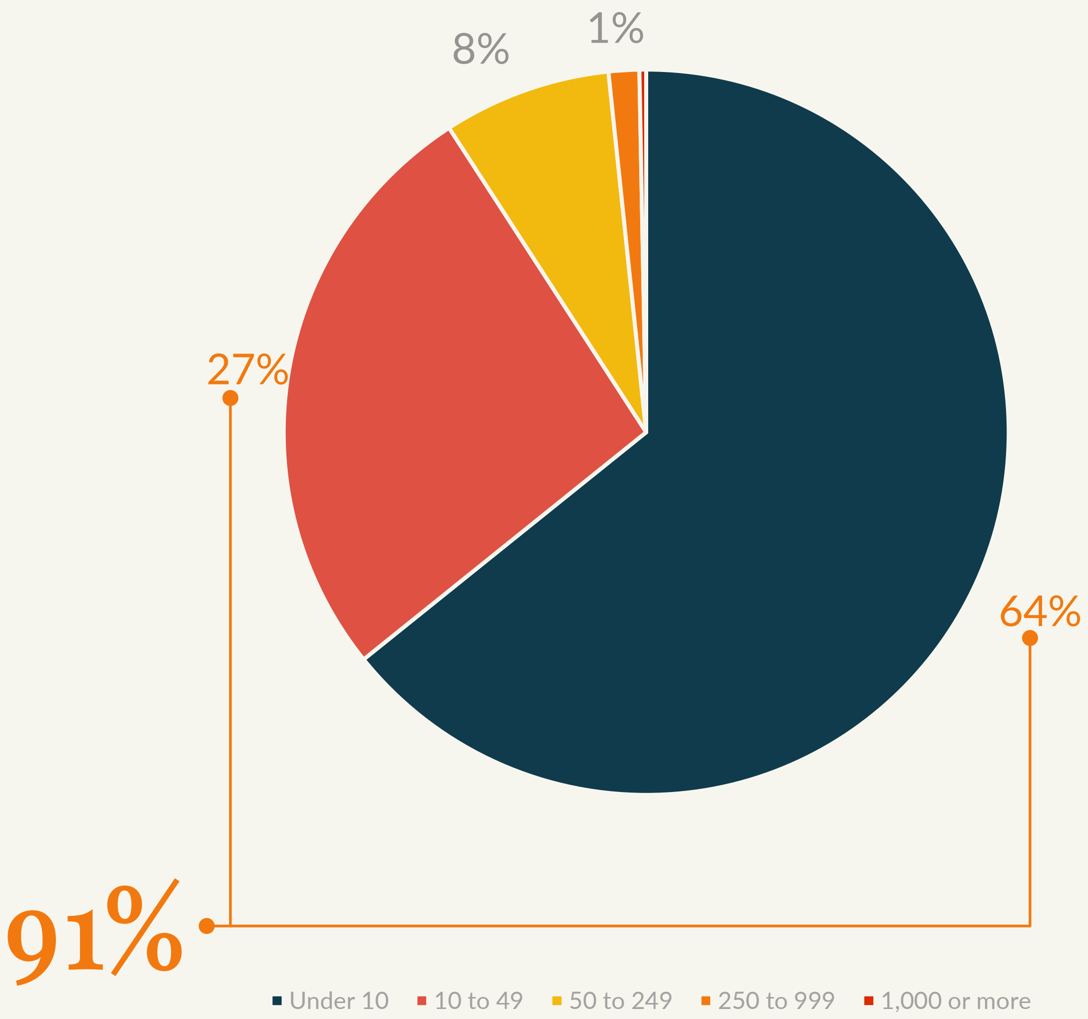
Digital Agency Composition

Sizes & Types

By our estimates, just over 45,000 digital agencies exist in the United States and Canada. The general distribution of digital shops in the United States skews heavily towards the smaller side. Companies in the 1-10 employee range make up 64% of digital agencies. Those in the 11-50 employee range make up 27%, with the remainder being shops with >50 employees. Digital marketing agencies tend to skew the smallest, followed by web dev shops and mobile devs.

Most of the Enterprise firms (>250 employees) in this industry are comprised of agency-holding companies. These are firms that own multiple smaller independent agencies that specialize across different focus areas. These allow the holding companies to work with many clients who could be competitors by distributing them across their network of agencies. This lets the holding company avoid any conflicts of interest while still providing a diverse set of creative solutions.

The small and medium-sized firms (<50 and 51-150 employee firms) are typically single agencies that can offer more services as they become larger with respect to revenue. The smaller agencies tend to be specialty shops, while the medium-sized firms tend to be more full-service. Then the larger firms return to specializing, primarily based on the industries served.



Source: Promethean Research – Digital Agency Industry Report 2023.

Four Functional Areas of an Agency

Revgen

Revgen's role is to… generate revenue. This consists of marketing, sales, business development, and account management.

Production

Production's job is to do the thing your revgen team told the client you will do. This functional area houses your developers, designers, marketers, copywriters, project managers, etc., who work on or manage client projects.

Support

Support roles act as the facilitation layer for the business. They include accounting, human resources, legal, and managers.

Leadership

Finally, Leadership's job is to set the firm's mission, vision, and goals. They are also responsible for closing major accounts, crafting the agency's culture, and setting the firm's strategic direction.

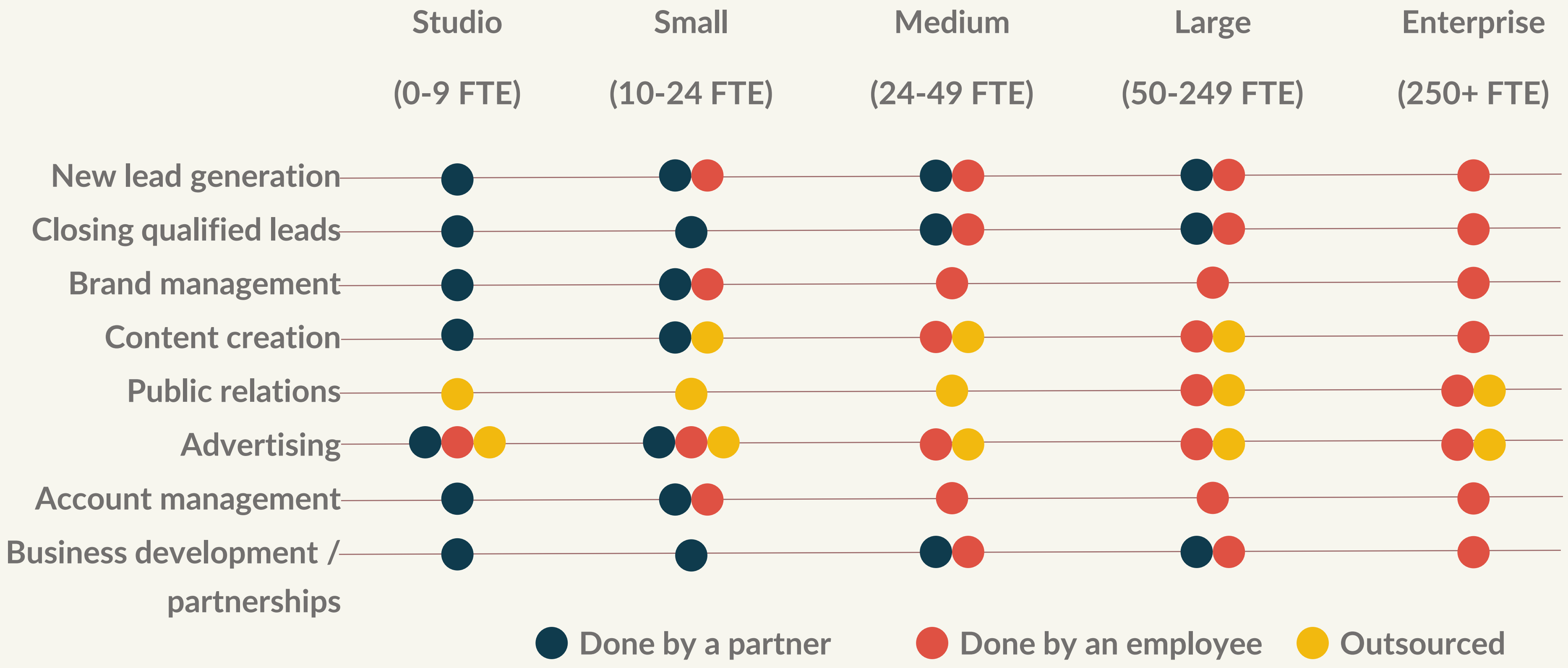
Agency Functions & Growth

When shops are small (<10 FTE), they usually rely on the owners to fill most of the functional roles. Owners will handle all of the revgen duties, a significant portion of the production duties, along with their leadership duties. They'll outsource most of the support roles until they get bigger.

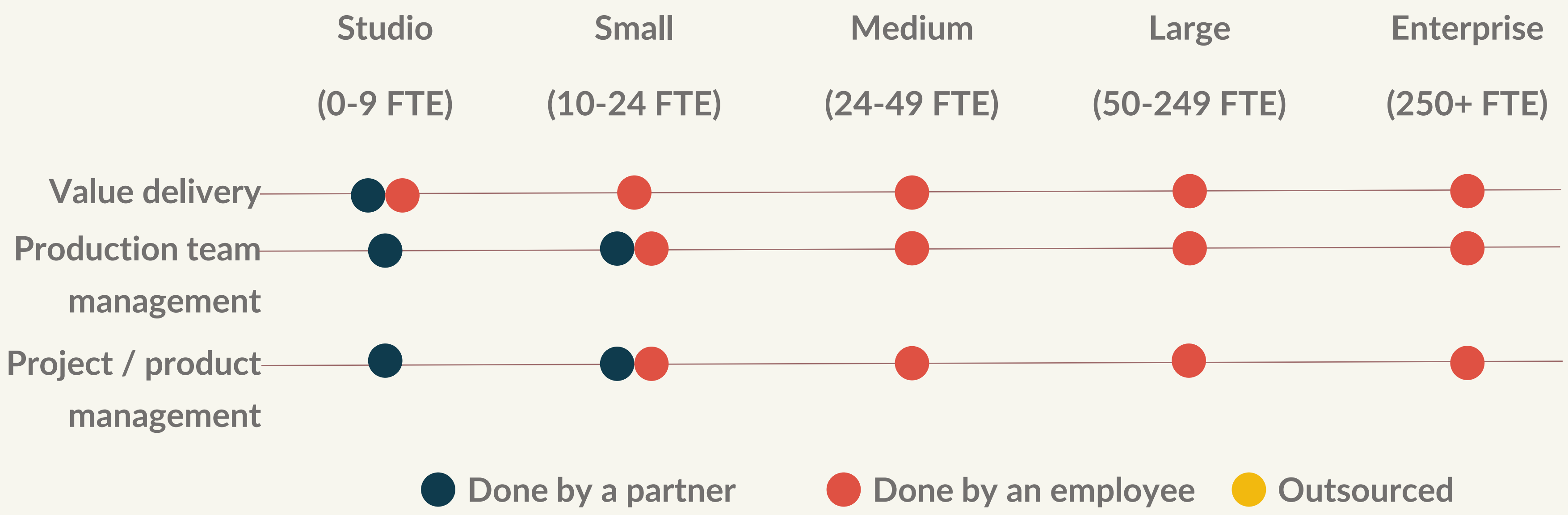
As they grow, shops bring in dedicated talent to fill out functional roles that were either done by the owners before, outsourced, or neglected.

What follows is a look at the relationship between the size of a firm and when they'll bring on a dedicated employee or vendor to handle various roles.

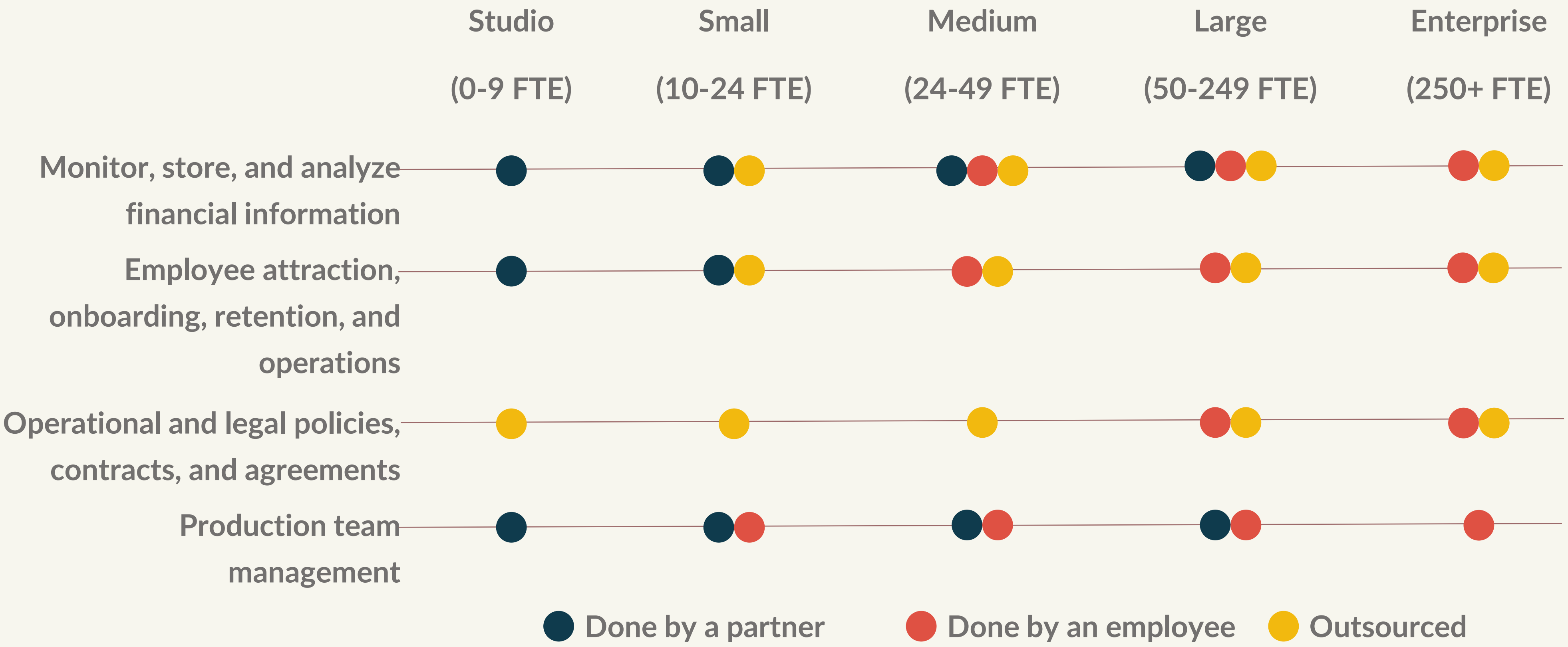
Revenue Generation



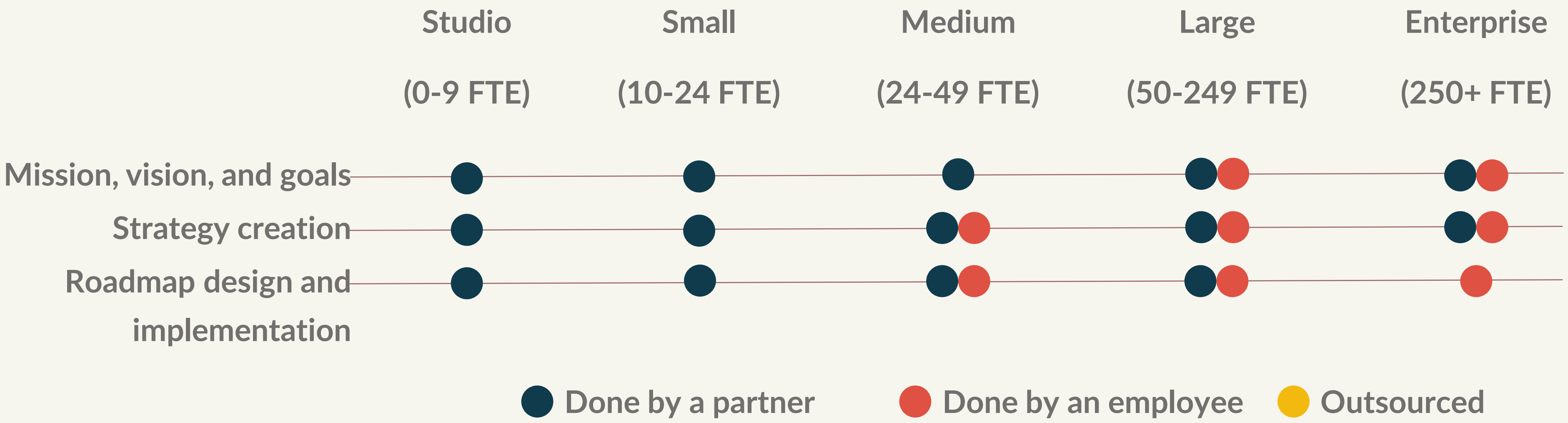
Production


Studio
(0-9 FTE)
Small
(10-24 FTE)
Medium
(24-49 FTE)
Large
(50-249 FTE)
Enterprise
(250+ FTE)
Value delivery
Production team management
Project / product management
Done by a partner
Done by an employee
Outsourced

Support


Studio
(0-9 FTE)
Small
(10-24 FTE)
Medium
(24-49 FTE)
Large
(50-249 FTE)
Enterprise
(250+ FTE)
Monitor, store, and analyze financial information
Employee attraction, onboarding, retention, and operations
Operational and legal policies, contracts, and agreements
Production team management
Done by a partner
Done by an employee
Outsourced

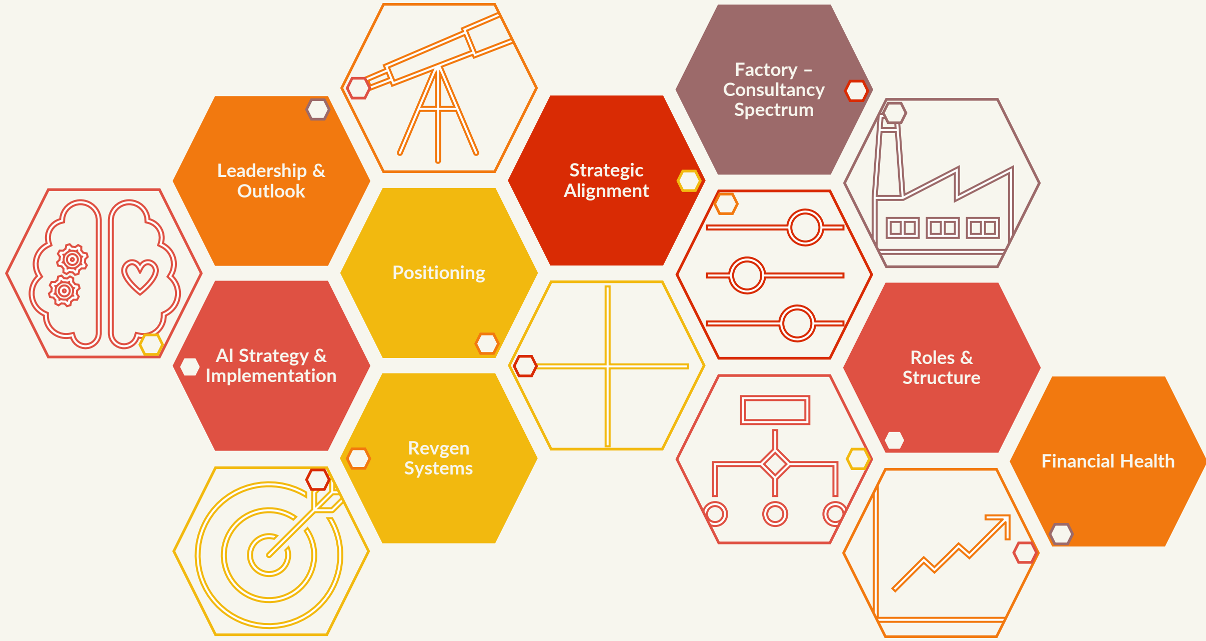
Leadership


Studio
(0-9 FTE)
Small
(10-24 FTE)
Medium
(24-49 FTE)
Large
(50-249 FTE)
Enterprise
(250+ FTE)
Mission, vision, and goals
Strategy creation
Roadmap design and implementation
Done by a partner
Done by an employee
Outsourced

Evaluate & Optimize

Evaluate and optimize eight core areas of your agency to boost margins, reduce friction, and make growth easier.

More info on an Agency Assessment



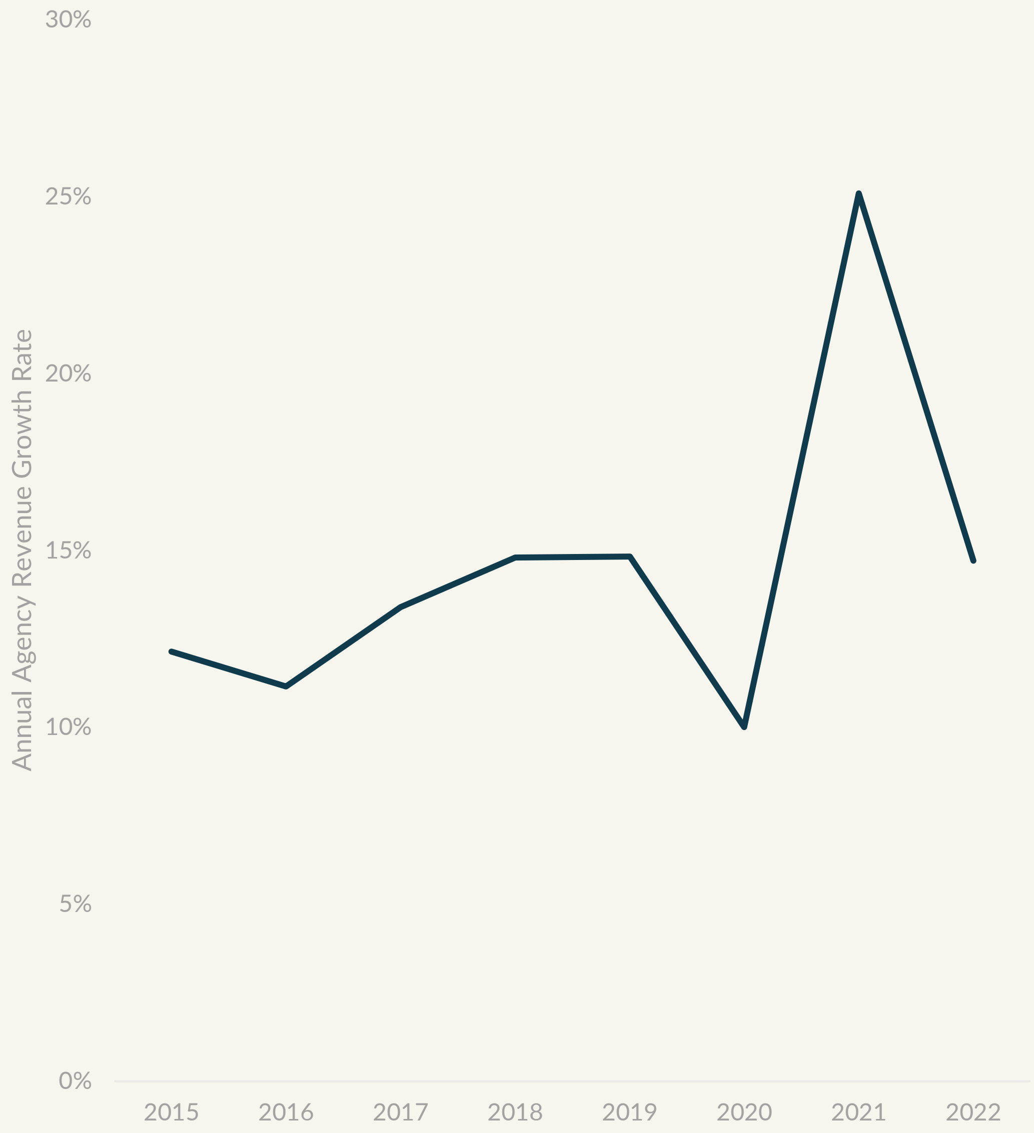
SECTION 04

Agency Revenue Profile

Revenue Growth

From 2015 to 2020, the average growth rate of agencies in our surveys was 13%. In 2021, the average growth rate almost doubled to 25% on the enormous demand for digital solutions by corporations. During 2022, we saw revenue growth slow back down to 15%, which is much more in line with historical trends.

As far as how an agency's size correlates with growth rates, we see fairly similar rates between Studio (<10 FTE), Small (10-24 FTE), and Medium (25-49 FTE) sized shops. They all tend to grow around 15% a year. This changes when we look at Large (>=50 FTE) shops. They tend to grow 36% faster than the smaller shops.



Source: Promethean Research – Digital Agency Industry Report 2023.

Primary Lead Sources

In a typical digital shop, whether it's dev, marketing, or design, they will derive most of their leads and revenue from referrals. While referrals can be a great way to start, relying on them for the majority of a firm's revenue generation presents a few challenges. The first is their lack of predictability. Second, they typically come from people with similar networks, which limits the ability to grow project scopes with new referrals. Finally, there's little to no control over the referral's quality, which can jeopardize relationships.

By no means are referrals bad. They're an excellent way to grow a business, but what separates companies that can break through the 30-50 employee plateau is often a strong revenue generation engine.

Pricing Methods

In 2022, seventy-five percent of firms used Time & Materials and Retainer models, while 65% used Fixed Bid pricing, and only 37% used Value-based pricing.

Fixed Fee / Project

The most common way to price services is with a fixed fee structure. This model is employed by estimating the cost of a project and then adding a margin to arrive at a fixed fee the client will pay. This type of model includes retainer-based billing along with progress-based billing.

This model works best with clients who have a set budget they're unable to exceed and need to know project costs beforehand. Both parties assume risk with these types of arrangements, as both cost overruns and savings are absorbed by the agencies. Fixed-fee models also may limit agency revenue growth as the option to add additional services typically isn't available until the contract renewal time.

Value-based

Pricing services based on the value an agency's work generates for a client is the goal for most agencies as it aligns the agency's and client's goals more than the fixed-fee model and can generate substantial profits for the agency. Agencies typically experience pushback when selling this model, as value-based prices can be much higher than cost-plus pricing. This model is best employed by experienced, proven agencies that can point to successes to help clients understand the return on investment.

Hourly / Time & Materials

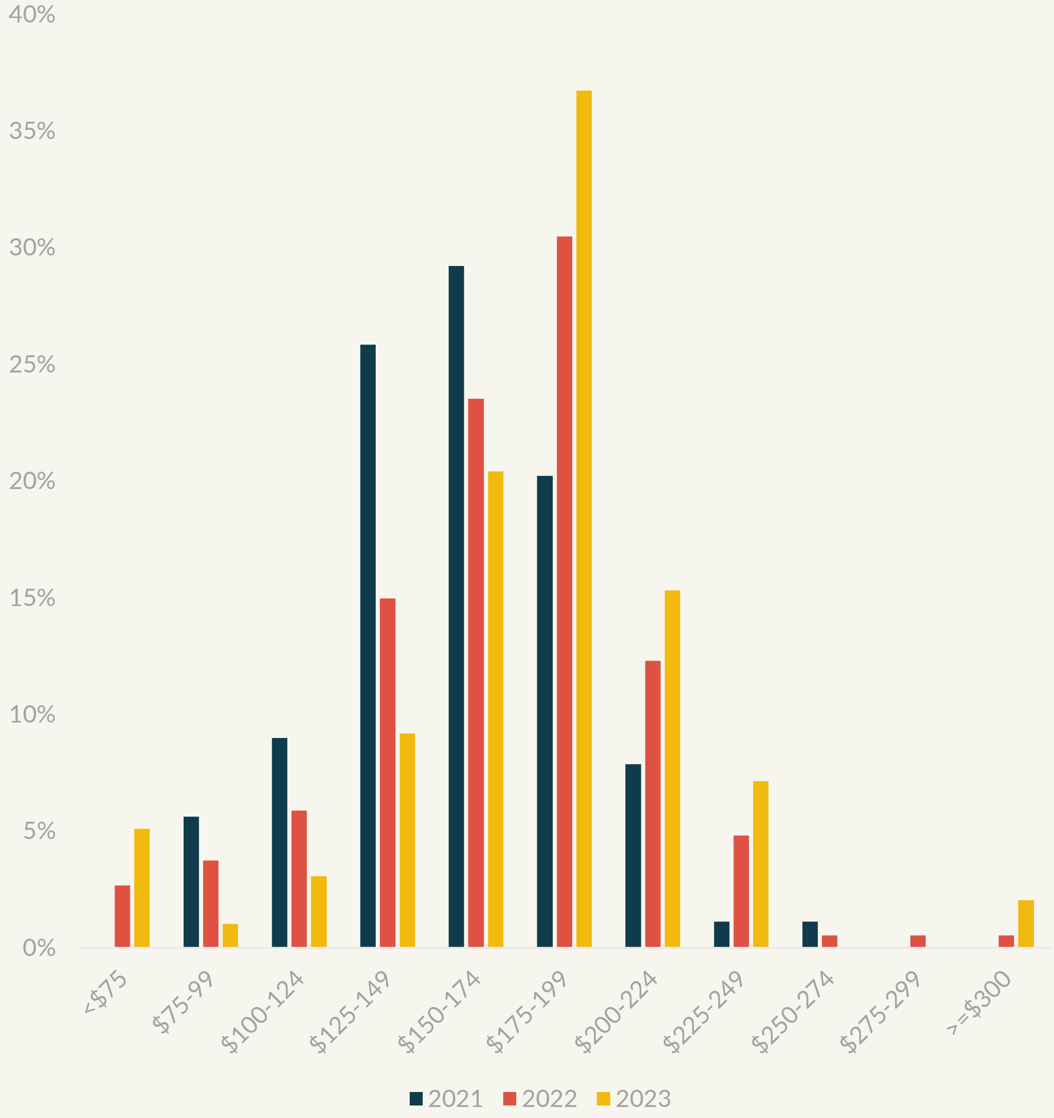
This is the simplest pricing model and is often employed by firms in their early stages. Here agencies price their services based on the costs and time required to perform those services and then bill on a periodic basis based on the time incurred. There can be a blended "firm-wide" hourly rate charged or different rates based on the skill level of the individuals working on the project.

Performance-based

This is where agencies (typically marketing agencies vs. dev or design) will charge a fee based on the change in a particular performance metric that they influence. This metric is often sales, but it could also be something more targeted that the client’s measuring like page views, social engagement, leads generated, etc.

Hourly Rates

38% of the agencies reported raising their prices in 2022. The most frequent hourly rate in 2021 fell within the $150-174/hr range. However, by the start of 2022, the rate had shifted to the $175-199/hr range. The average rates climbed even higher by the beginning of 2023, primarily driven by Studio agencies catching up a bit, half of which raised their prices last year, compared to only 28% in 2021.



Source: Promethean Research – Pricing Survey 2021, 2022, 2023 | Digital Services Outlook 2022 | State of Digital Services 2023

Advice That's Led to Impressive Results

Digital agency owners who've worked with us have been able to grow faster and earn higher margins.

MICRO-CASE: Agency Merger Evaluation & Strategy Recommendations

Dan reached out about merging two agencies. He wanted a growth strategy that would take advantage of the combined entities' strengths. After an extensive discovery phase, which included employee surveys, interviews with management, and detailed financial modeling, we uncovered a potential disaster. There was a significant risk to combining the agencies that wasn't apparent before. We recommended against the merger and provided a strategy and implementation plan to grow organically. This preserved the value inherent in HyperDrive today and provided a strong foundation to build on.

Let's see if we can help you and your agency

4.2X
Revenue Growth

5.2X
Net Income Improvement

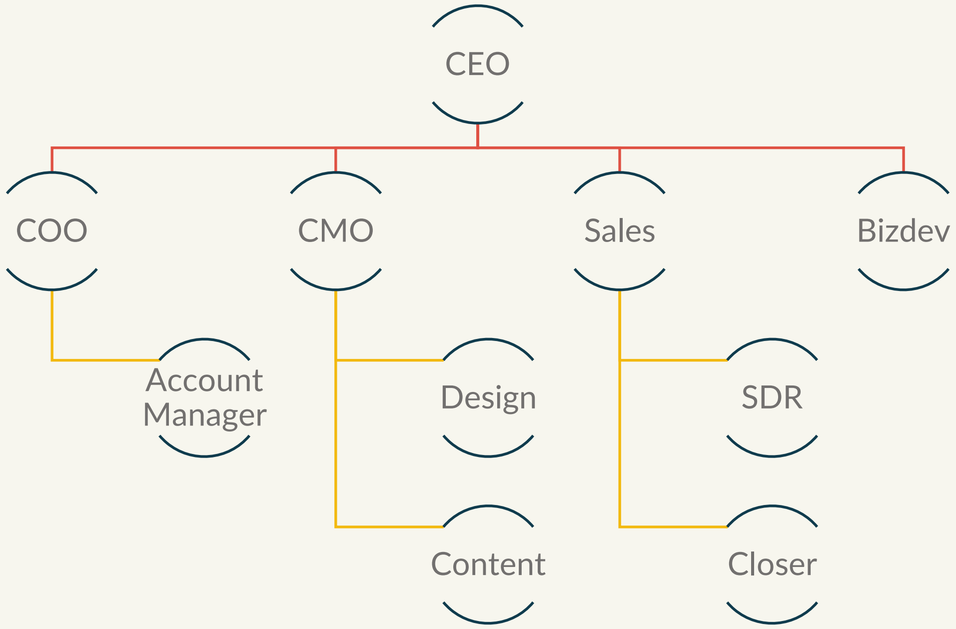
SECTION 05

Agency Ops.
& Profitability

Revgen Structure & Investment

In a standard shop of 25 employees, the responsibility of revenue generation typically falls on a partner, the CEO, or sometimes 1-2 salespeople (a Sales Development Representative – SDR, and a closer). There is typically a marketing professional that manages design and content direct reports, but there is rarely a formalized lead generation process. Sales processes are also typically bare bones. Our research has shown that account management can fall under sales, but it usually lives under operations. Business development is typically under the CEO's responsibilities, but we have seen cases where there are dedicated business development professionals that report directly to the CEO.

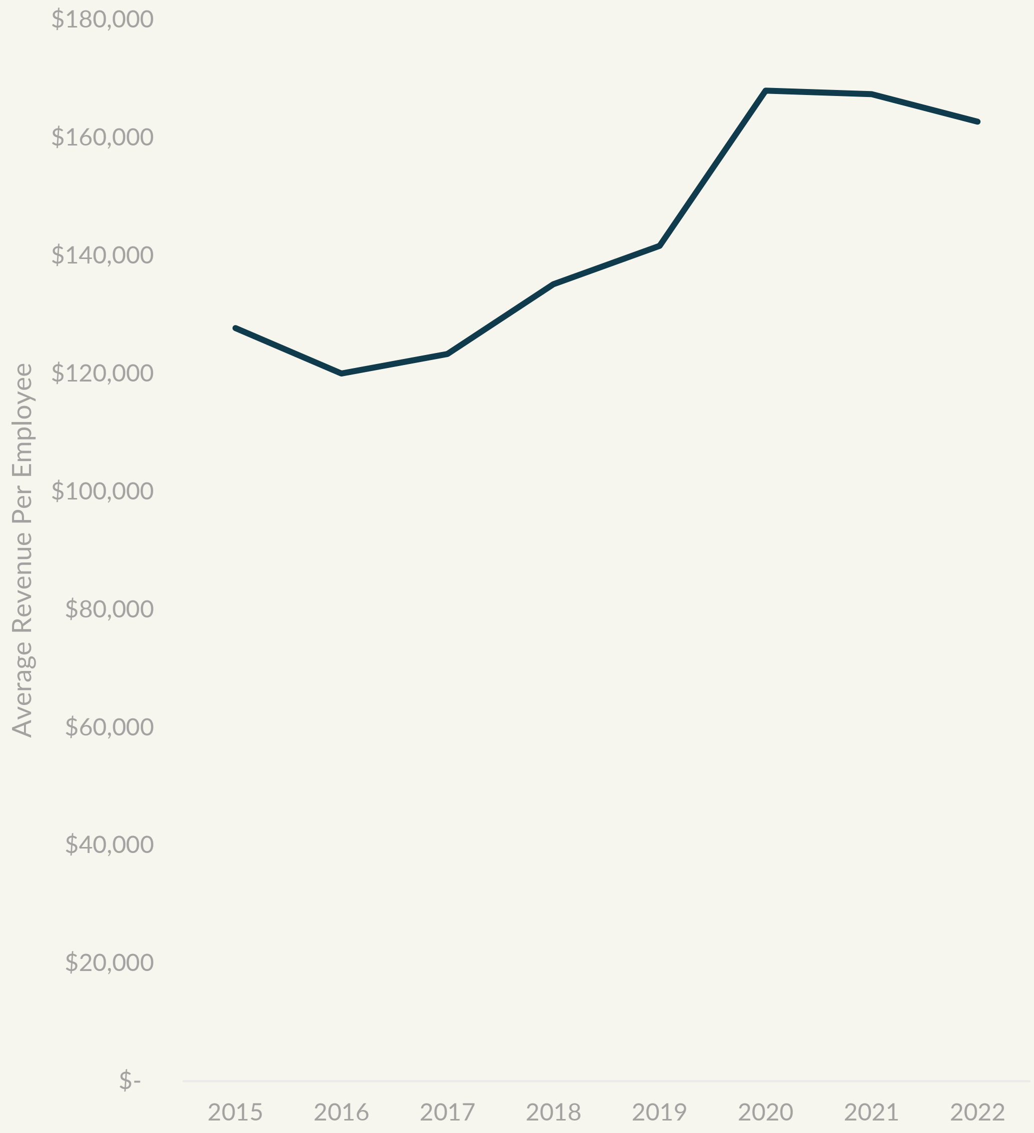
Most digital agencies will spend about 7% of their revenue on revgen activities. Those interested in growing faster than average will allocate 10-15% to revgen.



Source: Promethean Research – Repeatable Revenue Generation for Digital Agencies 2020

Revenue Per Employee

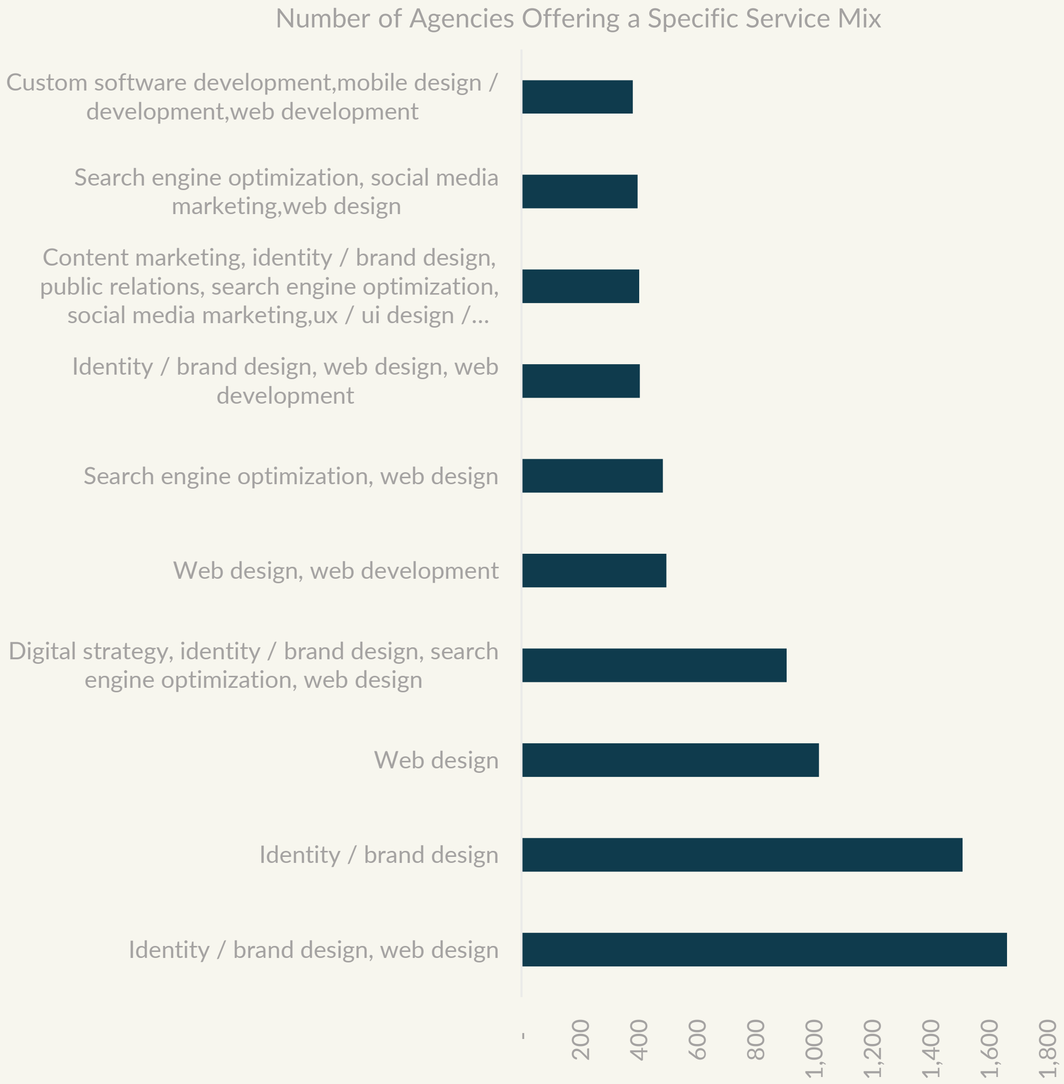
Revenue per employee, a common efficiency metric for digital agencies, has been trending upward since we began tracking it back in 2015. **The average agency made $163k per full-time employee in 2022.** We believe the increases in demand and pricing power are causing a general uplift in this metric vs. any kind of significant efficiency gains, but this may change as AI tools become better integrated and enable productivity gains.



Source: Promethean Research – Digital Agency Industry Report 2023.

Positioning & Service Mix

Roughly half of the shops in our surveys self-identify as specialists. They specialize by industry vertical, service mix, or both, but it's much more common to see agencies focus on a certain industry niche vs. a specific service mix. As agencies get larger, they tend to specialize more. The average agency will offer between 5 and 6 distinct services.



Source: Promethean Research – Digital Agency Industry Report 2023.

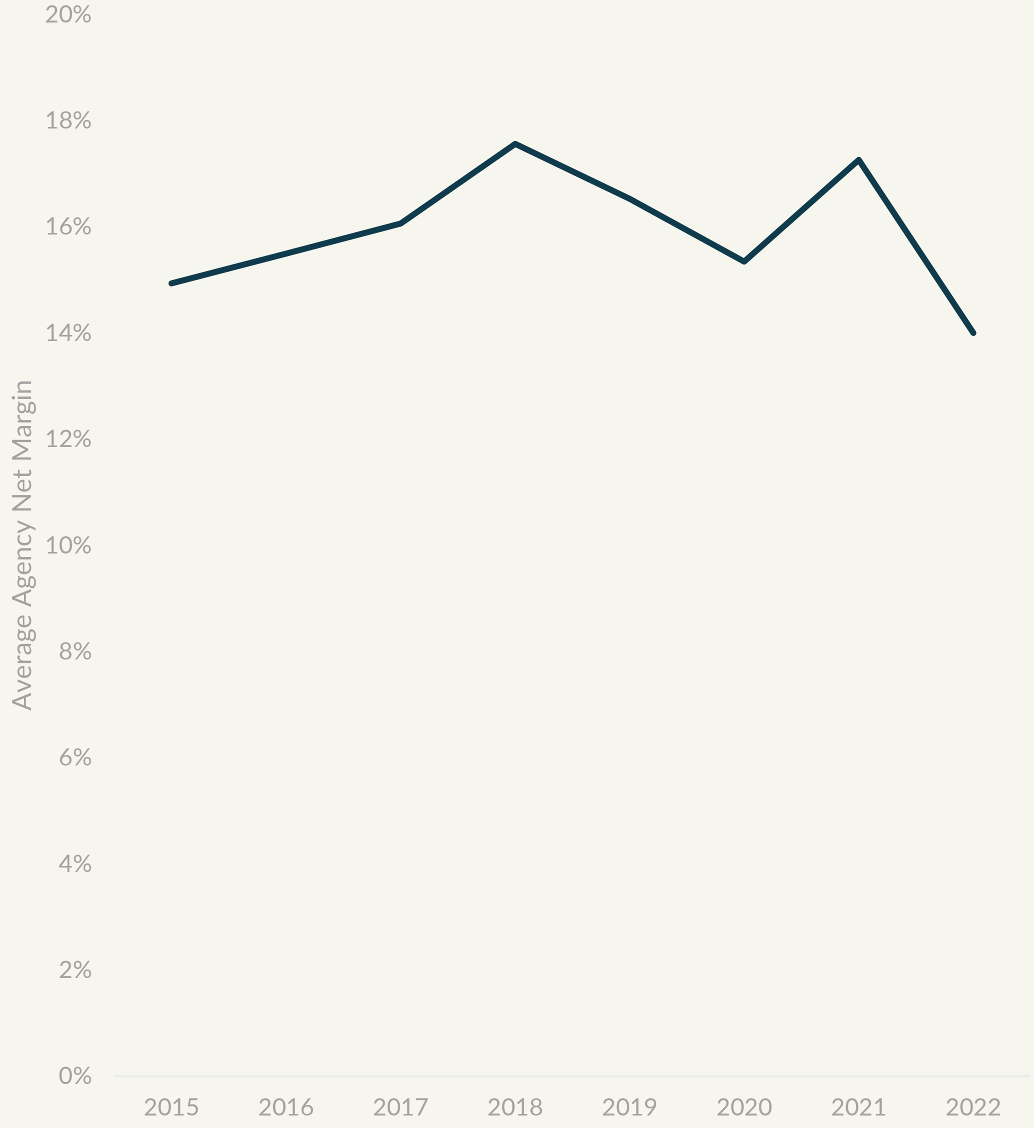
Digital Agency Profitability

Agency margins are mainly influenced by two levers. The most impactful is often the billing rate. Closely behind billing rates is an agency's utilization rate. These two levers have the most significant impact on an agency's profitability.

The **average profit margin for a digital agency in the U.S. since 2015 is ~16%**. Studio (<10 FTE) sized agencies are typically the most profitable, but after a shop grows past 10 FTEs, net income margins remain fairly stable at around 15%. This places digital agencies as one of the more profitable types of businesses.

The most significant expense for an agency is employee costs. Salaries and benefits make up almost all Costs of Goods Sold and a significant portion of Operating Expenses.

After employee costs, app and tool costs make up the next largest segment. According to our 2023 Digital Shop Tools Survey, the average agency spends 3.7% of its revenue (minus any passthrough spend) on tool costs.



Source: Promethean Research – Digital Agency Industry Report 2023.

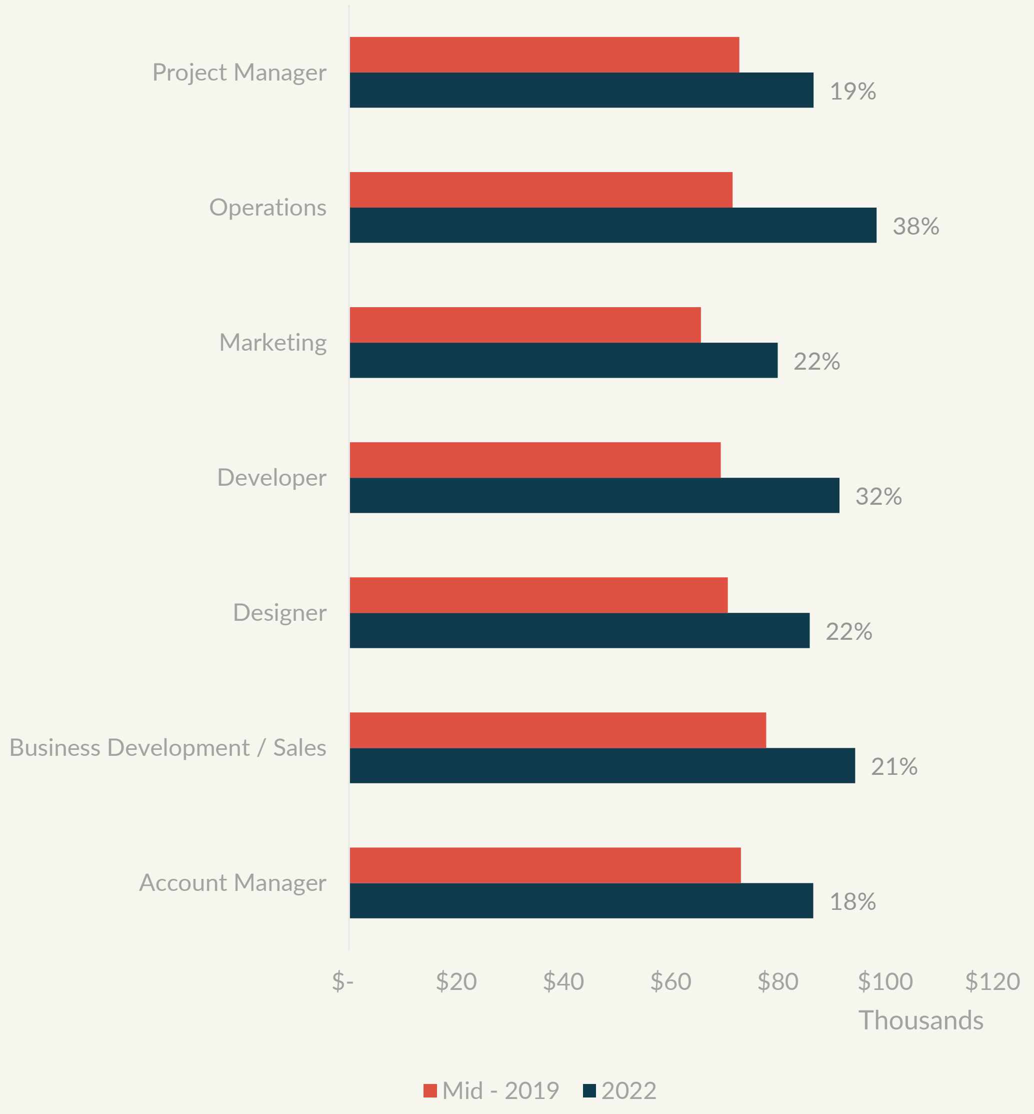
Employee Compensation & Salaries

Salaries are by far the largest component of running a digital shop. Many factors make identifying correct market rates more complicated, the most critical of which is a severe lack of transparency. Between 2019 and 2022, salaries for most positions rose 25-35%.

Non-Salary compensation has grown even faster than salaries since mid-2019 as digital shops use them to both attract and retain talent in this challenging labor market. This includes things like bonuses, options, and profit-sharing.

The average employee is expected to bill 25hrs per week and work another 13hrs on non-billable tasks for a total expected weekly commitment of 38hrs.

This distribution of billable to non-billable hours is highly dependent on the position type. Internally-focused marketers and Business Development / Sales employees are expected to bill the fewest hours weekly, with many not being required to bill any. Production employees (Designers, Developers, and client-focused marketers) are expected to bill the most, around 30hrs/week.



Source: Promethean Research – Digital Agency Salary Survey 2022

Owner Compensation & Salaries

The average combined compensation for an owner in our 2022 Salary Survey was $242k, half of which was salary, while the other half was comprised of dividends, withdrawals, bonuses, or other cash compensation.

Firm size correlated with greater compensation. Studio shop owners took home an average of $171k, Small shop owners earned $252k, and Medium shop owners received an average of $351k. Owners of any company size received average combined benefits of around $20k.

Average Salary	Average Dividends / Withdrawals	Average Bonuses	Average Other Cash Comp.	Average Total Comp.
$123,990	$104,948	$7,410	$5,516	$241,864

Source: Promethean Research – Digital Agency Salary Survey 2022

SECTION 06

Methodology & Demographics

Respondent Demographics & Sources

This report is a compilation of responses from digital agency owners and managers, primarily from North America. Multiple online surveys of digital service company owners were conducted from 2015-2023 to collect insights across key performance indicators. Interviews with owners, managers, and employees, plus specific company analysis, and public data, were also used to supplement the survey data. Please see the associated reports for exact demographic data pertaining to each.

Additional sources used in the publication of this report include:

- IDC Worldwide Digital Transformation Spending Guide (V2 2022)
- Gartner CMO Spend Survey 2017 - 2022
- Society of Digital Agencies: Global Agency Landscape Study 2022

For more information, including research and resources for digital shops, visit Promethean Research.

Promethean Research