generate

HOW TO RUN A PROFITABLE CREATIVE AGENCY

So, you want to run a profitable creative agency?

Good to hear, you're in the right place! This eBook is full of tips and strategies that you can employ in your agency to help improve your bottom line.

Now, as with many of these things, knowing the strategies is only a small part of the formula. Putting them into action and staying on top of their progress is key to success. It's important that you set aside ample time for working on the business on a regular basis rather than allowing all of your time to be sucked up by working in the business.

sections

01 hourly rates and how to set them

As you'll be well aware, wages are the single biggest expense for any creative agency. Recent figures show that wages represent almost 60% of gross revenue for many agencies in Australia which is higher than for many other professional services industries which tend to average between 40% and 50%.

Given that you are spending such a huge percentage of your revenue on wages you are going to want to ensure you're getting a good return on your investment! Setting employee productivity aside for one moment, to ensure you're getting a good return you need to have appropriate charge rates for your team.

Note: Some creative agencies have moved over to value-based or fixed-fee engagements. If that's you it is still important to know how hourly rates are set so you can ensure your fixed-fees are set at the right level. Moving to fixed fees is supposed to increase profitability, not decrease it!

Setting hourly rates is one of the key levers you can pull when it comes to determining the revenues you'll generate from a client. The traditional model is based off a multiple of the wages paid and revolves around a rule of three — one for you (being your staff member), one for the business (to cover the overheads), and one for me (being the profits), however achieving this 3 times return on investment is often seen as impossible for many small businesses. So they tend to go with lower rates to help make them more competitive when compared with the bigger agencies which tend to operate with bigger multiples.

Remember when setting the hourly rates you'll need to take into account the actual number of available hours each year, so that means taking out annual leave, personal leave, public holidays, etc. It also means allowing for down-time for things like training, administration work and getting a cup of tea!

The formula looks like this: Salary package x rate of return / available hours in a year = hourly rate

Now, some of you might be thinking that this is all very well and good, but our industry works on blended rates and that is what our clients expect. I would suggest that it's worth testing this belief out when pitching on your next new client.

Recent research shows that most consumers of creative services aren't primarily driven by price rather they are after the quality of the ideas contained within the pitch. This means they are unlikely to be scared off by having tiered hourly rates — having different rates for different levels of experience makes commercial sense and once clients understand that the average rates they'll be paying works out much the same as under the blended rate model you shouldn't encounter much resistance. This argument is much the same if you're working on a fixed or value-based model because you'll inevitably encounter situations where you need to charge for work outside of scope and will need explainable hourly rates to charge for this work.

The key takeaway here is to understand how your hourly rates are set. They are your key lever to pull when it comes to adjusting the revenue you make from a client so it pays to spend the time to really understand the rates. More than this, it can add some science when setting targets for both the business and for your team members.

02 budgeting

Whilst it may appear to be simple wishful thinking, budgeting is an important task that all business owners should undertake at least once a year. Go through the following process and I'm sure you'll agree.

First place to start is your top line. **Revenue.** Many businesses will start with the previous year as a base and this is a great place to start. I would also then calculate what the actual (or theoretical) capacity of your team is.

Capacity of team = Team member 1 (available hours x hourly rate) + Team member 2 (available hours x hourly rate) + ...

You'll then take this capacity amount and compare it with last year, invariably you billed somewhat less than what the team could have billed if working at full capacity. That's okay, let's take a figure mid-way between the two as your billings target for the coming year. You'll want your budget to be month-by-month so go ahead and split up the revenue over the year loosely based on what a standard year looks like for you — if it's like many agencies it'll be very lumpy rather than evenly spread over the year.

The **expenses** in your budget can be based on the year before allowing for any planned changes such as new staff, etc. Remember that new staff will also need to be taken into account when setting the revenue targets as they will change your capacity. You'll also want to allow some downtime when any new staff starts — this is due to training time and will affect not just the newbie, but also the existing staff who handle the training for you.

Once you've got this base-line budget in place you can start to see what the coming year might look like from a **cash flow** perspective — will there be any holes that need to be plugged either with extra work or possibly with a finance solution such as an overdraft or invoice financing? It's important to get onto these things nice and early because plugging cash holes can take a bit of forward planning and you don't want to be caught short and unable to pay wages or rent.

You can also use this baseline budget for some **scenario analysis**. You could adjust it to see what happens if we take on two new staff, or what happens if we fitout the office, or if we undertake a marketing campaign to grow brand awareness. Using this baseline you can overlay the changes that would result from these scenarios — i.e. extra revenues, extra costs, etc. — and start to see what other possible futures your business might have if you go down a certain path.

You may not hit these exact numbers next year, chances are you won't exactly and that's okay.

The point of budgeting is to give you a framework, or an idea, of what success for the coming year might look like so you can plan ahead accordingly.

It will give you a roadmap to follow and will help inform decisions you need to make when running the business.

03 how to incentivise your team

As well as being your number one asset, staff are your number one expense and as mentioned earlier it is an expense that you expect a good return from. You also want to ensure the relationship is a long and fruitful one because replacing staff and dealing with high staff turnover will have a massive impact on your bottom line as I'm sure you're all aware.

With this in mind you'll want to incentivise your team properly to ensure they are focussed, happy and productive. And to help minimise any itchy feet in your office. Please remember that everyone is a little different and will have different things motivating them so you'll need to have a range of incentives and you'll need to tailor them to your team.

Salary

You should be regularly reviewing information from a wide range of sources to ensure your pay packages are fair and marketable. You can do this via publicly available surveys, browsing the online job listings, discussing with fellow business owners in the industry, etc. Be competitive so that salary isn't a reason for your team to start shopping around. That said, don't let it become the be all and end all — if you're not in a position to pay market rates, be transparent about this and offer things you can afford (for example, extra leave).

Setting clear goals

People like to know what is expected of them and there are few things more demotivating than not knowing what your boss expects of you and what the path to success looks like. Ensure that all team members have clear position descriptions which include a clear outline of their duties, responsibilities, reporting lines, as well as key performance indicators and the path to success.

Bonus payments

There are many ways to do this. For example, where staff are fee earners you can have a bonus scheme based on achieving individual financial targets. These targets are simple to set once you've gone through the hourly rate calculations discussed above.

Birthday leave

Some staff like cakes and having a room full of well-intentioned people singing happy birthday at them, and some do not. With that in mind, why not offer your team members a day off on their birthday? Just keep in mind that some people really like coming in on their big day, so perhaps make it available any time within a week of the actual day.

Social events

Everyone has a story about a miser boss who only took the team out once a year and they had to pay for their own drink. Don't be that person Staff outings don't need to be expensive or debaucherous. What they should do is let the team know that you care and give them an opportunity to unwind. Most importantly they are an opportunity for team members to bond outside of the office — the team who plays together, stays together! These kinds of events are also great fodder for your firm's social media and can help when it comes to recruiting new staff, particularly the younger ones.

Interesting work

Speak with your team members regularly about the kinds of work your business handles and what in particular interests them. They may like working with particular types of clients, or particular types of work, or they may be interested in helping you run your business by handling things such as HR matters, systems and policies, IT, marketing, social media, etc.

Ask, listen, and action to keep your team members engaged and happy.

Regular feedback

Don't save feedback up for the annual review. Give feedback regularly! Positive feedback should be made publicly where possible so the team member can feel valued and to ensure other staff are aware of the person's achievements. Negative feedback should always be handled with care and should include a path to improvement. Annual reviews should focus on pay and the plans for the coming year — they shouldn't be used as a chance to dump on the team member for stuff that happened months ago. There are software solutions out there that can manage the review process, including 360 reviews for management, so you don't need to do everything manually which can be a pain.

04 KPIs

Key Performance Indicators

Before we get started, it'd be useful to quickly explain here what a good KPI looks like.
It needs to have all the relevant ingredients to ensure it the KPI is smart. Smart stands for:

Specific It needs to refer to something specific (e.g. sales up 5% on last year) and not something vague like 'make more money'.

Measurable The KPI needs to be measurable and obtaining that measurement needs to be easy and transparent (good accounting and job management software will help here).

Attainable Any good target is going to be inspirational, but you want to make sure it can actually be achieved in the real world and not just on a piece of paper.

Relevant The KPI should align with the broader goals of the business.

Timely You need to be able to achieve the set target within a specified timeframe. Best to keep it shorter rather than longer so you don't lose focus.

Now that we understand the basics of KPIs we can look at some good ones for creative agencies.

Utilisation rates

How much of your teams time is billable? You might be aiming for 80% chargeable vs 20% overhead for your professional team.

Recovery rates

How much of that billable time is actually charged to clients? Typically you're going to want an average of 100% meaning that any time written off each month is offset by time being picked up on other jobs.

Wages v Revenue

Most service businesses will want to cap wages as a percentage of total revenue. For many service businesses 50% is a good target though it may be a little ambitious for many creative agencies as the industry average is around 60%.

Billings

The big one for most agencies, this one shows what the billings are per staff or for the business as a whole. As discussed earlier you want to have billings targets set based on a realistic budgets based on your capacity and ability to deliver work.

Net promoter score

You want to have happy clients that will stick around, pay your bills and refer you more work. You might need to engage an external market research company to measure this one for you.

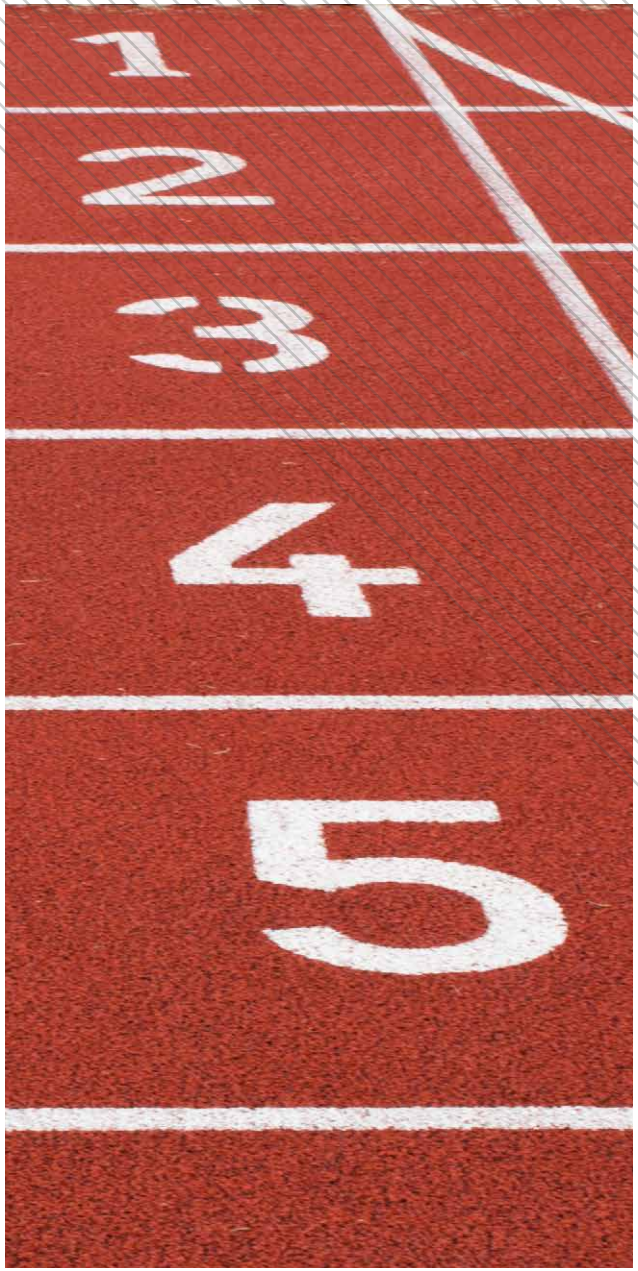
Staff turnover

The lower your staff turnover the less negative impact on your business and your clients.

Now that you've got a handful of KPIs for your business – you only really want 4 or 5, anything more at one time becomes unmanageable – you'll want to establish a system for reporting on your performance against the targets.

The system should be easy to use and nice to look at. We tend to recommend dashboard reporting packages to report on this stuff. Software will automate the reporting for you and give you something pretty to look at which for some reason is more motivational than a page full of numbers!

So you've got your KPIs and they are a good mix that you're happy with as well as a system to easily report on your progress. Now comes the most important part – setting strategies to achieve the KPIs! Each KPI should have a range of strategies to help you achieve the goals. These strategies should be reviewed regularly against your performance to see what is working and what needs to be changed – plan, implement, review, adjust. Rinse and repeat!



05 reviewing your insurances

You may wonder what insurance has to do with profitability. Well, aside from cutting costs by ensuring you are paying competitive rates for your coverage, insurance exists to protect against risk. **Any risk present in your agency represents a threat to your bottom line so in order to protect your bottom line you need to ensure you are covered. Simple.**

First up, you should have a good insurance broker handling this stuff for you. A good insurance broker is one who asks a lot of questions and seeks a deep understanding of your business and how it operates. They do this to ensure that any potential risk that your business may be exposed to is covered under the policies your business holds. Any broker that seems disinterested or unsure about what your business does is not someone you want managing you're the risk in your business. Like with any professional adviser, referrals from people you trust is probably the best place to find yourself a good broker. It's also wise to get someone who has experience in your industry rather than using a generalist (this is actually sound advice for all professional services).

Regardless of your broker you're also going to want to ensure all the major areas of your business are covered. Here are a few you may not have considered.

Professional indemnity, or PI, should cover you and your staff in the event a client makes a claim against you for doing shoddy work. Many in agency land don't feel this type of cover applies to them, thinking it's just for lawyers and accountants, but there have definitely been cases against creative agencies so don't get caught out!

Business continuation policies will cover you for the loss of income you may have if something happens to your business or your place of business. If your building burns down and you can't work for a few weeks then these policies will cover your loss of revenue.

Cyber insurance is becoming a crucial item to have and is typically not very expensive. It covers you for losses incurred if your business comes under attack online, for example your data may be held ransom by an overseas crime syndicate. Sounds far-fetched but it's happening with alarming frequency these days.

Directors and officers cover. This covers the directors and officers of the company from any action that may arise due to actions undertaken in the course of carrying out their job. This could arise from your dealings with staff or with a third party.

A good broker will go through all this stuff with you. If yours hasn't brought any of this up it might be time to shop your cover around. You'll be able to get better advice, better coverage and a better price by trying someone new. All of these things will help protect and enhance your bottom line.

06 financial reporting

When I was learning to drive, someone said to me, 'There's a tipping point where after loads of practice, you can suddenly drive the car. But up until then, the car drives you.'

The same principle can be applied to the owners of agency businesses and their finances. Many of them can't understand their financial statements, and until they do, their business is driving them. That said, many owners don't like to admit they don't understand the numbers or that if they do, they don't like to admit how infrequently they review the numbers.

See if you can answer these basic financial questions about your business:

What was your total revenue for last year?

How much profit did you make?

How much profit do you make per staff member?

How much does the business have in cash and trade debtors?

How much debt is on your balance sheet?

What are your debtors looking like?

The answers to these questions represent the baseline information a business owner should have at any given time. You may (or may not) be surprised to hear that many business owners can't answer these questions readily. It might be through unfamiliarity with financial reports or through a desire to concentrate on other parts of the business or through wilful ignorance. Whatever the reason, you should make every effort to get up to speed as quickly as possible.

> And that old excuse of creative people being bad with figures? It doesn't really cut it if you're running a business!

Getting a handle on the financial side of your business will alert you to potential issues before they become actual disasters and it will give you the confidence you need to make the right financial decisions in your business.

All this comes from just learning to read the reports which your accounting software generates for free and whenever you like. The increased confidence and control is great, but perhaps the most compelling reason to get across your business's finances is this: **with the money stuff demystified, you can concentrate on building your business.**

Want a starting point? Here it is. Simply book a meeting with your accountant and ask them to explain the three most common financial reports: profit & loss statement, balance sheet and cash flow statement. Afterwards, if you can then explain them to someone else, you'll know you've got them licked.

With these three reports under your belt, you'll not only be able to talk money with confidence, you'll be driving your business instead of the business driving you.

07 how to avoid scope creep

If there's a common operational problem faced by many creative agencies, it's the difficulty of completing jobs within the quoted hours. If you look regularly at these sort of businesses, it comes up all the time. Sometimes it's a matter of managing staff time correctly. Sometimes, it's about quoting accurately in the first place.

But sometimes, it's about scope creep: the tendency for a job to be extended by the client (and occasionally by staff who are over eager to please) to the point where the quoted price no longer covers the time needed to complete the job. When this happens, profit diminishes, and if the creep continues, the profit will disappear. After that point, the job becomes a cost to the business and you would have been better off saying no to the job in the first place.

It's worth noting here that this doesn't apply if you're simply charging by the hour for 100% of what you do. That said, clients will commonly ask for an estimate of works or more likely these days they'll be asking for a fixed fee for a particular piece of work or they may simply want detailed account statements each month. Either way you're going to be forced into being accountable for the time spent on a job and containing scope creep is an important part of this.

> Scope creep can be a difficult one to tackle, because it's ultimately about client relations. The 'look, we're now beyond what we originally quoted on' conversation is a tough one, and the lives of both client and agency would be easier if it never had to take place.

Here are few tried and tested methods for stopping the creep in its tracks:

Have a well drafted service agreement in place, signed by the client. This should clearly specify that you'll charge for additional hours outside the scope of work. This is a bedrock document for you to rely on if needed.

Specifically mention in the quote what happens if the scope blows out. That way the possibility is flagged up front.

Where additional tasks are requested mid job, point out to the client that they are outside the scope of work. Do this when the requests are made, not once the hours have run out. It makes for a much easier negotiation.

Offer the client alternatives to either downing tools or charging more money. Specify what you can deliver for the original quote. Provide clear pricing for each additional element.

Maintain good client relationships in case you have to have the conversation about additional hours. Again, it's much easier if you're on pleasant terms.

Develop good time management and job tracking skills. It's not the client's fault if you take longer to do the work than is necessary, or if your processes are inefficient. And never ever say these words: "well, the client didn't know what they wanted to begin with". It's your job to clarify the brief and understand the client's needs, even if they are unclear of that themselves. You're their guide through this process, not the other way around.

08 how to manage jobs effectively

Creative agencies will have a group of clients that they perform a range of tasks for and typically these tasks are referred to as jobs or projects and are considered discrete pieces of work that are scoped, delivered and invoiced for. As these jobs form the key way in which an agency earns money it's obvious that you're going to want to ensure that the process is well managed! We'll be taking a look here at what a job management system can offer a creative agency and how that can help with the overall performance of the agency.

Implementing and properly using a job management system is really important for profitability for a few reasons:

It helps your team know what to prioritise

It stops work from slipping through the cracks (e.g. what was Sally working on before she went on leave?)

It will give you mission critical information on how your business and staff are tracking

It gives you a snapshot of all current, future and past work going through your agency

In our experience we have found that agencies without these systems tend to be flying a little blind and this is no way to ensure profitability.

There are a few software solutions out there, all the good ones are cloud-based meaning no need to worry about installing anything or compatibility issues. There are loads of options out there, speak with your advisors and fellow agency owners to see what works for them.

Regardless of which you choose, a good system will handle the following for you:

Client database

The system will store all your client details and will typically have basic file storage though mostly you'll link the system to your existing cloud-storage solution for document storage.

Jobs

These will be attached to the clients and can be setup quickly and easily using templates. The jobs will have various stages to them, milestones, etc. which can all be setup as part of the template.

Timesheets

To record time against a job as well as other non-chargeable tasks such as admin or training.

Invoicing

This can be done straight from the job management system. The invoices and receipts will sync between the system and your accounting software which saves time and gives your team access to the info they need (and nothing you don't want them to see).

Reporting

The system will then allow you report on all of the above. This gives you the power to answer questions such as:

Which clients are the most profitable?

Which jobs were profitable? Which jobs did I lose money on?

How much time are my team spending on training each year?

What did Sally bill for the business last month?

Which team member is the most productive?

A good job management system is neither expensive nor time-consuming to implement and manage. You could say that it's impossible to run an effective agency without such a system in place. And remember that these systems are only as good as the people using them – rubbish in rubbish out – so ensure you have a 'champion' in the office to keep the system tidy and functioning properly.

You need accurate information about how your business operates in order to make effective decisions. Which clients to keep? Which staff to reward?

Without a system like this you're just operating on gut instinct which may not always be as finely tuned as you think. A good job management system will complement your financial record keeping system to give you almost all the data you need to run your agency effectively.

Looking for systems?

Dashboard reporting

Futurli

Wayahead

Job Management

Workflow Max

Harvest

Streamtime

Financial Reporting

Xero

09 cash management

You can offer the greatest service, with the most driven team, in a wealthy city and still have your agency fail, or at the very least not reach its true profit potential, if you're unable to manage cash flow and manage it well. A huge number of businesses — large and small — fail every year due to poor cash management and poor cash flow.

Managing cash doesn't need to be complicated. Here are a few tips to help stay on top of the cash in your agency:

Service agreements

Once your service proposal has been accepted and you're in the exciting honeymoon period of your professional relationship it's important to introduce the business equivalent of the pre-nup — the services agreement (aka the engagement letter). This should happen before any real work starts.

This agreement should outline what services your business will provide, to whom they are being provided, the agreed fees, payment terms, etc. They set expectations right up front so there are no surprises from either side – because nobody likes surprises. Explain in your agreement when you expect to issue your invoices, whether that might be upfront, as progress invoices, or maybe upon completion. The agreement should also stipulate that you reserve the right to charge for work requested that is outside of the scope of the original price (e.g. you've quoted to create a website, not manage their social media accounts) and it should outline your expectation that if invoices are unpaid you won't be undertaking any further work. It's a good idea to walk your client through the agreement as many people have a tendency to just sign things emailed to them without really understanding them.

The agreement should be signed by both parties and filed away for safe-keeping before the job starts. There are templates for these agreements floating around the internet, but our advice would be to have your lawyer draft something simple for you to use as a template for all your ongoing work.

Invoicing

Send the invoice, get paid. Sounds simple enough, but the crazy truth is that often people have trouble with cash flow because they simply aren't sending invoices for their work. Issue invoices regularly throughout the job and stop work if invoices are unpaid and overdue. Here are some good pointers for issuing invoices:

Make sure the invoice is clear and easy to read and understand — from who, for what, how much?

Include as many payment options as possible so there are no excuses for non-payment.

Send the invoice to the right person — ask upfront who the invoices should be sent to.

Don't send the invoices included with other work or documents or else they might get lost. Always send them separately and you can try sending them from a different email address (e.g. accounts@) to ensure don't get confused for anything else. Your job management and/or accounting platform should be able to help here.

Clients who don't pay

Unpaid invoices are the bane of any agency owner's life and whilst it isn't possible to avoid them altogether, there are some strategies you can employ to minimise the risk of late payment or non-payment of your invoices. Consistency is key here, make sure the procedure is always followed.

First, put yourself in your client's shoes. Did you make it clear about what the fees would be and when they would be payable? Have you issued sufficient reminders and notice to get the invoice paid? Are you offering a variety of payment methods? Have you delivered what you said you would deliver? Before setting the dogs on a client, check first to make sure the fault isn't yours.

Next, send reminders. Remembering to send these can be time-consuming, boring, and dangerous for client relations as it's easy to get wrong and receiving an undeserved overdue payment reminder can be upsetting for a client. Save yourself the hassle and set up an automated reminder service that plugs into your existing invoicing/accounting software. There are a few options out there that offer a low-cost, low-hassle solution which are quite effective at automating the reminder process.

Once an invoice is past a certain point you'll need to escalate the issue so the non-payer realises you're serious about collecting the money. After a few email reminders it's time to call. Remember to tread lightly, simply call to see if you've done something wrong or if there is some other explanation for the unpaid invoice. If no amount of reminders or calls will get you paid it may be time to lodge a statement of claim with the local court or engage a debt collection company or a lawyer. Debt collection companies usually just take over the job of emailing/calling/mailing the debtor and typically only have more luck that the owner because the debtor realises the severity of the situation. Lawyers can be very effective, but very expensive, always take this path with caution!

Best practice? Use software to automatically chase up invoices that are one week overdue, two weeks, three weeks, then start making calls. Following that you can consider sending a letter of demand typically at the three month point then involve lawyers at the 6 month point. Once burnt you should insist on payment upfront if you are going to continue working with the client.

Cashflow planning

Last, but certainly not least, it's important for all businesses to maintain a cash flow forecast for at least the next year. This will tie in neatly with the budget we discussed earlier. A forecast will allow you to spot possible cash shortfalls well in advance so that you can plan and act accordingly (e.g. by increasing your overdraft). On the plus side, they also allow you to see when you'll have a surplus of cash so that you can invest money back into the business (or take a dividend!) and be safe in the knowledge that the business will be healthy after the money has been spent.

Interested in increasing the profitability of your creative agency, but not sure where to start? Give us a call today, we'd love to help.

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