

**THE**  
**DIGITAL**  
**AGENCY**  
**HANDBOOK**



**HOW TO**  
**MAXIMIZE**  
**EFFICIENCIES &**  
**BOOST PROFIT**  
**FOR THE**  
**SERVICE-BASED**  
**BUSINESS**

**BELAY knows being an entrepreneur is hard. That's why we provide simple accounting resources designed for the non-accountant to understand and put to use.**

This resource is designed to help you navigate the challenges of being an entrepreneur. We know how good accounting can grow a business, especially when it comes to building a profitable digital agency. Expanding your client base while maintaining an efficient workforce is especially hard, which is why you need to understand how to account for and plan from the beginning to grow in line with your profitability goals.

The Digital Agency Handbook will familiarize you with the basics of accounting for a service-based business, so you can maximize efficiencies and grow profit. We hope you find this information helpful and that it contributes to your success. Should you need some help along the way, [we are here for you.](#)

Good luck and happy number-crunching!



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# PROFESSIONAL SERVICES ACCOUNTING



# PROFESSIONAL SERVICES ACCOUNTING

## How to Establish Efficiencies That Result in Profitability

**“Digital Agency.”** It sounds very high-tech, fancy, and intriguing, but what type of business is it referring to? A digital agency is a general term for a service-based business. Essentially, a business sells billable hours in exchange for labor.

Examples of service-based businesses include marketing agencies, architects, video production companies, or similar. Service-based businesses have their own, unique accounting considerations — those that better understand the numbers toward the magic formula: how much should I charge to make money? There is a lot more to figuring out that magic formula once you dive into the details. Questions to ask range from how much you should charge, to how many clients you need, to how many hours you actually pay for each hour billed to the client. For the digital agency owner ready to maximize their efficiency and profit, it helps to dive into the overall concepts to consider first. Let’s take a look at the major elements of professional services accounting.

A good starting point for understanding professional services accounting is understanding this: **as a digital agency owner, your biggest spend will be labor.**

### How to spend Labor Hours Efficiently

Labor is not just associated with doing direct tasks for the client, but also includes other types of labor, from administrative to marketing to internal time for training, days off, etc. This is a great place to start. From the accounting perspective, you will need to understand how to spend these precious labor hours in an efficient manner and track where your labor hours go. This is where the key to profitability for a digital agency lies. You will need to identify which labor hours fall into the overhead category and which fall under the directly billed category, then establish the return on the investment of each. Depending on the profitability of your efforts, it may also dictate whether or not it makes sense to bill per hour or as an upfront fee structure similar to a retainer.

## Your "Inventory" is Billable Hours

Sometimes it seems a bit more straightforward when you think of professional services in terms of a product-based business. You have a product, you have a price, and you sell it for said price to ultimately cover the costs of that item and leave some extra for profit. For the digital agency, the “inventory” is your billable hours. In simple terms, if you are charging \$100/hour for a service, you will be giving the client an hour of your time. Inside that time is where the analysis begins, and the efficiencies need to be established.



## The Breakdown of Hours and Why it Matters

Generally, we think of a full-time employee as one who works 40 hours per week, 52 weeks a year. That is not an accurate starting point for calculating your labor cost against your billable hours. It's not as simple as “I bill for three hours, Joe Employee does the service for three hours.” Inside that 40-hour work week needs to be a buffer to consider the other hours you are paying for that are not directly billable to the client. This includes internal items such as meetings, training, lunch time (if you include this on the clock), and holiday or vacation time. Realistically, you're likely getting about 32 hours a week on average that are directly related to the client task. This may equate to about 80% of their hourly cost being directly billed to the client. You must analyze this time first to drill down into the actual numbers.

While many employees aren't too keen on literally writing down their time and segmenting it by client or task, there are a ton of modern time-keeping and project management systems out there that help make this a touch easier.

**Remember, the key is to understand your return on investment by each hour spent.** Meetings and training sessions are well spent if they make your team better at their job and more efficient in meeting client needs, so they shouldn't be neglected entirely in an attempt to squeeze the most juice out of each employee.

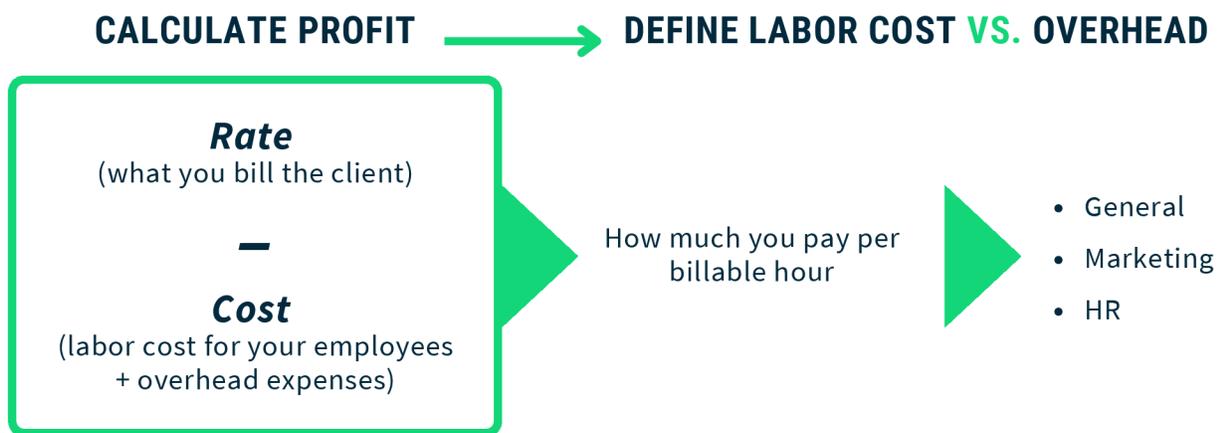
## Your “Cost of Goods Sold” is Your General/Administrative Labor

Outside of your client-facing employees are the meat and potatoes of every business; the general and administrative facet of the business. You have your owner(s), administrative assistants, your human resources team, your marketing, and more. These are essential team members to keep a business growing and humming along, but they share the profits of the billable hours. This is again where understanding your ROI and analyzing where their time goes becomes an important part of your business accounting.

If the billable hours are your “inventory,” these essential pieces are your “cost of goods sold.” Like the time spent on direct client needs, you will need to have an understanding of where your other functions benefit the business, as well as the costs associated with each.

Quality benefits, time off, in-house activities on the clock — these are all important parts of keeping up good morale and a quality workforce. Marketing efforts (should) speak for themselves as a return on their investment, through better outreach to the industry, a solid brand voice, and gaining more opportunities for the business. It makes sense to build these into your business pricing to build a solid foundation for your success.

Once your labor dollar efficiency is headed in the right direction, your business will be in a better position to be at its most profitable.



## The Bottom Line For Establishing Good Digital Agency Accounting

The basic equation for the service-based business profit is Rate (what you bill your client) - Cost (Labor cost for your employees and overhead expenses). The first step in understanding your biggest spend: labor. Then, you will need to drill down into what those labor costs are, how many hours you will pay for “per billable hour,” and how best to maximize your number of hours, so that you stay within the threshold of being profitable. In doing this, you will need to have a good sense of where your time is spent and the return on investment of your indirect hours, such as marketing and administrative tasks. By identifying each aspect of your business — directly billable to the client and overhead — you can start to have an understanding of where your profitability can continue to flourish or improve. Once your labor dollar efficiency is headed in the right direction, your business will be in a better position to be at its most profitable.



# UTILIZATION ANALYSIS



# UTILIZATION ANALYSIS

## The Journey to Understand Cost Per Billable Hour

If you are a service-based business owner up at night wondering if you're charging enough to cover your workforce, you're not alone. It's your biggest expense after all, and crucial to your growth as you take on more projects. The worry doesn't stop there. There's also the delicate balance between keeping employees productive, but not overworked. So how do you truly know the answers to these questions without losing sleep? You analyze your utilization and get to know your "cost per billable hour."

Let's dive into this concept a little deeper to better understand how analyzing your utilization can give you the data to capture your billable rate. It boils down to a few key areas of understanding: labor cost, expected billable time, and utilization rate. All of these items are displayed readily for our clients in the Digital Agency Workbook — a detailed spreadsheet analyzing the company's key expenses and revenue stats. Once you know these items, you can calculate out that magic rate.

### Labor Cost

As mentioned above, this is your biggest spend as a service based business, but essential to follow through on your client commitments. This boils down to answering two major questions:

1. **What is your payroll expense?**
2. **What are the expected billable hours spent working each year/month/week?**

When calculating your labor cost, it is "full-scale" payroll, meaning all the nuts and bolts on top of paying an employee. This includes not only salary, but insurance, benefits, payroll tax, 401k, etc. Since this will be your biggest expense as a company, the goal is to make it as efficient as possible. This means drilling down into the details to know it inside and out, from hourly to weekly to monthly to yearly. You will calculate the cost of labor against the time they are available to work to get each person's "cost per billable hour".



*What is something you can't get back once you've used it? **Time.***

## Time Tracking Is the most important

What is something you can never get back, once you've used it? Time. This is a major player in how best to start analyzing where you are spending those precious billable hours. This doesn't have to be complicated, but it has to be done in order to get an accurate sense of what each billable hour is worth. Just for fun — write down how much time you spend on certain tasks for projects, then compare this to a day (or month) of actually tracking your time. It's likely there will be a major disconnect between the two. This means the financial disconnect will be in line with the time usage disconnect. If you are not tracking time, you are not setting your service business up for success. If you are underestimating the time spent on quoted projects, you are in for some inefficient and costly business lessons. Get an accurate picture of how much time is spent per employee and per job, so you can track and understand who is getting overworked and who can step up their use of time.



## How Can You Make the Time You Pay for Work Better for You?

You will need to set benchmarks surrounding your time spent on client tasks. Then, average it over time to get a sense of the typical time spent surrounding a certain task to best calculate your hourly rate.

There are countless easy-to-use time tracking tools at your disposal. We use Harvest, which (like all of our other go-to systems) pairs nicely with other systems, like QuickBooks. If you are managing projects and using a system for that, chances are, they have a time tracking feature built in. Use it. These systems will help you quickly get a sense of where your time is going and how accurately your billing covers it. Depending on what you find, you may end up drastically changing your rates.



## Utilization Rate

The utilization rate factors in the amount of time the employee spends directly on client work. Assuming you are considering a full-time employee, for each 40-hour week, let's say 30 hours will be directly billable to a client. Within those other ten hours, you can assume that is time spent on vacation, sick days, and general/admin tasks like employee training, etc. Calculating this out into a percentage, you come up with a 75% utilization rate:  $30 \text{ hours} / 40 \text{ hours} = .75$

For employees not spending the classic 40 hours per week on the clock, you will calculate this based on the hours worked directly for the client as well. An employee who works 20 hours per week, having a target utilization rate of 75%, will need to spend 15 hours per week on direct client work:  $15 \text{ hours} / 20 \text{ hours} = .75$ .

For these examples above, your target utilization rate is 75%. By understanding this percentage, you can assess how many of their hours need to be spent on client billable work to stay in line with the goals of your company. Conversely, you can see how far off you are from efficiency for each employee, and adjust accordingly.

## Putting It All Together

Once you understand what you are tracking and how to best analyze it, you can start to understand what each billable hour needs to cover. We do this by calculating labor cost and dividing that by billable hours. Here is the breakdown:

### MONTHLY AVAILABLE HOURS

Assuming you have an employee available for 40 hours per week, 52 weeks per year, they will have a monthly amount of available hours totaling 173. We come to this number by saying this person has  $(40 \text{ hr/week available}) \times (52 \text{ weeks/year})$  and divide that by 12 months.

### ADMINISTRATIVE AND HIGHER-LEVEL EMPLOYEES

Keep in mind the employee's role when it comes to mapping this out. A director-level employee will have fewer billable hours dedicated to a project. A lower-level employee will have a higher concentration of billable hours focused on client work. You will need to adjust your calculations accordingly to add their billable time into the equation. Maybe the director will have about 50 hours per month (approximately 12.5 hours/week) on the project, so use the most accurate number to get the best calculation. Also, you will not include employees solely dedicated to general and administrative tasks in this number either. They are going to be in your overhead/billable hour category and added on separately.

### TARGET BILLABLE HOURS

To get the Target Billable Hours, you will need to multiply those available hours (173) by the target utilization rate (75%), to get your magic number. In this case, it is 130 hours per month. For an employee working 20 hours a week, their magic hourly number per month to stay in line with a 75% target utilization rate will be 65 per month.

### COST PER BILLABLE HOUR

To see what each employee will cost per hour, you simply take their total labor cost and divide it by the target billable hours. In the case of an employee costing \$5,235.19 per month, with 130 billable hours per month, they will have a cost per billable hour of \$40.27. If you use the normal hourly rate calculation and divide by the available 40-hour work week, it will produce a lower hourly number, but it won't be accurate. The overall goal is to factor in the time not spent on directly billed work to ensure your billable rates cover the outflows of the business.

## EXAMPLE: Basic Calculations for Full and Part-Time

	MONTHLY COST	AVAILABLE HOURS	EXPECTED UTILIZATION	TARGET BILLABLE HOURS	COST PER BILLABLE HOUR
CORRECT CALCULATION:	\$5,235.19	173.3	75%	130	\$40.27
INCORRECT CALCULATION:	\$5,235.19	173.3	100%	173.33	\$30.20
ONLY BILLING 20 HOURS:	\$5,235.19	173.3	50%	86.67	\$60.41
CORRECT CALCULATION WORKING 20 HRS/WEEK:	\$2,617.60	86.66	75%	65.03	\$40.26
	\$18,323.17	606.7		455.03	



**An employee working 40 hours per month, with 30 of those billable:**

$$(\$5,235.19 \text{ per month}) / (130 \text{ target billable hours per month}) = \$40.27$$

**Same employee, but assuming all 40 hours per week are directly billable (which is typically not sustainable):**

$$(\$5,235.19 \text{ per month}) / (173 \text{ hours per month}) = \$30.26$$

**What happens when that same employee bills only 20 hours per week, versus the 30? It changes the dynamic of their expected utilization and cost:**

$$(\$5,235.19 \text{ per month}) / (86.66 \text{ hours per month}) = \$60.40$$

**When that same employee is actually a part-time employee, you can see how the percentage of expected utilization keeps the cost per billable hours in line with that number, as a full-time employee at the same rate:**

$$(\$2,617.60 \text{ per month}) / (86.66 \text{ hours per month}) = \$40.26$$

This is the same as the first calculation.

Assuming all of the data in the chart represents your actual employee dynamics, you can see how having too much indirect time skews the overall target company utilization, with the less efficient employees.

*Voilà!* Now you know exactly what it costs you per hour for each employee to dedicate time to a project. Pretty cool, huh?

This gets you started on the basic understanding of what each employee costs per billable hour. Once you calculate your overhead costs, you will have your overhead per billable hour, and can also add on profit margins, to round out a full-scale review of where your pricing needs to be.

Stay tuned for the next overview, where we will dive into more detail on those aspects that play into an in-depth analysis. The biggest takeaway here is that your biggest spend (labor) needs to be properly analyzed in order to accurately project how much you should be charging a client to cover your costs. Without accurate time management and analysis of the full payroll expense, you won't be able to understand where your rates currently are. By ensuring accurate time keeping and by implementing a proper analysis, you will have a better basis for continually reviewing and assessing your labor costs moving forward.





# **BILLABLE RATE CALCULATION**



# BILLABLE RATE CALCULATION

## How to Ensure Profitability

You are diligently tracking time. You understand that you must consider the actual time you can allot to dedicated client work, and you are calculating the expenses that will always exist to run the business, whether you have a ton of clients or not. Good job! Now, let's make it all make sense by figuring in the profit margin you will need to consider to make offering your services truly worthwhile.

Obtaining this magic number lies in calculating the billable rate, and it can start to get a bit complex. Like utilization analysis, we will walk through each piece of the puzzle to make sure you are accurately taking each step to arrive at your magic number. While there may be a few fluctuations due to things like market rate for similar services and personnel, the basics required to accurately estimate your best billable rate will always be there.

## How to Get Billable Rate

The billable rate is the rate you charge each client to provide your service. How do you get it, and how do you pick one that actually makes you money?

The calculation for your billable rate is:

**(Cost per Billable Hour + Overhead per Billable Hour) x Profit Margin**

$$\begin{aligned} & \textbf{The Calculation for Billable Rate is:} \\ & \textit{(Cost per Billable Hour + Overhead per Billable Hour)} \\ & \quad \times \\ & \textit{Profit Margin} \end{aligned}$$

Seems simple enough, right? But let's make sure you understand how to accurately get these numbers, so that the billable rate remains an accurate calculation.

## "Per Billable Hour" — What is the 'Hour'?

You'll notice that each of the items in the calculation is "per billable hour." Remember, our billable hours are our inventory, meaning the number of hours we actually have to offer to client work. This is how we make money as a digital agency. We don't have 40 hours per full-time person; it's likely 30 for the classic full-time employee. We need to look at the true hourly rate, so leave the 40 hrs/week calculation alone. We only want to consider the actual time we have to dedicate to meeting our client's needs.

In the example below, you see in the highlighted green areas our calculation of the hours available for each production and overhead staff. Since all of our production staff are full-time, you can see the consistency in the “available hours” column, then the changes in the “target billable hours” column, as the utilization rates come into play. For the general and administrative staff, their expected utilization is 0, because they are not directly client-facing.

PRODUCTION	TITLE	AVAILABLE HOURS	EXPECTED UTILIZATION	TARGET BILLABLE HOURS
PROD. EMPLOYEE 1	Jr. Developer - #1	173.3	85%	147.3
PROD. EMPLOYEE 2	Jr. Developer - #2	173.3	60%	104.0
PROD. EMPLOYEE 3	Jr. Designer	173.3	85%	147.3
PROD. EMPLOYEE 4	Sr. Developer	173.3	65%	112.7
PROD. EMPLOYEE 5	Sr. Designer	173.3	65%	112.7
		<b>866.7</b>		<b>624</b>

INTERNAL/OVERHEAD		GENERAL AND ADMINISTRATIVE STAFF		
INTERNAL EMPLOYEE 1	Salesperson	173.3	0%	0
INTERNAL EMPLOYEE 2	Office Manager	173.3	0%	0
INTERNAL EMPLOYEE 3	Owner	173.3	0%	0

To be a successful service-based business owner and manager, you need to be laser-focused on how each hour is spent and ensure each is used to max efficiency. Your timekeeping efforts are the basis of this.

### What is the "Cost" in Cost per Billable Hour?

The cost we consider in cost per billable hour is your full-scale payroll expense against the utilization rate of each employee. We discussed this in detail in describing Utilization Analysis, where we walk you through assessing the capacity and output of each employee based on their time spent on client work versus general and administrative work. This calculation of cost takes into account all of the employees and their utilization rates (their payroll cost divided by the hours they work).

In the example below, you see in the highlighted green areas our calculation of the hours available for each production and overhead staff. Since all of our production staff are full-time, you can see the consistency in the “available hours” column, then the changes in the “target billable hours” column, as the utilization rates come into play. For the general and administrative staff, their expected utilization is 0, because they are not directly client-facing.

### LABOR COSTS

<i>PRODUCTION</i>	TITLE	ANNUAL COST	MONTHLY COST	AVAILABLE HOURS	EXPECTED UTILIZATION	TARGET BILLABLE HOURS	COST PER BILLABLE HOUR
PROD. EMPLOYEE 1	Jr. Developer 1	\$67,715	\$5,642.92	173.3	85%	147.3	\$38.30
PROD. EMPLOYEE 2	Jr. Developer 2	\$67,715	\$5,642.92	173.3	60%	104.0	\$54.26
PROD. EMPLOYEE 3	Jr. Designer	\$70,490	\$5,874.17	173.3	85%	147.3	\$39.87
PROD. EMPLOYEE 4	Sr. Developer	\$103,790	\$8,649.17	173.3	65%	112.7	\$76.77
PROD. EMPLOYEE 5	Sr. Designer	\$101,015	\$8,417.92	173.3	65%	112.7	\$74.72
				<b>\$34,227.08</b>	<b>866.7</b>	<b>624</b>	<b>72%</b>



Remember, your two biggest outflows of money are:

**1 PRODUCTION COST**

The payroll expense associated with doing client work

**2 OVERHEAD**

The general and administrative expenses + the typical cost of running a business

### Overhead per Billable Hour

To get this number, look at your overhead expenses. Overhead costs are those that need to be spent in order to keep the business running, with or without a ton of clients. This includes your human resources staff, marketing and sales, overhead expenses like rent and utilities, subscriptions, administrative staff, etc. Now you will need to turn that into an hourly rate.

Looking at them from a monthly perspective, there will be variations. The variations will come from things as simple as the days (and associated hours) of each month changing slightly, to things like the number of people on the job and their availability or utilization.

In the example below, you will see a summary of the overhead expenses highlighted in tan that show the salaries of our G&A employees, as well as basic overhead expenses. The calculation of those overhead costs in a per-hour calculation is highlighted in tan in the bottom row.

As you look at the other expenses outlined, you will see the totals from our production labor (direct client work) up top, and the total expected billable hours in the second-to-last row. See how each month varies slightly? This affects the overhead per billable hour cost in relation to those changes.

<b>EXPENSE/ BUDGET CALCULATION</b>				
	<i>JAN</i>	<i>FEB</i>	<i>MAR</i>	<i>APR</i>
PRODUCTION LABOR	\$34,227.08	\$34,227.08	\$34,227.08	\$34,227.08
OVERHEAD SALARIES	\$21,877.50	\$21,877.50	\$21,877.50	\$21,877.50
GENERAL AND ADMINISTRATIVE	\$1,500.00	\$2,500.00	\$1,000.00	\$1,500.00
OCCUPANCY	\$4,500.00	\$4,500.00	\$4,500.00	\$4,500.00
SALES AND MARKETING	\$3,500.00	\$7,500.00	\$4,250.00	\$3,000.00
<b>TOTAL OVERHEAD</b>	<b>\$31,377.50</b>	<b>\$36,377.50</b>	<b>\$31,627.50</b>	<b>\$30,877.50</b>
<b>TOTAL EXPECTED EXPENSES</b>	<b>\$65,604.58</b>	<b>\$70,604.58</b>	<b>\$65,854.58</b>	<b>\$65,104.58</b>

<b>EXPECTED/ BUDGETED</b>				
EXPECTED BILLABLE HOURS	624	675	725	700
<b>OVERHEAD PER BILLABLE HOUR</b>	<b>\$50.28</b>	<b>\$53.89</b>	<b>\$43.62</b>	<b>\$44.11</b>

As your revenue and your team grow, your overhead per billable hour should decrease due to cost efficiencies. For example, your human resources employee(s) still support the company’s HR needs, whether it spans 20 or 40 people. Or, from a general expense perspective, you will still need to pay rent whether you are filled with 10 people or 20. You can see this in the example above, as the hourly capacity goes up, and the overhead per hour dips down from \$50.28 in January to \$44.11 in April.

**Before Moving on to Profit Margin, Let's Remember...**

Not only does the importance of accurate time tracking come into play in your cost per billable hour, but timely and up-to-date bookkeeping as well. You need to have both accurate reports of time and expenses each month in order to make an accurate calculation of your production and overhead costs and the time associated with them.

## The Margin Piece

Now that you have figured out your major expenses in the production cost and overhead, it is time to figure out how much it will take per hour with various profit margin levels. We typically factor in 20% as a good point to pay the business owner(s) and keep the business moving forward in a healthy fashion.

In the example below, you can see the variations in what your billable rate should be based on the profit margin in the columns to the right. You can see the swing that is created by our two employees outlined in red; this (again) is related to their cost per billable hour, and influenced by their utilization rate being less or more than our target percentage. The average overhead per billable hour rate is outlined in green. This is what we are adding to the cost per billable hour to get the numbers in the “plus overhead per billable hour” column. The bold numbers in the “blended” row provide the average or target rates across all of the entries.

		BILLABLE RATE CALCULATION					
PRODUCTION	TITLE	COST/ BILLABLE HOUR	PLUS OVERHEAD/ BILLABLE HOUR	MARGINS			
				20%	30%	40%	50%
PRODUCTION EMPLOYEE 1	Jr. Developer	\$38.30	+ \$47.90 = \$86.28	\$107.85	\$123.25	\$143.80	\$172.56
PRODUCTION EMPLOYEE 2	Jr. Developer #2	\$54.26	+ \$47.90 = \$102.24	\$127.80	\$146.05	\$170.39	\$204.47
PRODUCTION EMPLOYEE 3	Jr. Designer	\$39.87	+ \$47.90 = \$87.85	\$109.81	\$125.50	\$146.41	\$175.70
PRODUCTION EMPLOYEE 4	Sr. Developer	\$76.77	+ \$47.90 = \$124.75	\$155.93	\$178.21	\$207.91	\$249.49
PRODUCTION EMPLOYEE 5	Sr. Designer	\$74.72	+ \$47.90 = \$122.69	\$153.37	\$175.28	\$204.49	\$245.39
<b>BLENDED</b>		<b>\$56.72</b>	<b>\$104.76</b>	<b>\$130.95</b>	<b>\$149.66</b>	<b>\$174.60</b>	<b>\$209.52</b>
OVERHEAD PER BILLABLE HOUR		\$47.90					

*It may be a complex calculation, but it is literally the lifeblood of your business success.*

Looking at the various employee costs, you will get a sense of how much variation there is across all of them. Again, this will be a function of their utilization and labor costs. Seeing the rates based on each profit percentage will help you see how much you can charge and how profitable you can be. As a decrease in overhead cost comes into play as you take on more client work, you will see a bump in your profitability as well.

Outlining the various margins and drilling them down to your end rate will give you an idea of how much you should be charging. In the example above, \$130.95 seems to be the rate to charge to cover your production labor and overhead, while factoring in a 20% profit margin. In an industry where \$150/hour is the norm, this may give you the opportunity to bring in a 30% profit, and potentially more, once you've leveled out the variations in the two employees outlined in red. Conversely, you may need to stay within a tighter budget to bid on a project competitively. In this case, you can see that your focus needs to be on maximizing your staff's utilization to stay profitable.

### **The Bottom Line**

In the examples outlined above, it is easy to see how one or two employees off their targets can greatly skew your optimum rates, but you will not be able to address those challenges until you have accurately identified the time usage and your overhead costs. This is a result of timely bookkeeping and accurate time tracking. Once you have mapped out your available hours properly and matched them to both your overhead and production costs, can you figure out your billable rate? It may be a complex calculation, but it is literally the lifeblood of your business success.





# **JOB PROFITABILITY ANALYSIS**



# JOB PROFITABILITY ANALYSIS

## How to Make Each Client Count

Job profitability is like teamwork; it takes a combination of individual players all doing their part for the success of the team overall. One bad player can bog down the good ones, and even more lackluster teammates can really bring down the team's performance. The trick is to have a team full of amazing athletes, like the team composed of your outstanding individual players, your service-based business, and its clients (or jobs). Your goal as a digital agency is to have a team of profitable clients, all working toward a truly profitable business. So, how does all of this tie into your service-based business functionality? Well, it's the next key analysis you must understand: job profitability.

## Your P&L Could Be Lying to You

Job profitability is to understand how profitable each job/client is individually. You may be excited to look through your P&L and see a profit month-over-month, but not knowing how each client/job stacks up individually is a dangerous trap. To avoid blindly going forward, you will need to analyze each job. You could have one major client that is pulling the weight of five others, costing you money and not realizing it in the high-level P&L views. Don't get too worried about this new analysis just yet; it is not super complicated if you know how to track and analyze your labor and overhead costs. It's one of the most important areas to dig into, once you've mastered the time tracking and overhead and billable expense tracking costs, which are crucial to service-based business accounting.



## Analysis Recap: Have This Down Before Moving Forward

Remember the days of math class, where you learned all of the basics before tackling the hard stuff? For instance, that complicated word problem about trains, or the complex algebra equation that was essentially impossible if you weren't comfortable with things like multiplication, division, and PEMDAS? Not a math nerd like us accountants? That's okay, we'll get to the point.

Here are the key items you need to know and track (If you need a recap, revisit the previous chapters explaining each):

- Time tracking per employee for each job/client
- Labor Cost Per Billable Hour
- Overhead Per Billable Hour
- Labor Costs per employee (also taking into account their utilization rates and staff class)
- Overhead costs per hour
- Desired profit margin
- Billable Rate (taking into account your costs/employee, overhead, and desired profit margin)

You will be using these calculations to compare against each job to see how they stack up, so if you don't have these nailed down, go back and get your analysis on.



## HOW TO ANALYZE THE NUMBERS

Got your data handy? Good. Here's how we run the numbers. Take a look at the rate you are billing your client. Let's use an example where you are charging a monthly retainer. This will need to take into consideration each month's costs. The best way to look at this is to see how many hours you spent on that particular client for the month and match that up with your billable rate. Remember, your billable rate is what you charge your client per hour to cover both labor and overhead costs and take into account the profit you need to make.

## BASIC CALCULATION EXAMPLES

### COMPARE BILLABLE RATE

Total time spent/staff member on client/mo) x (billable rate) = **Total revenue expected/mo**

(Client revenue/mo) - (Total revenue expected/mo) = **The number to compare**

Is this number greater than, lesser than, or equal to what you are charging?

### COST PERSPECTIVE

(Total monthly client revenue) - (Total labor + overhead costs) = **Your profit**

(Your profit) ÷ (Total labor costs) = **Profit margin**

Is this profit margin inline with your goal?

## JOB COST TROUBLESHOOTING: WHAT IF IT'S NOT PROFITABLE? WHY ARE THERE DEVIATIONS?

It'll be a pretty straightforward calculation and answer. Is it a negative number? Not ideal. Is it a positive number? That's good, but how "positive" is it? Does that positive number reflect the profit margin you were aiming for? Yes? Good. No? How much profit is it pulling? Is this slight deviation expected due to other factors, or is it a surprise?

You will need to dive in and calculate that percentage of profit to see how it is stacking up. Once you have done this for a month, keep analyzing each month to see if there are more deviations across the board or if they are fairly consistent. So what if there is a meager (or no) margin at the end of the month? Positive or negative, let's troubleshoot:

The first step in improving your profitability is understanding whether or not you are profitable in the first place, so pat yourself on the back for digging in. Sometimes the answer can be a huge “no, I’m not profitable,” or variations thereof. Remember the crafty P&L making you think you were doing just fine with its monthly overview in the black? This is where it gets called out. Keep in mind that sometimes you may have an off month on a job that is warranted. You know your business goals (which are not to lose money, of course), but sometimes you need to take a bit more time to earn a long-term client that will provide more business or a greater opportunity once you’ve proven your skills. Maybe you have a new employee who is taking longer to learn the ropes and will become a functional team member once they settle in, using fewer hours eventually. Don’t let these scenarios become excuses for poor performance, though. Monitor them closely and make adjustments as needed.

If these sometimes normal factors are not what’s affecting the job’s profit, it’s time to see why. Here are some troubleshooting questions to help understand where things may be losing balance:

- **Time Tracking:** Is this happening consistently and adequately?
- **Labor Cost Increase:** Did you recently increase the salaries of the employees on the job? Added benefits?
- **Are your staff members hitting their utilization rates?** This ties into proper time tracking. Make sure they are allotting all of their time properly to each client.
- **Overhead Costs:** Are there additional costs that are throwing off the profitability of your job?

By managing these factors, you will be able to make the needed adjustments to boost your profitability overall. You can see how the intricate factors need to be addressed before getting the true overall picture. Imagine not tracking time. See how that would make this impossible?

Once you have mastered the art of analyzing job profitability, you will improve your business profitability overall.

### **The Bottom Line in Job Profitability**

The key to better overall profitability for the service-based business is individual job profitability. This means looking at each client/job individually to assess their success. To properly do this, you need to track and understand cost per billable hour, overhead per billable hour, as well as the essential basics: time tracking, utilization analysis, and profit margins. By measuring your costs against your rate for each job, you will be able to see where adjustments need to be made in order to improve. This may be simply charging more for your services, adjusting the time spent on the job, addressing overhead costs, or changing your business model to be better suited to serve more profitable clients (i.e., more skilled labor at fewer hours, vs. lesser qualified labor at too many hours).

Once you have mastered the art of analyzing job profitability, you will improve your business profitability overall. Stay tuned, as we will dive into more intricate troubleshooting of job profitability in the coming digital agency-focused articles.



# KPIs TO REVIEW MONTHLY



# DIGITAL AGENCY KPIs

## Key Metrics to Review on a Monthly Basis

So far, we have discussed a few of the basics as they relate to Digital Agency accounting, but now it is time to take a look at the bigger picture. There are a few key performance indicators (KPIs) you should be aware of to monitor the overall success of your company. We will outline the basic elements required and how they will impact the big picture, so you can ensure you are getting the most out of your business data.

It is super important that you've got the basics figured out before we move on, so let's take a second to remember the items you should already understand and track that we have outlined in previous articles.

As a quick recap:

- We mapped out how to properly track and account for your time,
- How to get the true cost of your labor by factoring in utilization,
- Ways to calculate what you should be charging (billable rate), and
- How to understand what each client is costing you (client profitability).

In a perfect world, you have been up and running in these areas: time, labor, and client costs, and you are ready to view your business's profitability as a whole.

## Production Labor Versus Overhead Labor: Now is the Time to Get it Right

As we get into reviewing the higher-level picture, we will be focused on revenue and top-line growth. These two facets of your business need to be appropriately categorized to get accurate numbers. We cannot stress the importance of ensuring the smaller details are in check at this point. Here is your quick guide to making sure you've got things dialed in.

The team members who focus on the client project directly are production labor. They are going to be factored into the cost of goods sold and will influence your gross profit margin directly.

The team members focused on the general and administrative tasks are overhead labor. They should be in the Overhead, General and Administrative, or in the Sales and Marketing buckets.

Both need to be accurate to give your P&L the correct high-level data.



## KPIs you should be aware of to monitor the overall success of your company

### GROSS MARGIN

Generally speaking, the purpose of a business is to make money. The first indicator of your health in this area is gross profit margin, so we will start there. The basic calculation for this metric is:

Revenue – Cost Of Goods Sold = **Gross Profit**

Gross Profit / Revenue = **Gross Margin**

The target for this should be about 50%. If it's higher than that, awesome. The dynamic will change depending on the size of the company. Generally speaking, a company of about 5–10 will be in that 50% + range to be considered on track. As you venture into the 30–60 person range, margin will decrease because of how it works from a service perspective. This is experienced when you increase labor costs to expand your business.

### OPERATING PROFIT

The next side of the profit picture is understanding how your overall expenses tie into your operating profit. This is where the overhead cost number comes into play. The calculation for this metric is:

Gross Margin – Overhead = **Operating Profit Dollars**

Operating Profit / Revenue = **Operating Profit %**

This number is before interest, taxes, depreciation, amortization, etc (i.e., EBITDA). Your target number for this KPI should be 20%, especially for that smaller operation in the zero-to-20-person agency. As you get bigger, your percentage will likely get a bit lower as your labor gets more expensive, and as you are likely supporting more overhead.

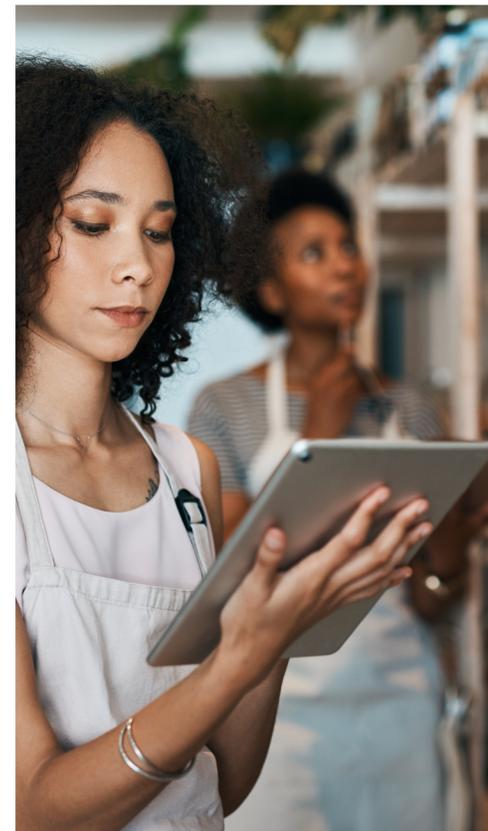
### REVENUE PER FULL TIME EQUIVALENT (FTE)

This number assesses how much revenue each employee is generating against many total employees you have. This number is typically annualized. A good range is \$100,000 per employee. A great range is \$200,000 per employee. Some agencies can hit this, but you are generally on track at \$100K with a team of up to about 30 people. To calculate this, you will do the following:

**Revenue / Total Headcount**

If you were to think of a perfect structure to hit the optimal Revenue per FTE, your staff should be organized like a pyramid, with the base containing your lower cost team members, doing more of the administrative and menial work. As you venture up, you will have more highly paid professionals.

For example, if you are at about \$73,000 per year salary average, and you have an annualized Revenue per FTE of about \$100K, you're making a net \$27K on your labor. Not too shabby. This goes toward covering overhead costs and other expenses.



## ★ UTILIZATION OF STAFF BY STAFF CLASS

The final metric that you should be assessing is your utilization of staff by staff class. So remember that percentage we were assessing as each employee's utilization rate? Remember how, when one employee was over- or underused, it threw the profitability dynamic off (especially depending on their rate)? This is where that comes back into play again.

Keeping track of utilization rate on a monthly basis will be the only way you can make sure your big picture numbers can be assessed properly. You will need to make adjustments or be aware of deviations that throw off the big picture. Ultimately, your employees should be hitting that target billable rate to make an accurate assessment of your target margins, but sometimes deviations happen for known reasons. For example, if a team member is below the target rate by 20% they may not need to be re-tasked to meet better utilization; it may just be a temporary cause. This could be that a newer employee is taking some time to get immersed in the flow of your business, or there's a longer-term employee taking a large chunk of PTO. Either way, tracking utilization on a month-over-month basis and comparing it against the targets will give you a heads up to make adjustments as needed.

## YOUR RECAP OF METRICS

So, here's the recap for you. The goal of tracking these metrics is to ensure you can adjust your operations to maintain and improve profitability. Whether it comes from adjusting rates, better utilizing your team, or both, you will need to track these metrics first to know where to focus your efforts. The second piece is to have the data required to track them: tracking time, utilization, production, and overhead labor, etc. When it's time to review the big picture of the health of your service-based business, these are your KPIs to track:

- Gross Profit Margin, targeting 50%
- Operating Profit, targeting 20%
- Average Bill Rate
- Revenue Per Billable Hour
- Overhead Per Billable Hour
- Revenue Per Production Labor Dollars, targeting \$2.00
- Revenue Per Full Time Equivalent (FTE), targeting \$100K
- Utilization of Staff, by Staff Class,

Once you get a sense of where your business stands using these metrics, you can make decisions that will help you improve and grow your business.

## 🏠 REVENUE PER PRODUCTION LABOR HOURS

In this metric, we are going back to our cost of goods sold area with production labor. We are assessing the value of each labor dollar spent on direct client work, answering the question: for the revenue I'm getting, what is the return on the production labor dollar itself? Remember, production labor includes the calculation of payroll + salaries + payroll taxes + benefits. To get the percentage of return on your labor dollars, use this calculation:

### Revenue / Production Labor Dollars

Your target is \$2.00 or above, or near that range for the 0-20. For example, if you have \$500k of revenue, maybe you have \$250k of spend on your labor dollars. Knowing your margins here will help you budget production labor dollars more accurately and can help you forecast costs (stay tuned, we will dive into this piece more later).



# KPI REFERENCE GUIDE



## GROSS MARGIN

Revenue – cost of goods sold = **Gross profit**

Gross profit / revenue = **Gross margin**

*Remember: the COGS are your labor.*

The target should be 50% or more. This will change depending on the size of the company, less as you grow.



## OPERATING PROFIT

Gross margin – overhead = **operating profit dollars**

Operating profit / revenue = **Operating profit %**

The target should be 20%, especially for a smaller (0-20) person agency. This is EBITDA – before interest, taxes, depreciation, and amortization.



## REVENUE PER FULL TIME EQUIVALENT (FTE)

revenue / total headcount

The target should be \$100K/employee on an annual basis. A great range is \$200K.



## UTILIZATION OF STAFF BY STAFF CLASS

total production labor hours / total available hours x 100



## REVENUE PER PRODUCTION LABOR HOURS

revenue / production labor dollars

The target should be \$2 or more. Remember, production labor includes the calculation of payroll + salaries + payroll taxes + benefits.



## AVERAGE BILL RATE

revenue / number of billable hours

## OVERHEAD PER BILLABLE HOUR

overhead cost / billable hours



# WHEN TO HIRE



# WHEN TO HIRE

## How to Plan For Adding Staff Proactively

If you are growing your service-based business and wondering if there is a magic way to know when or if you should hire, you are in the right place. While there are a few factors that will influence this decision-making, there is a way to map out how and when to add to your team to promote profitability. Hop on board, we are about to lay out the ways of understanding the dynamics of the digital agency that influence hiring decisions.

## The Basic Factors Involved

Firstly, the basics of your business need to be mapped out to assess your numbers. We outlined the intricacies of each in earlier articles. In short, you need to know what to charge, specific agency business metrics as a whole, to assess your profitability potential. We will be using the KPIs that a digital agency will be reviewing to help us make a good decision when it comes time to hire.

Looking forward to business growth, hiring is the next obvious step, but many companies make a very costly mistake by hiring too much, too soon. The best way to avoid this is to assess your business data properly and make informed decisions.

## Projected Sales

The first item that needs to be assessed and understood in the hiring process is your projected sales. For BELAY clients, we have a Sales Pipeline tab in our Digital Agency Workbook that will show the sales stats in an organized fashion. Most companies will be on top of this number anyway, but it is good practice to map out current sales (and clients), projected new clients, revenue churn, and how that looks from a revenue perspective.

REVENUE PROJECTIONS — CAPACITY PLANNING				
Projected Billings From Pipeline		JAN	FEB	MAR
PROJECTED SALES		\$65,000	\$80,000	\$105,000
BLENDED BILLABLE HOUR RATE (BUDGETED)	\$149.66			
BILLABLE HOURS REQUIRED		434.32	534.55	701.60
BILLABLE HOURS AVAILABLE	624			
BILLABLE HOURS OVER/(UNDER)		(189.68)	(89.45)	77.60
Goal				
REVENUE/PRODUCTION LABOR DOLLAR	2.5			
AVAILABLE TO SPEND ON PROD. LABOR DOLLARS		\$26,000	\$32,000	\$48,000
ACTUAL SPEND ON PROD. LABOR DOLLARS		\$34,227	\$34,227	\$34,227
OVER/UNDER — PRODUCTION/LABOR DOLLARS		\$8,227	\$2,227	(\$7,773)
GOAL FTE	124.80	3.48	4.28	5.62
ACTUAL FTE		5	5	5
OVER/(UNDER) STAFFED		1.52	0.72	-0.62

## Blended Billable Hour Rate

Understanding your Blended Billable Hour Rate is step two in your assessment. This will stem from your billable rate calculations and will be an average of your projected rate, hitting a specific profit percentage.

BILLABLE RATE CALCULATION								
PRODUCTION	TITLE	COST/ BILLABLE HOUR	PLUS OVERHEAD/ BILLABLE HOUR	20%	Margins			
					30%	40%	50%	
PRODUCTION EMPLOYEE 1	Jr. Developer	\$38.30	+ \$47.90 = \$86.28	\$107.85	\$123.25	\$143.80	\$172.56	
PRODUCTION EMPLOYEE 2	Jr. Developer # 2	\$54.26	+ \$47.90 = \$102.24	\$127.80	\$146.05	\$170.39	\$204.47	
PRODUCTION EMPLOYEE 3	Jr. Designer	\$39.87	+ \$47.90 = \$87.85	\$109.81	\$125.50	\$146.41	\$175.70	
PRODUCTION EMPLOYEE 4	Sr. Developer	\$76.77	+ \$47.90 = \$124.75	\$155.93	\$178.21	\$207.91	\$249.49	
PRODUCTION EMPLOYEE 5	Sr. Designer	\$74.72	+ \$47.90 = \$122.69	\$153.37	\$175.28	\$204.49	\$245.39	
<b>BLENDED</b>		<b>\$56.72</b>	<b>\$104.76</b>	<b>\$130.95</b>	<b>\$149.66</b>	<b>\$174.60</b>	<b>\$209.52</b>	
<b>OVERHEAD PER BILLABLE HOUR</b>		<b>\$47.90</b>						

For example, using your blended rate for a 30% profit, you can compare the hours you will need to hit your sales goals, and backtrack to see how that matches up from a labor perspective and a cost perspective. A great way to think about this calculation is to think of it in product terms. For example, your monthly revenue goal is your sales, and your labor hours are the units. To sell a total of \$120K of product, you will need 800 units to do it, or to meet the revenue goal of \$120K, you will need 800 labor hours to get there.



For example, using your blended rate for a 30% profit, you can compare the hours you will need to hit your sales goals, and backtrack to see how that matches up from a labor perspective and a cost perspective. A great way to think about this calculation is to think of it in product terms. For example, your monthly revenue goal is your sales, and your labor hours are the units. To sell a total of \$120K of product, you will need 800 units to do it, or to meet the revenue goal of \$120K, you will need 800 labor hours to get there.

REVENUE PROJECTIONS — CAPACITY PLANNING				
Projected Billings From Pipeline				
	JAN	FEB	MAR	APR
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000
BLENDED BILLABLE HOUR RATE (BUDGETED)	\$149.66			
BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83
BILLABLE HOURS AVAILABLE	624			
BILLABLE HOURS OVER/(UNDER)	(189.68)	(89.45)	77.60	177.83
Goal				
REVENUE/ PRODUCTION LABOR DOLLAR	2.5			
AVAILABLE TO SPEND ON PROD. LABOR DOLLARS	\$26,000	\$32,000	\$48,000	\$48,000
ACTUAL SPEND ON PROD. LABOR DOLLARS	\$34,227	\$34,227	\$34,227	\$34,227
OVER/UNDER — PRODUCTION/LABOR DOLLARS	\$8,227	\$2,227	(\$7,773)	(\$13,773)
GOAL FTE	124.80	3.48	4.28	5.62
ACTUAL FTE	5	5	5	5
OVER/ (UNDER) STAFFED	1.52	0.72	-0.62	-1.42

So what if the billable rate calculation is off or inaccurate? Well, that will skew your numbers. If you make changes to your blended billable rate, you will see how a lower number will affect the other items. Typically, if you have a lower billable rate, you will require more hours to obtain the sales goal. This is why it is so important to have access to your real-time, accurate data — like your billable rates. Only with accurate information can you make finite adjustments to better meet your goals and make solid decisions to move forward.



## Billable Hours Available

How many hours do we have available to use? Heading over to our Labor Cost Tab, we see a list of our employees, their rates, and the available hours they have. Considering their utilization rates, we will see an overall number of hours at our disposal each month.

LABOR COSTS			COMMISSIONS <small>(WOULD TYPICALLY BE HERE BUT IS NOT APPLICABLE TO THESE EMPLOYEES)</small>							
PRODUCTION	TITLE	SALARY	BONUSES	TOTAL WAGES	TAXES (8%)	INSURANCE	401K	ANNUALC OST	MONTHLY COST	AVAILABLE HOURS
PROD. EMPLOYEE 1	Jr. Developer 1	\$55,000	\$1,500	\$56,500	4,520	5,000	1,695	67,715	5,643	173.3
PROD. EMPLOYEE 2	Jr. Developer 2	\$55,000	\$1,500	\$56,500	4,520	5,000	1,695	67,715	5,643	173.3
PROD. EMPLOYEE 3	Jr. Designer	\$57,500	\$1,500	\$59,000	4,720	5,000	1,770	70,490	5,874	173.3
PROD. EMPLOYEE 4	Sr. Developer	\$87,500	\$1,500	\$89,000	7,120	5,000	2,670	103,790	8,649	173.3
PROD. EMPLOYEE 5	Sr. Designer	\$85,000	\$1,500	\$86,500	6,920	5,000	2,595	101,015	8,418	173.3
									<b>\$34,227</b>	<b>866.7</b>
INTERNAL/OVERHEAD			\$15,000							
INTERNAL EMP. 1	Salesperson	\$60,000	\$1,500	\$76,500	6,120	5,000	2,295	89,915	7,493	173.3
INTERNAL EMP. 2	Office Manager	\$45,000	\$1,500	\$46,500	3,720	5,000	1,395	56,615	4,718	173.3
INTERNAL EMP. 3	Owner	\$100,000	\$1,500	\$100,000	8,000	5,000	3,000	116,000	9,667	173.3
									<b>\$21,878</b>	



Once you understand the hours you have to use, you can go back to your overview to see where you are in terms of having enough (or needing) more hours to meet your revenue goals.

## REVENUE PROJECTIONS — CAPACITY PLANNING

### Projected Billings From Pipeline

	JAN	FEB	MAR	APR
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000
BLENDING BILLABLE HOUR RATE (BUDGETED)	\$149.66			
BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83
BILLABLE HOURS AVAILABLE	624			
BILLABLE HOURS OVER/(UNDER)	(189.68)	(89.45)	77.60	177.83

### Goal

REVENUE/ PRODUCTION LABOR DOLLAR	2.5			
AVAILABLE TO SPEND ON PROD. LABOR \$	\$26,000	\$32,000	\$48,000	\$48,000
ACTUAL SPEND ON PROD. LABOR \$	\$34,227	\$34,227	\$34,227	\$34,227
OVER/UNDER — PRODUCTION/LABOR \$	\$8,227	\$2,227	(\$7,773)	(\$13,773)
GOAL FTE	124.80	3.48	4.28	5.62
ACTUAL FTE	5	5	5	5
OVER/(UNDER) STAFFED	1.52	0.72	-0.62	-1.42

In this example, we need 434 hours to meet our goal for January, but have a total of 628 hours at our disposal. We are all good, if not over-staffed, for this month. But looking ahead to our business months, we see that we are in a pinch and need more capacity to meet our revenue goals. So what does this mean for hiring?



In this example below, it means we probably need to start hiring in late January/early February to help meet our hourly needs. Keep in mind that you will need some buffer time for new hires. They will likely take more time in the beginning stages, finding their footing and getting trained, so you need to adjust your goals so you are hitting your target hours with maximum efficiency.

## REVENUE PROJECTIONS – CAPACITY PLANNING

### Projected Billings From Pipeline

	JAN	FEB	MAR	APR	
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000	
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BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83	
BILLABLE HOURS AVAILABLE	624				
BILLABLE HOURS OVER/(UNDER)	(189.68)	(89.45)	77.60	177.83	
<b>Goal</b>					
REVENUE/ PRODUCTION LABOR DOLLAR	2.5				
AVAILABLE TO SPEND ON PROD. LABOR \$	\$26,000	\$32,000	\$48,000	\$48,000	
ACTUAL SPEND ON PROD. LABOR \$	\$34,227	\$34,227	\$34,227	\$34,227	
OVER/UNDER – PRODUCTION/LABOR \$	\$8,227	\$2,227	(\$7,773)	(\$13,773)	
GOAL FTE	124.80	3.48	4.28	5.62	6.42
ACTUAL FTE	5	5	5	5	
OVER/(UNDER) STAFFED	1.52	0.72	-0.62	-1.42	

Once you understand the hours you have to use, you can go back to your overview to see where you are in terms of having enough (or needing) more hours to meet your revenue goals.



## Revenue Per Production Labor Hour

In our recent outline of the monthly KPIs each digital agency should be reviewing, revenue per production labor was one of them. Having these numbers to compare will help us answer this question: I need to hire, but what should I be spending to hire? If you remember from our overview of this metric, we had a target of 2. To get the magic hiring number, you will need to take your sales goal number and divide it by 2.

### REVENUE PROJECTIONS — CAPACITY PLANNING

#### Projected Billings From Pipeline

	JAN	FEB	MAR	APR
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000
BLENDABLE BILLABLE HOUR RATE (BUDGETED)	\$149.66			
BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83
BILLABLE HOURS AVAILABLE	624			
BILLABLE HOURS OVER/ (UNDER)	(189.68)	(89.45)	77.60	177.83
<b>Goal</b>				
REVENUE/ PRODUCTION LABOR DOLLAR	2			
	\$32,500.00			
AVAILABLE TO SPEND ON PROD. LABOR \$	= D5 / B14	\$32,000	\$48,000	\$48,000
ACTUAL SPEND ON PROD. LABOR \$	\$34,227	\$34,227	\$34,227	\$34,227
OVER/UNDER — PRODUCTION/LABOR \$	\$8,227	\$2,227	(\$7,773)	(\$13,773)
GOAL FTE	124.80	3.48	4.28	5.62
ACTUAL FTE		5	5	5
OVER/ (UNDER) STAFFED		1.52	0.72	-1.42

In this example, you have about \$32.5K to spend to meet your \$65K goal for January. Remember, the higher the labor production hour number, the better. This means more margins are made on your labor spend. You will see below the example of a 2.5 target, and how the amounts change to show less spending on your labor dollar.

### REVENUE PROJECTIONS — CAPACITY PLANNING

#### Projected Billings From Pipeline

	JAN	FEB	MAR	APR
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000
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GOAL FTE	124.80	3.48	4.28	5.62
ACTUAL FTE		5	5	5
OVER/ (UNDER) STAFFED		1.52	0.72	-1.42

The number you get when plugging in your revenue per production labor target is your “available spend.” The next item to consider is your “actual spend.” This comes from the numbers tracked in the Labor Costs tab. Our example below shows where the number came from:

SALARY	BONUSES	TOTAL WAGES	TAXES (8%)	INSURANCE	401K	ANNUAL COST	MONTHLY COST	AVAILABLE HOURS
\$55,000	\$1,500	\$56,500	4,520	5,000	1,695	67,715	5,643	173.3
\$55,000	\$1,500	\$56,500	4,520	5,000	1,695	67,715	5,643	173.3
\$57,500	\$1,500	\$59,000	4,720	5,000	1,770	70,490	5,874	173.3
\$87,500	\$1,500	\$89,000	7,120	5,000	2,670	103,790	8,649	173.3
\$85,000	\$1,500	\$86,500	6,920	5,000	2,595	101,015	8,418	173.3
							<b>\$34,227</b>	<b>866.7</b>



This shows the data from your tracking of monthly spend. When you compare the actual spend to your available spend and your labor hours against the sales targets, you will be able to assess how much more available spend exists for hiring. This is your over/under or “delta” for production labor cost. Note: these numbers look a bit different, since they are now showing a target of 2.5 versus 2 in Revenue per Production Labor.

REVENUE PROJECTIONS — CAPACITY PLANNING				
Projected Billings From Pipeline				
	JAN	FEB	MAR	APR
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000
BLENDING BILLABLE HOUR RATE (BUDGETED)	\$149.66			
BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83
BILLABLE HOURS AVAILABLE	624			
BILLABLE HOURS OVER/ (UNDER)	(189.68)	(89.45)	77.60	177.83
Goal				
REVENUE/ PRODUCTION LABOR DOLLAR	2.5			
AVAILABLE TO SPEND ON PROD. LABOR \$	\$26,000	\$32,000	\$48,000	\$48,000
ACTUAL SPEND ON PROD. LABOR \$	\$34,227	\$34,227	\$34,227	\$34,227
OVER/UNDER — PRODUCTION/LABOR \$	\$8,227	\$2,227	(\$7,773)	(\$13,773)
GOAL FTE	124.80	3.48	4.28	5.62
ACTUAL FTE	5	5	5	5
OVER/(UNDER) STAFFED	1.52	0.72	-0.62	-1.42

REVENUE PROJECTIONS — CAPACITY PLANNING				
Projected Billings From Pipeline				
	JAN	FEB	MAR	APR
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000
BLENDING BILLABLE HOUR RATE (BUDGETED)	\$149.66			
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BILLABLE HOURS AVAILABLE	624			
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Goal				
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GOAL FTE	124.80	3.48	4.28	5.62
ACTUAL FTE	5	5	5	5
OVER/(UNDER) STAFFED	1.52	0.72	-0.62	-1.42

Knowing this potential means you can understand what you have to invest in finding new employees or contractors to meet your goals and grow. This number will also change as you adjust that goal number, as seen here when we updated it to 2.5 from 2.

**How Many People Do I Need to Hire? It's in the "Goal FTE" row**

Our final number gets us the answer we need: How many people do I need to hire, and when? First, let's review the stats we need to have accurately recorded, so we can ensure you are seeing the accurate calculations.

These are the items you will need to track and assess:

- Revenue/sales projections
- The billable hours required to make those sales, based on your rates
- The billable hours available to provide (and the over/under tracking)
- The amount you have available to spend on new hires, based on your revenue per production labor dollar

The next question left to answer is the goal full-time equivalent, also known as FTE. This will answer, "How many people do I need to hire to meet my goal?"

REVENUE PROJECTIONS — CAPACITY PLANNING					
Projected Billings From Pipeline					
	JAN	FEB	MAR	APR	
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000	
BLENDED BILLABLE HOUR RATE (BUDGETED)	\$149.66				
BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83	
BILLABLE HOURS AVAILABLE	624				
BILLABLE HOURS OVER/(UNDER)	(189.68)	(89.45)	77.60	177.83	
Goal					
REVENUE/ PRODUCTION LABOR DOLLAR	2.5				
AVAILABLE TO SPEND ON PROD. LABOR DOLLARS	\$26,000	\$32,000	\$48,000	\$48,000	
ACTUAL SPEND ON PROD. LABOR DOLLARS	\$34,227	\$34,227	\$34,227	\$34,227	
OVER/UNDER — PRODUCTION/LABOR DOLLARS	\$8,227	\$2,227	(\$7,773)	(\$13,773)	
GOAL FTE	124.80	3.48	4.28	5.62	6.42
ACTUAL FTE	5	5	5	5	
OVER/(UNDER) STAFFED	1.52	0.72	-0.62	-1.42	

This is the average billable hours monthly for all employees. You can see this as you hover over the calculation for "Goal FTE."

REVENUE PROJECTIONS — CAPACITY PLANNING					
Projected Billings From Pipeline					
	JAN	FEB	MAR	APR	
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000	
BLENDED BILLABLE HOUR RATE (BUDGETED)	\$149.66				
BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83	
BILLABLE HOURS AVAILABLE	624				
BILLABLE HOURS OVER/(UNDER)	(189.68)	(89.45)	77.60	177.83	
Goal					
REVENUE/ PRODUCTION LABOR DOLLAR	2.5				
AVAILABLE TO SPEND ON PROD. LABOR DOLLARS	\$26,000	\$32,000	\$48,000	\$48,000	
ACTUAL SPEND ON PROD. LABOR DOLLARS	\$34,227	\$34,227	\$34,227	\$34,227	
OVER/UNDER — PRODUCTION/LABOR DOLLARS	\$8,227	\$2,227	(\$7,773)	(\$13,773)	
GOAL FTE	124.80	3.48	4.28	5.62	6.42
ACTUAL FTE	5	5	5	5	
OVER/(UNDER) STAFFED	1.52	0.72	-0.62	-1.42	

You will find this information under the Labor tab in the Digital Agency Workbook.

To get the number of employees you need, take the billable hours required, divided by the goal FTE, to get your number.

SALARY	BONUSES	TOTAL WAGES	TAXES (8%)	INSURANCE	401K	ANNUAL COST	MONTHLY COST	AVAILABLE HOURS	EXPECTED UTILIZATION	TARGET BILLABLE HOURS	COST PER BILLABLE HOUR
\$55,000	\$1,500	\$56,500	4,520	5,000	1,695	67,715	5,643	173.3	85%	147.33	38.30
\$55,000	\$1,500	\$56,500	4,520	5,000	1,695	67,715	5,643	173.3	60%	104.00	54.26
\$57,500	\$1,500	\$59,000	4,720	5,000	1,770	70,490	5,874	173.3	85%	147.33	39.87
\$87,500	\$1,500	\$89,000	7,120	5,000	2,670	103,790	8,649	173.3	65%	112.67	76.77
\$85,000	\$1,500	\$86,500	6,920	5,000	2,595	101,015	8,418	173.3	65%	112.67	74.72
<b>\$34,227</b>								<b>866.7</b>		<b>624.00</b>	<b>72%</b>

In our example, we need 432.4 billable hours, and we will divide those by our goal FTE of 124.80.

✓ SUM: 624.00  
AVG: 124.80  
MIN: 104.00



### REVENUE PROJECTIONS — CAPACITY PLANNING

Projected Billings From Pipeline	JAN	FEB	MAR	APR	
PROJECTED SALES	\$65,000	\$80,000	\$105,000	\$120,000	
BLENDED BILLABLE HOUR RATE (BUDGETED)	\$149.66				
BILLABLE HOURS REQUIRED	434.32	534.55	701.60	801.83	
BILLABLE HOURS AVAILABLE	624				
BILLABLE HOURS OVER/(UNDER)	(189.68)	(89.45)	77.60	177.83	
Goal					
REVENUE/ PRODUCTION LABOR DOLLAR	2				
AVAILABLE TO SPEND ON PROD. LABOR \$	\$32,500	\$32,000	\$48,000	\$48,000	
ACTUAL SPEND ON PROD. LABOR \$	3.480164182	\$34,227	\$34,227	\$34,227	
OVER/UNDER — PRODUCTION/LABOR \$		\$2,227	(\$7,773)	(\$13,773)	
GOAL FTE	124.80	= D8 / B19	4.28	5.62	6.42
ACTUAL FTE	5	5	5	5	
OVER/(UNDER) STAFFED	1.52	0.72	-0.62	-1.42	

We get 3.48.

<b>GOAL FTE</b>	124.80	3.48	
ACTUAL FTE		5	
OVER/ (UNDER) STAFFED		1.52	

According to these numbers, we have five people. This means we are over capacity for this month. We knew this by our overage of billable hours in red, from the lines above. As we look across the coming months, where we have larger sales targets and will need more people, we can see how we get closer to our target number of people. The closer to our higher need months, we see that by March, we need more than our current number.

<b>GOAL FTE</b>	124.80	3.48
ACTUAL FTE		5
OVER/ (UNDER) STAFFED		1.52

	JAN	FEB	MAR	APR	
<b>GOAL FTE</b>	124.80	3.48	4.28	5.62	6.42
ACTUAL FTE	5	5	5	5	5
OVER/ (UNDER) STAFFED	1.52	0.72	-0.62	-1.42	

Understanding this goal number will help you plan the correct timing of your hiring needs, based on the time it takes to hire and onboard.

What we can ascertain from the example is this:

- We should be hiring one person by February at the latest
- We need one person again in March
- We need at least two more people total by April

Keep in mind that at the end of the day, you need people on the bench, so to speak. This will help manage the fluctuations experienced within a service-based business, from clients needing more work on short notice to basic employee churn from someone out sick or leaving the company. You don't want to be in a pinch, especially if a client needs more support, which will give you more revenue. Having that buffer of employees will help alleviate some of these common challenges, and by knowing your goal FTE, you can have that basic understanding of how many you should have.

By knowing your goal FTE, you can have that basic understanding of many employees you should have to cover regular churn and potential increase in client demand.



## **The Bottom Line About When to Hire**

That's a lot of calculating and assessing, so we will wrap up the overall items we have discussed in detail here. The key to understanding when and how many employees to hire all starts with the data you record and update. If you don't have access to up-to-date information, start by doing that. You will need to understand and forecast sales each month, and know your actual spend on your current employees, from hours to actual payroll. By knowing what capacity you have in hours and dollars, you can start to assess if, and when, you need to add more to your team to stay within a good profit range, and be ready to take on the needed client work to keep your company moving forward.



**BELAY**

FOR **BUSY LEADERS** WHO REFUSE BUSYWORK