



# Bill for Value and Profit

*How to get a handle on the "value" of your "people" – an engineering firm's most important resource.*

**W**hat is the value of a firm? How do we increase the value of our firm? What financial information does the firm need to operate? Why do these need to be separate questions?

Every firm declares that, "Our people are our most important asset." In my work with A/E firms, I've seen many companies' financial statements – but I have yet to see "people" listed anywhere on a firm's balance sheet.

However, I certainly have seen, in detail, the impact of results of, and costs for "people" on every P&L, and reflected in a firm's valuations.

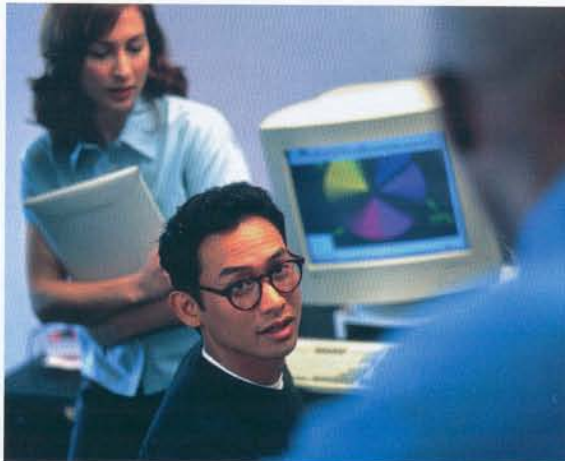
## INCREASE YOUR VALUE

Firms are in business to make a profit, and the owners of those firms want their firm's value to increase. Most firm owners and partners are familiar with the most common standards used to value firms: Net Revenue; Gross Income; and Operating Profit. Net Revenue is the most common way to gauge a firm's actual size.

However, Gross Income and Operating Profit are the better way to gauge its value, because they reflect how good the people and the managers are.

A firm can simultaneously manage its operation toward Gross Income and Operating Profit, and thereby increase its value, by focusing on, monitoring, and improving basic operational "indicators" that are fundamentally related to these "value standards."

In my experience, the two most important indicators of a firm's profits – and, ultimately, its value – are its billing



to accomplish the requirements of projects at least up to the quality standards established by the firm and the client.

Operational "indicators" provide a way to measure and monitor the "efficient and effective" aspects that determine whether or not a firm makes a profit. Figure One shows how these indicators are related to the value standards.

## A LOOK AT THE INDICATORS

multiplier and utilization rate. Yet, most firms have no system in place to track and monitor these at the firm level . . . let alone the project and team levels.

How do you know if you're making or losing money, let alone why, if you don't review those items that determine profit?

## KEY FACTS

In order to understand the importance of these indicators, it is necessary to recognize a couple key facts about the industry:

- Costs/salaries of people and related expenses (taxes, insurance, etc.) comprise upwards of 70 percent or more of an A/E firm's total expenses. That's no surprise, as the thing that A/E firms "sell" is the hours and talents of those people. As such, exactly how well people are trained, motivated, and then utilized, whether on projects or not, are the most important factors determining whether any profit or value will be generated.

- Any manager at an A/E firm – at any level – has one primary job: to efficiently and effectively utilize people

The billing multiplier is Net Revenue divided by Direct Labor. It adds up to: How many dollars of Net Revenue are produced for each dollar of salary paid to someone working on a project. It is, if you like, the "price" of your product.

Remember the old rule-of-thumb of three? ("If we can bill out our people at three times what we pay them, we should be able to make money.") Essentially that rule still works, as the historical billing multipliers in different A/E specialties and sub-specialties still tend to average within a range of 2.80 to 3.25. Billing multipliers should be measured and reviewed monthly at the firm level, the division level, the department level, the client level . . . right down to the project level. Why monthly? All project managers (PMs) need to be aware and reminded of what drives the firm: the effective use of people.

What's more, a monthly review is a good way of spotting a project, or a PM, in trouble. Why project level? A PM manages a project, but an entire firm's results, regardless of firm size, are nothing other than the sum of the results of each of its projects.

FIGURE ONE

**VALUE STANDARDS**

- \$ **Gross Revenue**
- **Direct Expenses**
- \$ **NET REVENUE**
- **Direct Labor**
- \$ **GROSS INCOME**
- **Indirect Labor**
- **Other Overhead Expenses**
- \$ **OPERATING PROFIT**

**INDICATORS**

- BILLING MULTIPLIER =**  
**NET REVENUE/Direct Labor**  
**Determines Gross Income**
- UTILIZATION RATE =**  
**Direct Labor/Total Labor**  
**(where Total Labor = Direct Labor +**  
**Indirect Labor)**

To get your firm's utilization rate, divide Direct Labor by Total Labor. It is a straightforward indicator of the proportion of a firm's total manpower that goes to project effort.

Likewise, utilization rates should be measured and reviewed monthly, right down to the lowest team level. Why monthly? All managers need to be aware and reminded of what drives the firm – efficient use of people. Why review down to the team level? It's also a good way of spotting a team in trouble, or with no work.

Utilization rate calculations are not possible at the project level. PMs only control the Direct Labor on their projects. Control of indirect/non-project time of people (and therefore control of the firm's utilization rate), is at the next-higher team/studio level, upwards through department, division, and firm level. At those levels, utilization rate is the most important indicator of how people's time is being managed, and how much of a firm's "product" – the hours and talents of its people – is being "sold" to clients.

What's a good utilization rate?

A firm's rate should be at the 65 percent level. No person can or ever will be more than 90 percent utilized, as indirect labor also includes time for vacations, holidays, non-billable marketing, and so on. It also includes all administrative and secretarial staffers.

Operating departments and divisions should have utilization rates in

the 70 percent to 80 percent or higher range.

**INFORMATION YOU MUST HAVE**

You should use billing multiplier information to review overall firm performance by different, non-organizational segments – such as by client type, project type, service line, geographic area, and so on.

Can you name the best ones for your firm? That information helps identify areas of weakness or strength. As such, this information feeds right into strategic and marketing planning: developing plans to take advantage of particular market competencies, or eliminating market weaknesses.

Operating profits of 12 to 16 percent of net revenue are just average. Many firms earn more; too many firms earn less. I've worked with the major accounting systems in the A/E industry, and each is capable of generating the information needed to produce the indicators determining those profits.

It's important to integrate the use of these indicators into a firm's everyday operations. The goal is to have every person doing what he/she can to optimize these indicators, and thereby a firm's profits and value. ■

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