Agency Insights

by My Accountancy Place

2017 has been a difficult year for the agency world. As we've started working with more and more agencies, we've seen that many of them are facing significant challenges in their financial performance.

The term "digital agency" didn't really exist just 20 years ago. 5 years ago you would still be in demand if you had digital skills. In 2017 it feels like being in demand is a greater challenge. There are so many agencies and freelancers with skills in digital that competition has become fierce. And whether you view certain agencies or freelancers as competition or not, the fact that your clients and prospects see it that way, means they are!

So it's never been more important to stand out from the noise. Standing out means getting brand awareness but it also means real deep rooted brand credibility. And that only comes from being great at servicing a real need for real people who are able and willing to pay you for solving that need. When you prove an ability to add significant benefit to a market, and that benefit is greater than the cost, you provide value. The more benefit you can provide, the more value you create. The more value you create, the greater your ability to charge more.

Find Your Price

Agencies can charge more for what they do. Both a higher rate, by demonstrating value, and more in total fees by charging for a higher proportion of their available time. You will undoubtedly face objections about your pricing but be very careful not to allow that to de-rail you. If a prospective client says you are too expensive, either you haven't been able to demonstrate your value proposition in a way that they can understand, or they are the wrong client. Imagine that pricing was never a real objection, and you had to take responsibility for improving your value proposition, that's the only option you have. Try looking at it this way: if you had to double your prices, what would your value proposition have to look like and who would it be designed for?

Charging a premium price is at the heart of building a successful agency. If you don't charge a premium price you attract the wrong clients, the wrong staff and leave your agency constantly hanging from a fine thread as margins are so tight that you can be a phone call away from being out of business. But when you build a value proposition so strong that you know exactly who you want to service, what you will do for them and how you articulate the benefit to them, you are able to charge a premium price, attract clients who love you and respect your time, attract staff who are talented, enthusiastic and loyal and you achieve strong margins which allow you to say no often and make the right decisions for your business.

Key Metrics

Once you are charging a higher price, there are some key metrics that you should track in order to understand how your agency is performing and we've analysed these metrics into a list below, along with real data across our client base.

Real Revenue Per Head
Real Revenue is the top line sales less any procurement costs borne on behalf of the client. We divide this Real Revenue by the total number of Full Time People. If someone works 3 days per week, they are 0.6 of a person. Include regular freelancers in the number of people.

Industry Average: £57.7k

MAPView:
Targeting a 60:20:20 ratio of Staff Costs:Overhead:Net Profit is typical for a healthy agency. Our clients average salaries are £32.3k, meaning that by the time Employers National Insurance has been accounted for, the total cost for the average staff member is £35.7k. To achieve the 60% Staff:Turnover ratio above on these assumptions would require a Revenue Per Head of £60k.

Net Profit Margin (also known as EBIT)
A measure of the proportion of revenue that is left after deducting all expenses, expressed as a percentage. This excludes finance costs and tax expenses. The business makes £x of EBIT for every £100 it generates of revenue. The net profit margin can be further improved by improving price, volume, cost and expense management.

Industry Average: 2.25%

Revenue Growth
A measure of the percentage change in revenue for the period. Management should ensure that revenues increase at rates higher than general economic growth rates (ie. inflation).

A "high growth" company has been defined as one which grows it's revenue:
- at a rate of 20% or more
- 4 years in a row
- from a starting base of £1m

Achieving that rate of growth equates to doubling revenue from £1m to £2m in 4 years.

Industry Average: 18.8%

Return on Capital Employed (ROCE)
A measure of the efficiency and profitability of capital investment (ie. funds provided by shareholders & lenders). ROCE monitors the relationship between the capital ('inputs') used by the business and the earnings ('outputs') generated by the business. ROCE is arguably one of the most important performance measures. The higher the result the greater the return to providers of capital. You can compare the return that you are getting from investing in your business vs investing it anywhere else e.g. Stock Markets, Property, Savings Accounts.

Industry Average: 10.07%

Accounts Receivable Days:
A measure of how long it takes for the business to collect the amounts due from customers. A lower number indicates that it takes the business fewer days to collect its accounts receivable. A shorter time to collect debtors has a positive impact on Cash Flow. A higher number indicates that it takes longer to collect its accounts receivable.

Industry Average: 55 days

Quick Ratio
The Quick Ratio is a measure of the ability to pay short-term creditors immediately from liquid assets (Cash + Debtors). A quick ratio of 1:1 or more is considered 'safe'.

Industry Average: 1.75:1

Growth for The Industry but Not for Your Agency

The analysis tells some interesting stories. Revenue growth at 18.8% shows that the industry is still experiencing significant growth overall which, considering the demand for digital capability across the economy is no great surprise.

Low Margins

Worryingly, the profit margins down at 2.25% are little over a tenth of what they should be if the 20% benchmark is anything to go by. Rising salary expectations could be a factor in this but as we've discussed, that's why prices need to rise in order to maintain margins. And if you are not recovering the time that your team are being paid for, then even higher prices won't solve the problem.

Generating Cash

The length of time it takes agencies to get paid magnifies the problem of low margins. Being paid on an average of 55 days means that you would need to achieve a 15% profit margin in order to survive on your own terms (cashflow breakeven). A margin of less than 15% on 55 days credit means that you rely on external funding to survive. For some that might mean invoice finance, an overdraft or a loan, but many agencies find themselves using the taxman as their funding source, which is an extremely dangerous game. Many of the agencies that have found their survival at threat this year have been because HMRC had had enough of acting as their line of credit.

Although the Quick Ratio at 1.75:1 suggests that agencies have enough liquid assets to cover their short term liabilities, they still need those assets (debtors) to convert into cash.

And We're Back At Pricing...

With a desire to grow and hit revenue targets, prices are discounted and problem clients are over-serviced, leading to an over resourced team and severe pressure on margins and cash. It doesn't need to be this way. There are agencies charging more than you and if you focus on providing the right services to the right market, you can charge higher rate and get paid for a higher proportion of the hours you and your team work.

Recovery

When you are charging the right price, your number one job is to recover the cost of running your business, and make a margin. You MUST run a cost and capacity analysis to understand the true cost per hour, day, month and year of running your business. That includes making realistic predictions of how much time each team member can spend on chargeable work. When you run this analysis, you see what's possible for your agency if you fill it with the right work and deliver efficiently. You also see the costs of every wasted hour.

And Getting Paid...

All agencies need mechanisms to ensure that they get paid frequently and reliably. Your terms & conditions shouldn't be something that gets hidden away in the small print. That's how fallouts happen. Just because your terms stipulate that you invoice at every stage and get paid within 14 days, doesn't mean that your client is expecting that to be the case. And if they are not expecting it, they will not be happy when you send them that invoice or that email chasing for payment.

Bring your terms to the front of the proposal. Your clients aren't choosing you based on how slowly they can pay you. The right clients certainly aren't anyway! So bringing your invoicing and payment terms to the forefront of your proposal makes it very clear from the outset what they should expect and it puts off the clients who are going to cause you trouble later down the line.

Examples of terms that you could put into place are:

- Invoice on achievement of defined milestones (not time based)
- Ensure those milestones are **controlled by you** - e.g. invoice when we **send** the web design over for you to provide copy, NOT when you have **provided** the copy
- 14 days payment terms - there is no legislation that stipulates that you should offer anything more favourable
- Get paid via direct debit - if they are serious about working with you and paying you then why should they be nervous about automatically settling your invoices as they fall due?

No Time Like The Present

There are some real warning signs coming from the industry. Many agencies are struggling to breakeven, they are not collecting cash quickly enough, yet they are putting more hours in than they can possibly sustain. The good news is that is not always this way. Some agencies are very profitable, get paid on time and although working hard, they are controlling their business, not being controlled by it.

How long will you wait until you take action? How long will you delay building the business that you know you are capable of? How long will you delay giving you and your family the life that you deserve? No-one determines the success of your business as much as you do. As a business owner you have a far greater ability to influence your own success than any government, client, supplier or staff member does. You can change almost everything around you if you want to, but you have to actually go and do it, it won't happen until you do.