

83%

Profitability Lessons for the Agency Owner: Book One

Mastering the Profitability Mentality

acelo 

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Never a good time to drive blindly

By Geoff McQueen, Accelo CEO

There's never a good time to be driving blind. It's only if you're parked on the side of the road with your sun visor up over the windshield, that you should even feel remotely comfortable about not being able to see out the front windshield.

And yet many people running service businesses today are driving blind. The information they have to make good decisions for their business, particularly on a financial basis, are often informed by gut feel. They only have a guess of where they're going and what's in front of them, which is why it hurts so much—damaging the business and their team—when they run into an unseen obstacle.

Why can't they see forward? The financial performance of the business is only evaluated using historical information that comes from their accounting system. In addition to being reward looking, this information lacks clarity—it shows them their earnings or profit margin on a single entry which is the final result or outcome, without the fidelity to know why and learn lessons to improve financial performance in the future.

This is metaphorically like driving down a winding mountain road with your windshield blacked out. And of course, when things go wrong, when there's a crisis, a client emergency or a predicament with a project, that's a bit like the car glancing off the guardrails—and hoping you weren't driving too fast or being too big to crash into the ravine.

It's bad for the car, you don't like it, your team doesn't like it, your client doesn't like it. It's damaging. It is damaging to relationships, damaging to people's motivation and you just end up careening your way down with the windshield blacked out because you can't see, in real time, where you are or look forward to where you're going when it comes to truly understanding your revenue, profitability and financial performance in your business.

From my experience running a professional service business, this was one of the greatest disappointments. You work so hard, you win clients, you're making progress and then bang, you hit the guardrail, at best a bit damaged and shook up, worse stopped dead and teetering over the edge of the ravine, and worst of all with a failed business as the metaphorical car goes into the ravine.

There's never a good time for living like that. There's never a good time for running your business without any visibility into how it's performing. What I learned is that the most important aspect to business success is profitability. If you don't understand the detail behind your projects or clients, and if they are profitable, you're headed for failure.

Just as you're getting a handle on your business, then a catastrophic business event happens—like a pandemic. Events like these only make it worse and reduce the margin for error, then you have a really big problem, especially if you're only looking to the past for answers.

Even if times are good and the business is growing, the nature of a services business means you're possibly at even greater risk.

You have high fixed costs. Most of the labor costs have to be paid on time, or you will either have your people quit or the government come after you. Your income or revenue comes from client projects, which often have a time lag both in terms of when you can invoice them (which is often when you've completed your work) and when you get paid (which is when the client decides they will pay you, a situation out of your control). This means you're constantly operating with negative cash flow, which is why both tough times and growth times are both very, very risky unless you can look forward.

Unfortunately, a lot of professional service businesses can't look forward because the financial and operational tools they have available have generally been limited to only showing them the past.

These factors add up to a difficult situation where the agency owner is almost forced to drive blindly. Without having information about your profitability while you're doing the work, and not having information about billable utilization, you can't track the financial performance of your business. If you're driving without being able to see where you're going, no wonder 50% of small businesses don't see their fifth birthday. And that is in good times!

My goal with this book is to share a number of tips, insights, and perspectives to achieving profitable success in your business. This book focuses on your profitability because it is the biggest determinant of your survival and success.

If you're driving blind, the consequences for not changing the way you do business are high. If you do embrace a profitability mentality and disciplined practice, you'll stay on the road, be able to drive a lot faster than competitors and fulfill the reason why you started this crazy adventure in the first place: to fulfill your mission, do great work, and serve your clients with your expertise.

Profitability: Key to surviving and thriving

Living the dream

You're a creative. Whether you're an architect, an aspiring media mogul, or tech guru, you've got a mission. Your mission is to use your creative talents to serve clients with your passion. Your agency represents you and your commitment to quality work.

Celebrating that first big client win was priceless. But then the bills started coming in long before the first project payment arrived. Paying you and your staff kept you up at night as you realized that your dream might quickly become a nightmare.

Unless you have somehow worked out how to turn lead into gold, the reality quickly set in that you will run out of funds. It wasn't just a financial headache, but could prevent you from fulfilling your mission, while hurting your employees, clients, and reputation.

We're here to tell you that you can do great work that is fulfilling and important and helpful to your clients. But you have to learn to make more than you earn. That takes discipline and knowledge of your profitability of every project, program, and business unit.

Around [40% of small businesses](#) are profitable, with 30% breaking even and 30% continuously losing money. With these numbers, it's imperative for businesses to understand that profitability is the key to not just surviving, but thriving as a business. When you're profitable, you can take care of today and make investments you need for tomorrow's success and prosperity. Now that's the real expression of your creativity!

Being creative and prosperous aren't mutually exclusive. You can do both. We'll show you how.

Small Businesses

40%
are profitable



30%
are breaking even



30%
are losing money



Driving blind

Your business is like a car that needs clean windows, regular fuel and routine maintenance to run at peak levels. As an agency owner, you want to be in the driver's seat so you know where you're going and have the confidence that your car will get you there. But if you can't see out the windows, or have enough fuel, you're driving blind and headed for a major wreck.

You need to be able to look forwards, backwards, and sideways to make sure you know where you're going, which in business is done with accounting reports. The problem is that most of those reports aren't in current time. They're what happened last month which won't help you with today's decisions. If you're running your business with Quickbooks alone, you know this problem all too well as you look at what happened yesterday. It keeps you from being proactive about today.

You need to know today's profitability. Is that new client worth taking on? How profitable are your current clients? Do you have enough cash flow for the next payroll and beyond? If you don't know, you're driving blind.

Visibility requires discipline

When you have visibility into your business, you build confidence in your ability to drive it. As you become more disciplined about managing profitability, a strange thing happens. You become more confident. You're better able to grow your business, serve your customers, and ultimately achieve your mission.

You're probably a forward-thinker because you're mission-driven as a creative leader. Now, you're also forward-looking, because you grab the right opportunities that propel your business, while declining the wrong ones that don't serve you or the client.

Being disciplined about profitability puts guardrails around your business. It keeps you from making wrong turns—the decisions that hurt your business. You look at not just the business as a whole, but individual projects and business units because you know the costs, revenue, and profits from each effort.

You have the tools to look forward and give you the right data that makes you a better decision-maker and true driver of your business.

No more driving blind. From today forward, commit to knowing your profits and you'll make better decisions while growing your business.

Profitability gives you the visibility you need to make critical business decisions that make the difference between surviving and thriving.

Shifting focus: Developing the profitability mentality

In the driver's seat

Now you know that you need to be profitable, not just to keep the lights on while fulfilling your mission. A [survey by CB Insights](#) found that of the top 10 reasons startups failed, simply running out of money ranked second on the list. What practical steps can you take to make sure your company doesn't meet a similar fate?

You're told to review your financial statements. It says that you spent X and earned Y and the result just happened to be Z. If that's how you're still managing profitability, you're always going to be two steps behind, unable to catch up and see what's coming.

When you understand the power of profitability, you learn that it is not something that happens to you—it's something you need to actively manage. It is something that is actually critical to your survival and for you to succeed and thrive.

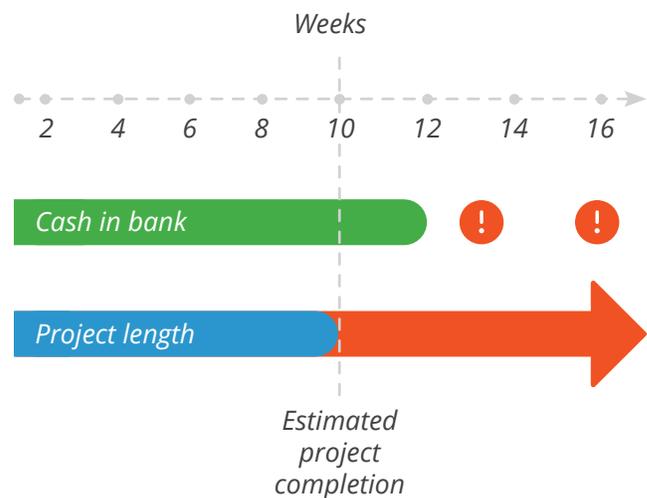
To get in the driver's seat, you need to actually care about and monitor your profitability, as opposed to just thinking, "If we get enough new customer sign ups or enough new projects in the door, we'll be fine."

If you don't manage profits, you are depending on luck, not skill. The danger with luck is that it will run out. You need to change your approach, which also requires a new attitude.

Avoiding an accident

It takes one driver, drifting into the oncoming lane, to cause a major wreck. If you're not managing profits, your client projects will do that to you, draining your profits and causing a spin out.

On average, most agencies have about 3 months of cash in the bank as their capital buffer. The average project length is 2.3 months (about 10 weeks). Should that 10 weeks expand to 12, 14, or 16 weeks before it's completed, it's easy to see how a disaster might happen.



If you're not proactive, you're in an accident-waiting-to-happen situation where you run out of cash before you complete the project, bill the customer, and receive payment. Add on the external shocks of a pandemic, and your business can be in dire straits quickly.

No one deserves to be in that situation, especially when you do great work for clients and have great, hardworking team members.

Profitability rules of the road

Driver's education classes teach you the rules of the road, but mostly they teach you awareness and how to be a defensive driver. When running your own business, you also need to adopt a similar mentality to stay aware of the dangers around you that will damage your profits and your business. Data, and the decisions you make based on it, is critical to your profitability mentality.

1

Raise your expectations. You can't afford to say, "we've never done it that way because the information isn't available." Challenge yourself and your team to get a handle on the numbers you need to run your business. Profitability is your new criteria for making business decisions. Remember—if you rely on luck as a strategy, it will run out.

2

Data confidence is critical. Make sure your data is trustworthy and you know and understand the source of the data. This data will power essential reports and business insights that come from timesheets, budgets, quotes, and invoices. Garbage in, garbage out.

3

Make your financials operational. In the old days you could just sit down with your accountant or financial adviser once a month (or even, shockingly, a quarter) and look at your financial statements. That isn't good enough anymore. You need to have financials be part of your daily business routine. Make sure that everyone who can affect the outcomes of your business knows what to look for, what to care about, and ideally, to get a predictive heads up before something becomes a problem that is costing you money or doing your business damage.

Your profitability is dependent upon having trustworthy data that leads to clear managerial decision making.

Know your profitability by client and project

Know your destination

“Overall profitability was 16% of revenue last quarter,” your bookkeeper proudly tells you. That’s great, but if you have two projects that are profitable and three projects that are seriously in the red, you’re in trouble. If one of those red territory projects tanks, so does all of your profitability.

You need to know more than average profitability. Accounting reports just give you a historical view, an average of your entire business, but that’s not enough. You need to know the profitability of all projects and all clients. It’s essential to predict future profitability on an ongoing basis, not just when there’s a problem and you decide to go forensic on why you have big losses.

To understand profitability by client, project, or business unit, you will need granular data. That means you will need specific tools that capture all costs related to each project from payroll to overhead. If you are proactive and disciplined about this practice, you’ll have a better understanding of what drives profitability by client and project and make better choices about which clients are best aligned with your profitability goals.

Is your engine light flashing?

Imagine you’re driving your car and you notice that the engine light is on and there’s smoke coming out of the tailpipe, but the tires are in good shape and you’re still moving forward. Just because the car is still moving doesn’t mean it’s not in trouble.

If you choose the wrong clients, you will have a similar situation. You will have some clients that move the business forward, but others will eat up your resources, damaging the entire business. You need to make sure all parts of your business are healthy, profitable and contributing to the whole. Without attention to the profitability of your business, you’re headed toward the red zone.

If you just use accounting reports to manage your business, it will seem like everything is fine because it reports only historical averages. Without understanding the profitability of each client or project, you won’t know if they are helping or hurting your business.

All systems go

Ideally, you understand the projected revenue, costs and profit for each client and project. When you have the right tools to capture the information, it's much easier to make better management decisions about which clients to bring on to help you grow your business and ultimately fulfill your mission.

Should you only bring on profitable, prompt-paying clients? That decision is up to you, but if you don't have the information to know if they are profitable or prompt-paying, then you are once again driving blind. Having the granular information to make smart decisions about your business is critical.

Calculating profitability will determine who is the best fit for your company and keep you in the driver's seat.



78%

Protect and respect recurring revenue

Course correction

You've been practicing being a disciplined driver, using profitability by client or project to support your business decisions and promote the health of your agency. You understand that profitability and cash flow are critical, so you've been charging retainers to keep up with your payroll needs.

Ultimately, you will come across the situation where you have a \$1,000/month retainer, but after analyzing your costs, it turns out that it's \$5,000/month of work. It's time for a course correction.

While recurring cash flow is great, it does need to be profitable. In this instance, your goal will be to keep cash flow coming in, but make it profitable. Do you renegotiate with your client? Use different resources to lower your costs? This is where you will be challenged to use your creativity but keep one thing in mind: that cashflow is precious and needs to be protected. It's covering your payroll costs, so move ahead with intelligence, but caution.

Cash or credit?

Cash is still king. It keeps the doors open, but you don't know if it is profitable until you analyze it. Like debt, it will eventually catch up with you if you are spending more than you are generating.

Recurring revenue streams are vital and create a foundation for your business to survive (if they are unprofitable) or thrive (if they are profitable).

Until you analyze the profitability of each recurring revenue stream, you won't know if it is adding to the bottom line, needs to be renegotiated, or canceled in favor of more profitable work.

Retainers can also be a pain to manage if you don't have the right tools. If you're not comparing your retainer to your costs on a monthly basis, you won't know if you're in trouble. If you're just treating it as, "out of sight, out of mind", just cashing the check without considering the costs, it will eventually catch up with you.

Proper alignment

Besides cash flow, recurring revenue provides another benefit: emotional and psychological stability. Knowing that you don't have to start from ground zero every month to generate new work has a huge psychological effect on you as an agency leader and your team.

Recurring revenue closely aligns your revenue, expenses, and project timelines. Consider it a recurring paycheck you receive for ongoing work. It helps to even out the “lumpy revenue” cycle that is common to service businesses, covering your fixed costs so there is a smaller gap that has to be covered by new work.

Understanding if your recurring projects are profitable can have a huge impact on your business. With the right approach, it can be made into a really high functioning area of your business that doesn't stress you out and more importantly, covers your payroll costs.



Recurring projects add to your cash flow and profitability, allowing you to make investments for the future, while covering today's costs.

Profitability triangle: Budgets, timelines, and utilization

The fork in the road

It won't be long before one of your team members raises the inevitable question: why are you paying me \$46 an hour, but billing the client \$500 an hour?

It's the kind of question that gets talented staff members to think they should start their own agency. You can't just say, "I've got overhead to cover." They probably won't believe it because they can't see it. They don't know your costs like you do.

You have a dilemma. Do you share your financials with your employees? Is being too transparent beneficial to the company?

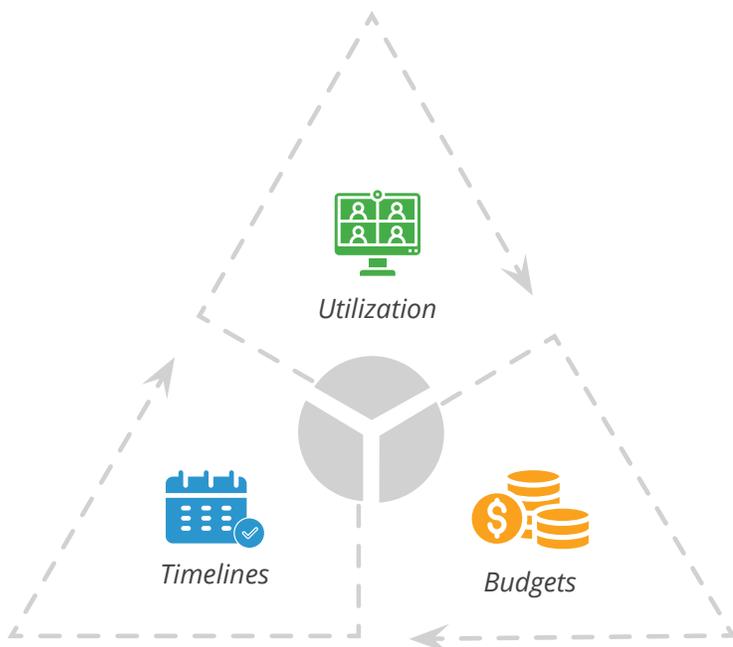
YOU'VE ENTERED THE PROFITABILITY TRIANGLE:
calls & meetings that don't accomplish anything.

The best route is probably to make sure everyone has high utilization, where they are keeping busy staying billed. To achieve high utilization, you have to make sure you have timelines that are tracked and monitored, as well as having additional work to do if one of your clients puts a project on pause. You're also going to need a cash buffer for those times when you have no billable time for downtime, vacations, and slow times of the year.

And that's why you bill \$500 an hour—to create a cash bank to keep paying people when there's no billable work to do. That kind of information you probably can share with your staff.

Keeping people busy means keeping them highly utilized, which means you have to have timelines that are monitored to keep earning revenue, and watch your budget to control costs.

When utilization goes up, so does profitability, allowing you to focus on the things that are in everyone's control, avoiding the negative consequences you might get from sharing the details of your profitability projections.



Which road do you take?

As a newbie agency owner, you can look at your projected Quickbooks budget for payroll and other expenses, add a percentage for profit, and hope you squeak by with a bit of profit.

As you gain experience, you might add a bigger percentage for profit, when you discover you have times when no one is contacting you for new work. You've discovered the truth about "lumpy revenue" and that it can drain your cash reserves.

A little more down the road, you discover the impact of utilization. Perhaps you've gotten burned by paying someone \$50/hour plus 30% benefits, added up to about \$65/hour. You think

that charging \$500 per hour will surely be fine, but you discover that your \$65/hour person is only billable 10% of the time, leaving you with a gap for you to pay.

On a bigger scale, you may discover that you need \$100,000 to pay your monthly payroll costs, but you only have a \$20,000 project earning revenue right now. Your utilization is tanking, quickly putting you in the red zone.

Without understanding how timelines, utilization, and costs impact your profits, and your ability to stay in business, it can quickly snowball until you find yourself lost, on the path to business failure.



Getting on the right road

We've explained how understanding profit is key to staying in business. But understanding the components of profitability, and how they impact each other, is a critical balance act that every successful agency owner should practice.

Focus top to bottom on the profitability trinity of utilization, budgets, and timelines, assigning their focus to the appropriate staff level in your organization.

1

Stay on budget. Keep your project managers, account managers, and delivery managers focused on the client or project budget. Every project should have a budget that is based on timelines, hourly rates, and associated costs. Keeping an eye on budget performance, with special focus on current and future issues, will help them stay on budget and stay profitable.

2

Inform the client. Keep the client informed of your budget performance. The sooner that delivery or budget issues are addressed, the better. You should know immediately when you are off track and schedule a discussion with the client for next steps. If you go too far over budget, or beyond the scope of the project, you might not get paid.

3

Monitor utilization. This is probably best monitored at the senior levels so you have a broad view of how it is impacting the organization. Being hyper-focused on utilization can be distracting for managers on the front lines. Know your costs, your revenue, and make corrections where needed. Understand how much time is being spent on running client work, doing client-facing tasks, or performing internal administrative work.

4

Get paid. We will discuss the details of this in another chapter, but it is senseless to do all of that client work and not bill them on a regular schedule. Make sure you have the systems in place that capture all related costs, create a detailed invoice, and you get paid on time.

When everyone is sufficiently utilized on billable client work, then your profitability is pretty much assured.

Driving clearly

Sophisticated tools for the advanced driver

If you've embraced your role as driver of your business, you've discovered that you are now driving a completely different vehicle.

In the old days, you were driving blindly with a car that barely functioned. You relied on historical reports to make business decisions while losing sleep as you hoped you could make payroll and keep the lights on. You grabbed any client work you could get because it meant you would have some cash coming in the door.

Today's car has 360 degree clarity. You understand the past, but don't let it make decisions for you. You have the tools you need to clearly know the revenue, costs, and profitability of every client, helping you to make decisive and insightful business decisions. You can pay today's bills, hire great people, and invest in the future. In short, you have clarity, and that clarity brings confidence into all you do.

Recalibrating your route

If you've ever gone past your destination while using your GPS, a gentle voice will constantly remind you that you need to recalibrate your direction and ETA. Without a GPS, you've probably made some wrong turns, delaying how long it will take to reach your destination.

If you're only looking back, you're probably making decisions without current information. The reality is, if you're going to be somebody

who's actively managing your business's profitability, and not just getting a score at the end, you can't just shrug your shoulders and accept the way things are. That's what will happen if you only rely on historical accounting reports instead of today's information. You need to be able to not just look back, but be present and look forward so you can make good decisions for the future.

When you have the right tools, you can quickly recalibrate what you are going to do. You've got enough information before you're in the hole. You can have an immediate conversation with your client to discuss the current budget and determine what next steps are.

As an agency owner, you're going to end up in "surprise land". The question is, when will you find out about it? Before or after you can effectively do something about it?

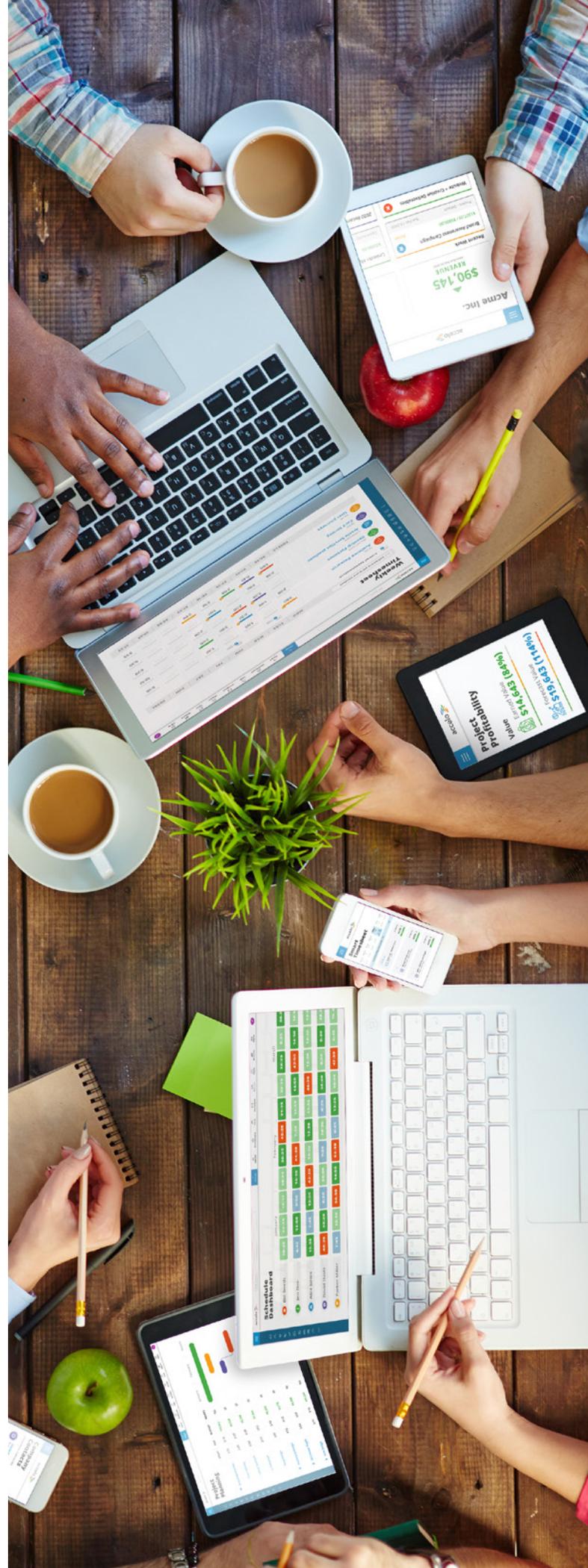
Driving by the dashboard lights

Managing profitability relies on more than just an accounting system. You need to implement systems that identify what is going on today, which will require some time and effort. But once they are implemented, you'll be able to look forward and see forecasts, plans, and predictions. You will see what is expected to occur, based on those budgets, estimates, timelines and performance. In short, you can look forward and make decisions before you end up in damage control mode.

Implementing systems takes time and effort. But like any good executive, you will find that there is an ROI that will make both you and your business happy and fruitful. Payback comes in the form of cost avoidance, by not taking on those clients that will drain your resources because they're unprofitable. Payback comes in the form of taking on profitable projects that you know in advance how much they are adding to the bottom line. Payback comes in the form of quicker paying clients because they have all the information they need from your detailed invoices.

Systems that give you a 360 vision help you drive the business with greater vision, clarity and decisiveness.

But you can only achieve that state through forward-looking systems that offer current insights for better decision making.



Conclusion

Once you've developed a profitability mindset, it's time to master it. You'll make profitability your #1 responsibility, allowing you to survive the twists and turns you encounter on your road to success.

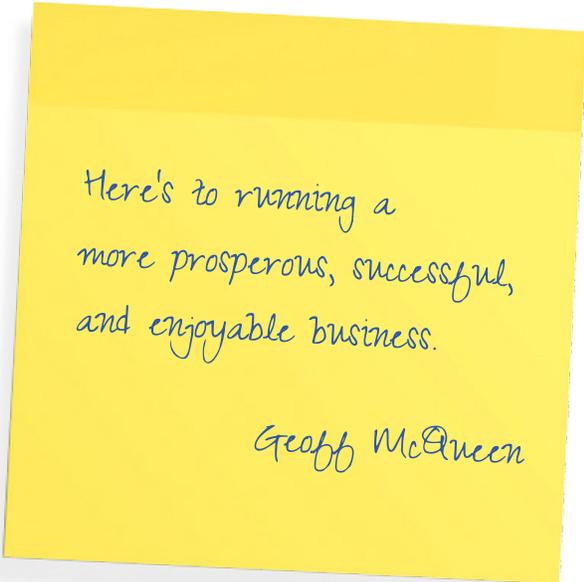
Discipline isn't an ugly word. It's required to not only practice, but instill profitability throughout your organization. The people you look up to, the icons in your industry, didn't get there by luck. They focused, practiced, and mastered their ability until it became second nature.

Discipline, when coupled with the right mindset, becomes skill. Skill, timing, and opportunity lead to success.

As you become more skillful in understanding your budget, timelines, utilization and what profit you need to meet your goals, you will be better able to achieve three key goals:

- Accomplish your mission by serving clients to your fullest, without worry that you're not making money.
- Achieve your revenue goals by setting realistic milestones and timelines.
- Create a thriving business that is profitable, allowing you to invest in your business' future.

It is my sincerest wish that you drive into the future with clear vision, no longer driving blindly. It's critically important to not become one of those 50% of businesses that doesn't make it past their 5th birthday.



Here's to running a
more prosperous, successful,
and enjoyable business.

Geoff McQueen



About Accelo

Built For Your Service Business

Since its founding in 2011, Accelo has prioritized giving professional service businesses unprecedented levels of visibility into the overall health and management of their company. Serving small to medium-sized businesses in 42 countries, Accelo helps owners, managers, and service professionals succeed by providing a better way to manage client work, deliver higher quality work, and provide insight into the company's profitability.

To learn more about Accelo, [visit **accelo.com**](https://www.accelo.com)