



# Profitability Lessons for the Agency Owner: Book Two

Mastering Cash Flow & Expense Management

acelo 

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# Keep your eyes on the road

By Geoff McQueen, Accelo CEO

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Your driver's education teacher taught you a valuable lesson. Keep your eyes on the road. By looking ahead, you can see what bumps, curves, and cliffs are in your path so you can do something about them before an accident happens. With occasional glimpses in your rear view mirror and side to side, you lessen the probability of being blindsided from any direction.

Traditional business wisdom is the opposite. They want you to use your rearview mirror to drive your business. Historical accounting reports and last year's trend lines won't move you forward very quickly. It takes more time and energy to calibrate last month's or last year's expenses to drive forward.

## **You can't master the road ahead if you're always looking backwards.**

In the Spring of 2020, we quickly learned that history no longer mattered and our only way forward was by looking forward. It required business owners to be more creative, yet have a greater understanding of what was happening to their business day to day.

## **It has never been more critical to focus on today's information to understand and calibrate your actions to move your business forward.**

If you run a service business or creative agency, you recently had to make nearly instant decisions to adapt to new circumstances. You had to develop new ways of doing business to stay connected to your customers, manage remote work environments, implement new technologies, and still make a profit to keep your business afloat.

If you were still in business in the Fall of 2020, it meant that you knew your costs, managed your cash flow, and stayed profitable while still serving your customers. You focused on the road ahead using current information to drive your business.

It's time for every business to master their ability to create cash flow and manage expenses, especially their #1 cost: labor. Diligence is the key, along with understanding your costs, and using the right technology to stay focused on the road ahead.

I've been there. I know the harrowing adventure you go through as a leader of an agency. But I also know that the right approach to cash flow, expense management, and client management, combined with technology, will support you in keeping your eyes on the road.

Stay focused!

# Know your Costs

## The costs of ownership

“Hey, what’s your revenue this quarter?” Most of the people running small businesses and agencies, and even the team members inside of them, will say, “Oh, you know, it’s about this amount.” Ask them what their costs are and they don’t have a clue.

As a service business, you have a unique business model. Because you have a talented team, you have mostly labor costs. But you’ve found out that labor costs are more than just an hourly rate. Health insurance, state and local taxes, FICA, vacation, and other benefits are all added on top of that hourly rate. With benefits running about 30% of total salary, your \$50,000 a year employee can quickly become a \$65,000 payroll cost.

Multiply that cost by the number of employees you have, all of whom expect a consistent paycheck, and you’ve signed up for a HUGE responsibility. That number will only continue to grow when you consider other factors such as pay raises or bonuses.

You know that profitability is your #1 criteria. You’ll have to do the math to make sure that when you bill your clients, you are covering your labor and benefits costs, along with your lease, technology, and other expenses. But your labor costs are the primary thing to keep an eye on since studies indicate they can run between [50%](#) to [80%](#) of gross margin.



## Paying the passengers

You may be the driver of your car, but your employees are your passengers. They have come along to help you to your destination (your client), and they expect you to get them there safely. But there are a few unique characteristics about a service business.

Service businesses in general, and agencies in particular, run on a model where clients pay you for your expertise, your professional skill, your knowledge, for your advice and for what you can do for them. They are depending on you to provide a skill that they can't, won't or don't have the time to do themselves.

But this kind of creative project work has, shall we say, "lumpy revenue." Your employees may want a consistent paycheck, but you don't get consistent payments from your clients. And the reality is that like most small businesses, you can't control your revenue picture.

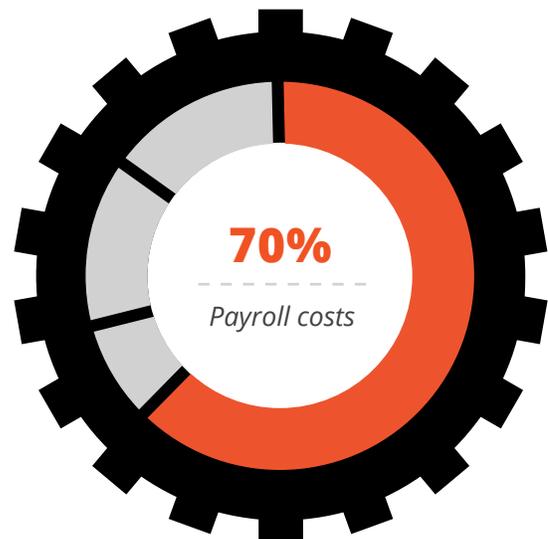
The good news is that you can control and monitor your costs. And that's why you're in the driver's seat. Your costs shouldn't and won't be as inconsistent as your revenue. And it's one of these ironies of life that often the least significant costs, which are often the discretionary ones, get the most amount of focus. But because you have mostly labor costs, these expenses will be a consistent outflow of salary, taxes, and benefits so you will need to monitor them closely.

## Make labor costs visible

Driving blind means that you can't see. If you don't know your costs, you won't be able to see if you are about ready to run over a cliff.

Still obsessing about small, discretionary expenses? Wondering if you can pay that \$99 software license this month or pay the electric bill? The easiest way is to make them visible. Put your most recent and current costs into a pie chart. And you will see the biggest part of the pie—about 70%—will be payroll costs. Focus on THAT big piece of the pie and you will make a huge step toward understanding not only your costs, but your profitability.

**You won't be able to focus on profitability unless you know and closely monitor your costs, especially payroll expenses.**



# Understand your Cash Flow

## Driving through a storm

“You don’t have enough cash for the next payroll,” says your bookkeeper. It’s the stuff nightmares are made of.

You’ve been focusing on profits, but there’s one more ball to juggle: cashflow. Now that you have employees, clients, and even your home mortgage riding on your business, you have to understand how frequently cash flows in and out of your business.

Most agency owners think they’ve gotten good at juggling. That massive 10 week project is now 12 weeks long, and you haven’t invoiced them yet. You start looking at your outstanding bills, wondering who you will and won’t pay—the same thing your clients do to you. You might be thinking, “Oh well, we’ll just pay our tax bill late, there’ll only be a small interest charge. It will take a while before they turn the lights out and we can pay rent late. What’s the landlord going to do, lock us out tomorrow? It’s a pandemic.”

This is when it’s time for not just a profitability mindset shift, but a cash flow shift as well. You are personally responsible for the health of your business, which ultimately runs on cash.

## Running on empty

Cash flow is a very critical consideration because you can’t pay your payroll with accounts receivable, with money you haven’t received yet. Knowing when money is expected to come in and go out is critical for your business. It’s the gas in your tank. Running out of cash creates a whole other cycle of cash infusion steps that take more time and effort than most small business owners have.

Agencies need a cash buffer because of one reality: service businesses often run on negative cash flow. You’re waiting for clients to pay invoices, which you don’t have control over. You need to manage the best you can in this environment, protect your resources, and stop feeling like you need to be in 100% control because there’s not many things in life where that is true.

What is true is your fixed payroll costs. If you need motivation to monitor cash flow, it should be because most of your expenses are payroll-related. Those costs go out the door with strong regularity. You’ll find out within a day that absolutely your engine, your business, is on fire. Pay attention to your cash flow and your payroll costs since they are closely linked.

## Keeping the tank full

The good news is that there are ways to get clients to pay you in a timely fashion. These include:

**1**

**Get a retainer.** It's important to make sure that you've got some coverage there at the front end. If you can get the customer to front you money, you can cover that payroll for at least the beginning of the project's lifespan.

**2**

**Bill routine progress payments.** Make sure that you're invoicing for progress payments. Don't wait until everything is finished or you might not get paid at all.

**3**

**Include a detailed invoice.** Ideally, your invoice has an appendix or a series of additional pages with the information that outlines what you did and why they should be paying you. Make sure that invoice shows the most recent payments that they've made and the previous invoices that they've been invoiced for. If you don't outline work performed payments made, they may not understand it and it will go to the bottom of the pile to be processed. The more you can provide really good, clear information on your invoices the fewer delays there will be.

**4**

**Clearly state your payment terms, and hold customers to them.** It can be enough to sink your business, especially if you're growing. Understand the history of how client's pay. For those who pay late, raise your prices to reflect that you have additional costs while you are waiting for them to pay you beyond the stated payment terms. Know in advance who you are dealing with the project's lifespan.

**5**

**Managing growth and profitability.** If you land a windfall project, you will need to manage profitability throughout the project lifecycle, especially in the event that the project dries up, gets cancelled, and you don't get the full amount. Actively manage the project and stay close to your client to manage any speed bumps.

**Cash flow is essential to the financial and psychological health of your company. Secure customer agreements that keep cash coming in to pay your essential bills.**

# Track all employees' time

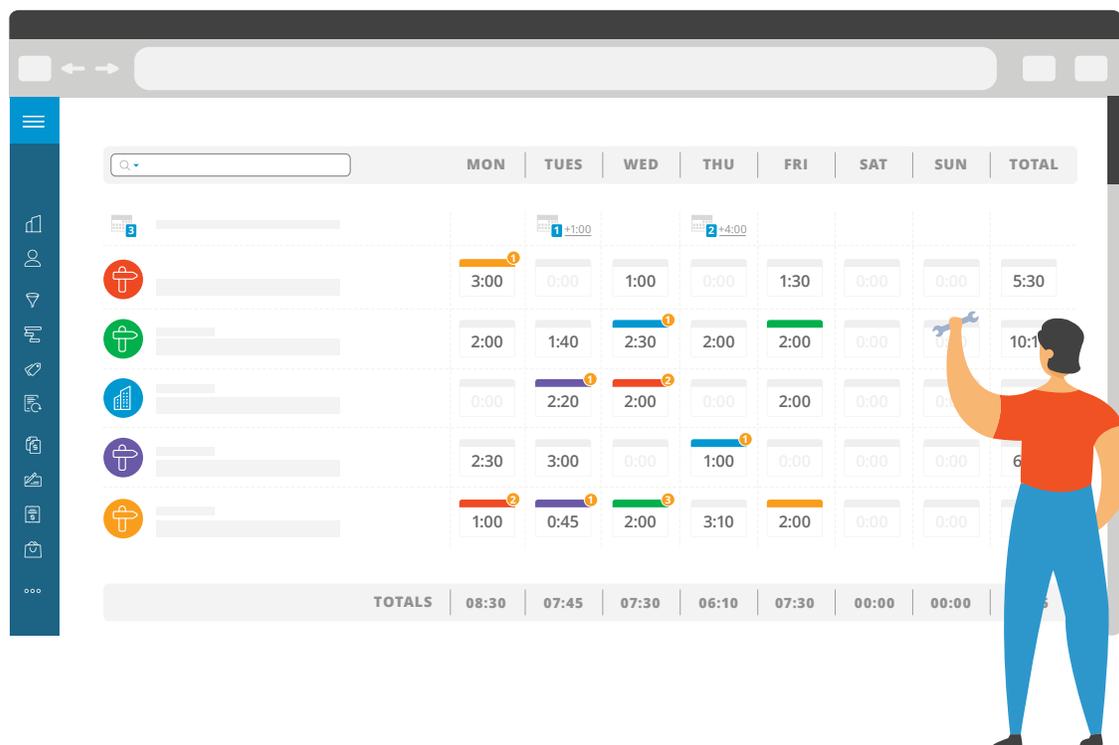
## Glimpsing the road ahead

The light bulb went off. Profitability is key to staying in business. You need to know your costs, especially your payroll costs, to make critical decisions. But that data is based on something people hate to do: track everyone's time.

It feels like administrative overhead. It makes people uncomfortable because if they didn't do a lot of billable work, it will now be visible and they will be held accountable.

In a service business, time is your money. If 50% to 80% of your costs are directly related to your people, they need to be productive. If you don't track your time, you don't know your costs. If you don't know your costs, you can't determine your profitability, and it all just snowballs downhill from there. A study found that [80% of employees' timesheets](#) have to be corrected due to employees' forgetfulness.

This alarming statistic shows that you need tools that track time in sophisticated ways that give you the granularity to understand the profitability of each project, each client, or each business unit. We're talking more than just time and attendance, but allocating costs to every email, every meeting, everywhere time is used.



## Time is your odometer

The IRS allows you to deduct your mileage for business-related purposes. To do that, you need to differentiate which miles you drove for business and which you drove for personal reasons. Luckily with the advent of mileage apps, tracking mileage is much easier than the old-fashioned mileage notebook.

We're talking the same thing here. As you move the business forward, you have to understand where you spent your mileage or your time. Guessing your time means that people will say, "I spent 10 hours this week on Project X," when they really spent 12.5 hours. You'd be missing out on 2.5 billable hours times the number of days and number of people who are estimating their time. The difference is substantial.

Profitability means tracking the hours and the revenue you've earned. Unless you track the number of hours actually spent, you won't know your true costs or profitability.

## Automated tracking

Technology now makes it easier for everyone to track their time. Just like mileage apps, time apps help capture time spent on tasks and potential billable hours.

You're not looking for perfection in capturing every hour spent. Unless you're a law firm, you don't have to bill in 6 minute increments. Like the 80/20 rule, if you get the majority of hours, you don't have to waste time tracking down the nitpicky 15 minute gaps spent here and there. No one is perfect, but capturing the most time spent can end up in the most revenue earned.

**Payroll costs are the largest costs for your business and the basis for your client billing. Tracking time spent—everywhere it's spent—is critical to profitability.**

# Never start without a payment

## Warning signals

One day your phone rings. It's the head of marketing at a Fortune 50 firm who needs your help. "Look, we've got this really important deadline. The agency that we were working with has suffered a setback. We know we've done a little bit of work with you guys in the past, and we'd really love to do this major project. Can you start right away?"

Your heart is pumping 90 miles an hour. The thought of having that corporate logo on your wall and a case study on your website would be golden. You respond, "Sure, let's get started." You clear the decks, commit your people, and schedule meetings for tomorrow's kickoff.

But there's no mention of payment. No thought given to the opportunity cost of not doing the work.

As the red lights go off in your head, you tell yourself, "It'll be fine."

You do the work. You commit your people and put other paying client work to the side. Your employees are excited, but they're not worried about getting paid next week. You are. Commitment before agreeing to payment puts you in serious survival danger at this point.

## Driving too fast

In this situation, you are the only one taking a risk. If you start, and they get approval to move

forward, you win big. If you start, and they don't get project approval, you lose big.

In these situations, you must get upfront payment.

Hold firm to this policy and you will appreciate how incredibly valuable it is. If you stray away from it, you risk getting burned.

## Giving the green light

Get a signed agreement and at least a deposit. If you get excuses like, "but it will take 3 weeks to get it through our purchasing division" or "we only put new vendors into our SAP system once a month," you should consider moving on. But remember this:

Businesses can move really fast when they want to.

If they really want this project done, they will move heaven and earth to do it. Stand firm, but remain professional reiterating that you are committed to the project, but are unable to get started or provide a deadline before a deposit is paid. You'll lower the risk of getting burned and make sure you take care of your business and your profitability. The corollary to this is never deliver, in terms of handing over the keys, without payment.

**If they want it, they'll pay for it.  
Stand firm and get paid.**

# Create alternative revenue streams

## Your insurance policy: products and services

You have a talented, highly motivated, hard-working team. You've weeded out the unprofitable projects, and focused on consistent profitability, and solid recurring revenue to cover your fixed (mostly payroll) costs.

But it still may not be enough to cover your costs and grow your business. Now what do you do?

As a service business, your primary money-making approach is trading dollars for hours. If your hours tank, so does your revenue. What do you do? You're going to need a backup plan, and insurance policy, so you can make money 24/7/365, not just 9 to 5.

It's time to consider multiple streams of income. Training programs, online content, and other services will allow you to share your expertise and expand your client base, even serving as a feeder for new work. In today's remote-working, pandemic environment, going digital is imperative for everyone.

Additional revenue streams, including online products and services, can be highly profitable and add cashflow infusions to cover your high fixed costs.



## Advance your business

The service industry business model is changing, rapidly. The pandemic eliminated face-to-face meetings, forcing everyone to go digital overnight. Employees now Work-From-Home (WFH), creating new challenges for agency owners as they connect with clients, business partners, and staff in new ways. Simultaneously, it's time to invent new revenue streams that aren't based on the time-for-dollars model.

Your clients may be shifting to more of a digital model as well, forcing you to re-think your service offerings and how you provide them. Do you have an expertise to leverage in digital training classes? Informational videos and tutorials?

If traditional streams of revenue are drying up during this time, agency owners should look to pivot their expertise to new offerings that can be highly profitable. Why? Unlike trading hours for dollars, training programs and products are created once, and sold hundreds of times. A live virtual training can be offered once, but reach thousands of people.

## Automated driver

Agency owners should find ways to decouple your input costs of hours from your output value that you're billing for. Bundling services can be one way to provide value and step away from the hourly billing model. Find those offerings that don't have a time input cost, or if a time input cost is relatively small, you can draw attention and focus to the non-time value, which is delivered. For example, think service + free how-to-guide, which provides additional value beyond the hours provided.

Create once, sell multiple times, is the new model for additional revenue. If you create a training video series that took you 20 hours to produce, but you can sell it to all your clients, it's a highly profitable, win-win for everyone.

Virtual training programs have lowered the cost of attendance (no travel costs for attendees) while increasing the profitability. Sharing your expertise with current clients while feeding your sales funnel is a key way to generate cash, create visibility, and offer a highly profitable service.

Trading hours for dollars will still be at the core of the service and agency business model. But to increase profitability and cash flow, it's time for agency owners to uplevel and offer products and services that go beyond the traditional model, create cash and profits.

Use your expertise to offer training products, bundled services, and additional revenue streams.

# Prioritize invoicing and receivables

## Going slow in the fast lane

"Yay! It's time to do monthly invoicing!" - said no one ever.

You probably hate it too. You have to email people for their timesheets and expenses, and probably work nights and weekends to collect it all to get invoices out the door. And sadly, they are probably inaccurate because they don't include all of the time that could have been billed.

If you hate to do invoices, you probably are slogging through a process that produces a one page PDF with an amount due for five figures, with no supporting information. Your calculations are lodged in an Excel spreadsheet somewhere, with only you who know what those errant columns of numbers mean.

Once your client receives your invoice, they will rarely rush to cut a check. Why? Because that one page PDF for \$50,000 that says "Thank you for your business" goes to the bottom of the pile because there's no detail on how many hours, what project, or what dates you performed the work. Your client's \$15/hour bookkeeper is the lifeline between them and your cash flow.

Getting paid is just as big a priority as doing the work. It means that you have to provide detailed, high quality invoices, with substantiation, that provide an audit trail for the client and get you paid on time. When you have the systems in place to create these invoices, your life gets easier, your weekends free up, and you get paid faster.

## Behind your client's wheel

Put yourself in your client's shoes for a minute (or better yet, ask your bookkeeper about your Accounts Receivable process). Their bookkeeper or accounting department has no knowledge what your project is, how long it takes, or how important it is to the company. Your invoice probably ranks somewhere below their payroll, utilities, and executive credit card bills in terms of importance. If they are juggling their cash flow, your invoice might go right to the bottom of their to-do list.

Once their bookkeeper looks at it, they have to code it to the right project or chart of accounts. But wait, there's no detail on your invoice to tell them what project, what services, or what account they should charge it to. No purchase order or service date listed? That will take extra time to investigate.

It's not until your invoice turns up on the "90 days past due" column on their receivables report that they take action on it.

Meanwhile, you completed the project months ago and must keep paying payroll even though you haven't been paid yet.

## The lean, mean, A/R machine

Today's world moves too fast to get paid late. There's no reason you can't provide all the information your client needs to pay your bill without a followup investigation. It is time to send clear, complete, and convincing invoices, backed by automated systems that capture all the revenue that is due to you.

In addition to billing for the current month or project, make sure your invoice clearly represents the percentage of project completion, what the client has already paid and when they paid you, as well as outstanding balances due.

If you're tired of chasing clients for payments, consider automating your statements and reminder processes. Follow up with your client regularly, with a tactful reminder that they owe you for services rendered. Automation is highly attractive to organizations, reducing the amount of time required to create and chase invoices, while improving the cash flow cycle.

**Quality invoices, generated from an automated process, are a key to prosperity, helping you get paid faster for everything that is due to you.**



# Conclusion

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It has never been more critical to actively manage your business. It not only makes you more profitable, but gives you a competitive edge because you will be prepared for the future.

**Cash flow and expense management are the foundation of profitability—mastering these skills, with today’s technology, will grow your business.**

Technology and automated tools make it easy to look at today and where you’re headed so you can look forward and make forecasts and good decisions.

You can leave behind the times where you looked back in time for answers. We lost that ability in the Spring of 2020 when we rapidly, and jaggedly, entered a new frontier. We no longer can afford to repeat past mistakes.

Real time information and automated processes give you the insights you need to make sound, insightful business decisions.

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.

Profitability, and the processes that support it, are the most important thing you can focus on. It will determine if you survive, thrive, or fail.

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

*Geoff McQueen, Accelo CEO*





# 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)