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A&E Firms Maintaining Financial Footing

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How quickly times change. By most accounts, 2007 was one of the most successful years in recent memory for New England's architectural and engineering firms. All the key financial indicators for the industry showed continued improvement and project backlog reports going into 2008 looked strong.



However, 2008 is proving to be a challenging environment in which to do business. The combination of the upheaval in the real estate market, the subprime lending crisis, and its effect on overall capital markets have added up to a quick downturn in our economy. This has also led to a reduced amount of cash available for investment in projects from banks and investors. We are clearly operating in a recessionary environment and from a financial management perspective, this is no time for guesswork.

When operating in this type of environment, A&E firms need to be proactive with their decision making and must make informed business decisions in a timely manner. So what should firms be doing to manage their bottom lines in this challenging environment?

Historical and current trends generally are a good place to start. They help determine

what has been happening in the market and what trends are likely to continue. Trends can also be helpful in determining what key factors have been most influential on a firm's profitability. For example, historical industry trends clearly show that there is a direct correlation between staff utilization (how busy staff is) and firm profits. To maximize staff utilization, it is critical that firms keep a close eye on project backlog reports and continuously match up the project backlog to current firm staffing levels.

The best approach to dealing with the uncertainty in the market and how it affects business is to focus on the known rather than the unknown. This involves analyzing current and historical data, applying best practices and developing management tools to help make timely decisions. Many A&E firms focus on a few key financial areas to help them identify trends to assist in making decisions. The following are five key areas to focus on when navigating through this recessionary period:

- Staff utilization. Staff utilization is a measurement of what percentage of time staff spends working directly on client projects. A high staff utilization percentage typically means the staff is very productive. A&E firms should typically be targeting an annual staff utilization percentage of 64 percent to 66 percent. According to an annual architectural firm survey produced by Boston-based accounting firm DiCicco, Gulman & Co., the average for staff utilization has been approximately 64 percent for the past two years. Annual utilization rates for firm principals typically average 50 percent while technical staff annual utilization percentages can run as high as 80 percent. This rate should be tracked at least monthly; however, many firms watch these trends on a weekly basis. A consistently low trend in the utilization rate may indicate a need to make staffing adjustments.
- Project management. Now more than ever, it is important to continually assess project profitability and make sure jobs are progressing according to plan and budget. Best-practice firms place considerable emphasis on project management training to ensure that projects are profitable and executed efficiently. Jobs that are completed on time and on budget increase a firm's profitability. They also enable a firm to effectively allocate resources and take advantage of new opportunities. In light of current market conditions, it is advisable to create budgets for each phase of a job, in dollars and hours, and continually monitor progress against the budget. Changes in job status and job performance need to be addressed immediately. One of the key statistics to monitor is the effective billing multiplier. This statistic is calculated by dividing the net fee earned on a project by the direct labor incurred on a project. The industry standard target is a 3.0 multiple, but that multiple should be measured against the project budget and/or forecast to ensure there are no major swings in expected job performance.
- Accounts receivable management. In a recessionary environment, it is important to continually evaluate and monitor your accounts receivable due from clients. Just as important is evaluating the ability of new clients to pay your invoices before they hire you. This may be new to some firms, but in this environment it is critical to assess clients before entering into contracts with them. Keep a close watch on accounts receivable and focus on timely billing and collection policies. Profitability is not real until the cash is actually collected. A&E firms should have systems in place to easily determine the status of a client's account at any time and constantly watch the aging of accounts receivable balances. Many firms will stop work on a project if an accounts receivable

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able ages beyond a certain number of days.

- Backlog. Continue to monitor and update backlog reports. Many firms research their clients to see how they are faring in today's economy. One of the most challenging aspects of doing business in today's economy for an A&E firm is managing the backlog report. It is difficult to manage when you have a signed contract ready to go but the contract stalls because of items such as delayed financing. An A&E firm's only defense is to stay in constant contact with clients and know what the contract status is at all times.

- Business development. It is important to maintain and even ramp up business development efforts when working in a recessionary environment. Competition is stiff and firms need to continue to identify and de-

velop opportunities for new projects. Best-practice firms position themselves in those areas of the market place that are best suited to their current strengths and future goals. This enables them to focus on the market sectors where they have or are gaining experience instead of pursuing clients in industries that may have been unprofitable for them in the past. It is tempting to reduce prices in a recessionary environment to keep the work coming in, but best-practice, high-profit firms are not hired based upon price. Resist the temptation to reduce pricing below acceptable profit levels; this is the best way to avoid working hard to break even or even losing profits.

Despite all of the uncertainty out there, it's important to focus on opportunities that exist. For example, while the dollar is strug-

gling, domestic firms are viewed as a bargain for many international projects. This may also be a good time to focus on attracting qualified employees and upgrading staff capabilities as other firms are reducing their workforces.

Remember, best-practice firms are able to maintain their profitability and competitive edge because they plan for the future while continually assessing and improving upon their current strengths and weaknesses. They are also disciplined. Best-practice firms remain diligent in those areas such as staff development and project management that represent ongoing challenges. By taking a proactive approach to management, a firm can take advantage of business opportunities and capitalize on trends in the profession – in spite of uncertain economic factors. ■

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