teamwork.com

Mastering Agency Profitability Guidebook

A GUIDE TO MAXIMIZING YOUR AGENCY'S REVENUE

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INTRODUCTION

Busy agencies frequently manage packed schedules and multiple responsibilities to ensure client projects (and everything else) run smoothly. With all this going on, it's vital not to lose sight of the big picture.

We're talking about profitability. Let's face it: Nobody wants to lose money.

According to a 2023 BenchPress report, an **average agency's gross profit is 40%.**

Did your agency crush this benchmark? Or did you fall short?

Failing to make profitable deals and smart investments can keep an agency from thriving, no matter how talented the team and how awesome the deliverables are.

Yes, some challenges can hinder profitability. Scope creep, the wrong tools, improper resource management, and beyond can all stagnate an agency's progress and success. As a result, some agencies swing to the extreme of overservicing (going above and beyond client expectations) to try to head off this stalling. But, as much as it may seem like a good idea on the front end, overservicing can decrease an agency's productivity and hinder growth, too.

To achieve true profitability, your agency needs to find the sweet spot between what you do well, and what clients are willing to pay for it; providing a stellar service without edging into overservicing territory.

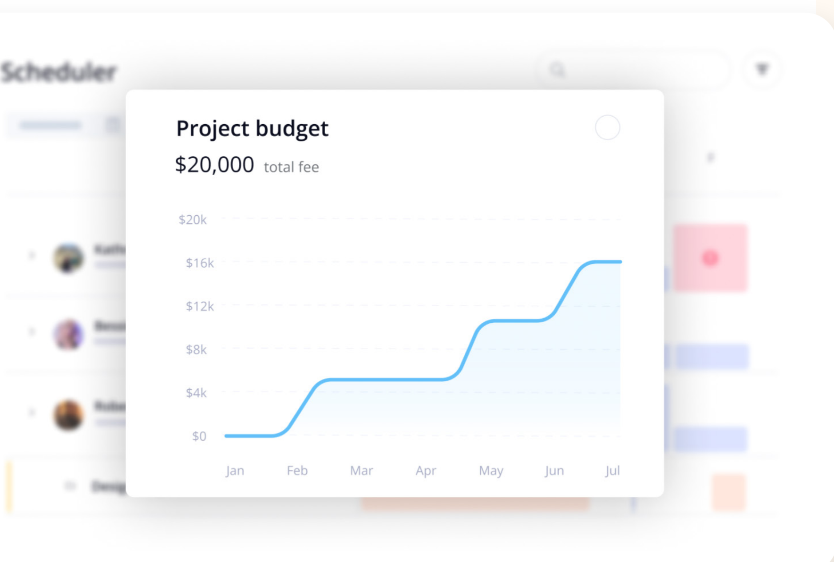
The concepts in this eBook will help resolve or mitigate the profitability challenges agencies face. The result? Agency leaders will learn to manage day-to-day operations in a way that amplifies profitability and productivity.

WHAT DOES AGENCY PROFITABILITY LOOK LIKE? THE METRICS THAT MATTER

Starting and running a profitable agency requires consistent oversight.

It may seem like your agency is bringing in lots of clients and revenue — but is it enough to cover your payroll, technology investments, taxes, and other expenses (with plenty leftover)?

You've got to know how to gauge whether the agency is profitable or not and if the efforts are sustainable. To figure that out, you'll need to look beyond your sales revenue.



KEY METRICS FOR MEASURING AGENCY PROFITABILITY

"If you don't know your numbers, you don't know your business."

- **Marcus Lemonis**, CEO & Entrepreneur

Using analytics to measure your agency's success is essential for building an accurate picture of its profitability. There are several helpful metrics that you should regularly use as a measuring stick of how you're performing.

Setting up some key performance metrics (KPIs) in advance keeps you organized and focused on the big picture — growing your agency.

The right analytics can help small and medium-sized agencies scale and grow fast. Teamwork.com works with thousands of profitable, successful agencies of all sizes, giving us first hand insights into which analytics are the most helpful to monitor. Let's dive into the metrics that consistently help our clients see results.

GROSS PROFIT

This metric gives agency leaders a better view of how you're doing than revenue alone. Gross profit is calculated by taking the cost of goods sold and/or the costs associated with a service provider and subtracting this amount from the revenue.

This KPI tells you how efficiently your agency delivers your service. If high materials and labor costs are too high, it eats into your gross profit.

FIG. 1

$$\text{Gross profit} = \text{Revenue} - \text{COGS}$$

COGS: COST OF GOODS SOLD

NET PROFIT

Net profit builds off what gross profit tells you. To calculate it, take your gross profit and subtract the additional operating expenses and taxes.

This metric gives you an idea of whether your agency is making more than its spending. If the net profit isn't where it should be, it may be a signal to find ways to cut expenses or raise prices.

FIG. 2

$$\text{Net profit} = \text{Gross profit} - \text{Operating Expenses} - \text{Taxes}$$

GROSS MARGIN %

Calculating the gross margin % requires knowing your agency's net sales. Take your total revenue, subtract the cost of goods sold (COGS), and divide your answer by your total revenue.

This metric sheds light on how much of each dollar the agency makes is retained as gross profit. For example, a 30% gross margin means that $3 out of every $10 in revenue is retained as gross profit.

A lower-than-average gross margin % may indicate your agency should raise its prices or look for ways to reduce costs.

FIG. 3

$$\text{Gross margin \%} = \frac{\text{Net sales} - \text{COGS}}{\text{Net revenue}}$$

NET SALES = GROSS REVENUE - (RETURNS + ALLOWANCES + DISCOUNTS)

COGS: COST OF GOODS SOLD

OPERATING PROFIT

FIG. 4

$$\text{Operating profit} = \text{Revenue} - \text{COGS} - \text{Operating expenses} - \text{Depreciation} - \text{Amortization}$$

COGS: COST OF GOODS SOLD

Another important KPI is the operating profit, which is the funds left after an agency has paid all business costs, excluding interest, and before they pay taxes.

Operating profit is another way to measure an agency's ability to make more money than it spends. This metric offers insight into the agency's health.

NET INCOME

FIG. 5

$$\text{Net income} = \text{Total revenue} - \text{Total Expenses}$$

Net income drills down even further into an agency's profitability by subtracting the expenses (COGS, admin and operating expenses, taxes, interest, depreciation, and other expenses) from the total sales.

This metric is the bottom line for an agency that gets down to the nitty-gritty of how much you're making. Calculating net income also lets leaders see how much is spent on every business expense, which helps make sound operating decisions.

EBITDA

FIG. 6

$$\text{EBITDA} = \text{Net income} + \text{Interest} + \text{Taxes} + \text{Depreciation} + \text{Amortization}$$

Short for "earnings before interest, taxes, depreciation, and amortization," EBITDA is one of the most widely-used key profitability measures for all types of businesses. It's an accurate metric that can be used to compare your agency with others, measure its profitability, and determine its worth.

AGI

Adjusted gross income (AGI) is the money you keep to actually run your agency after you've served your clients. This is the money that goes to overhead expenses, salaries, and pre-tax profits.

FIG. 3

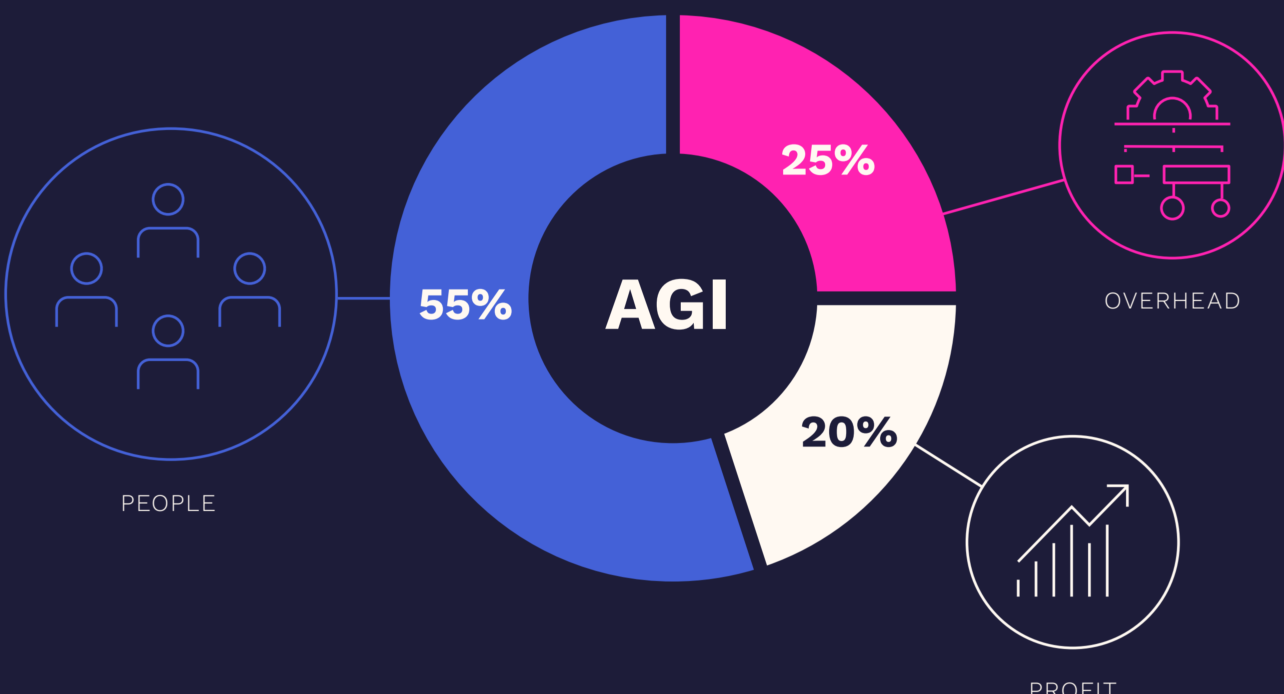
$$AGI = Revenue + billings + sales - COGS$$

AGI: ADJUSTED GROSS INCOME

COGS: COST OF GOODS SOLD
EQUIPMENT AND MATERIALS INCLUDING CONTRACT LABOR

"The ideal ratio for an agency is that 55% of your Adjusted Gross Income (AGI) should be spent on your people (salary and benefits), 25% on overhead (accountants, rent, tools etc.) and the goal is to leave 20% profit before taxes."

- **Drew McLellan**, CEO, Agency Management Institute



PLANNING, PROCESSES, AND PEOPLE: THE PATH TO MAXIMIZING AGENCY PROFITABILITY

Keeping your agency on track and aligned with your profitability goals can be challenging. After all, there's never a "normal" year or project, is there?

Fortunately, by being proactive, agency leaders can reach or maximize agency profitability year after year. This takes planning, processes, and people.

PLANNING

Workload management and forecasting

Understanding your team's workload is a key factor. Underutilizing certain employees while overworking others can lead to burnout. Using workload planning software can help project managers easily see what everyone is working on and make more informed decisions about where and how to allocate tasks. When work is appropriately distributed, you'll deal with fewer bottlenecks — and can identify them before they affect your project timelines.

Forecasting is another crucial piece of the puzzle. A forecast isn't necessarily a prediction, but a comprehensive evaluation of the facts you do have to help you better prepare for the future.

6 QUESTIONS TO ASK TO HELP YOU FORECAST BETTER

1. Do you know which months are typically your busiest?

2. Do you know your team’s availability with vacation time?

3. Have you factored in having fewer people to do the work during the holidays?

4. Will you need to hire more contractors and freelancers to fill resource gaps?

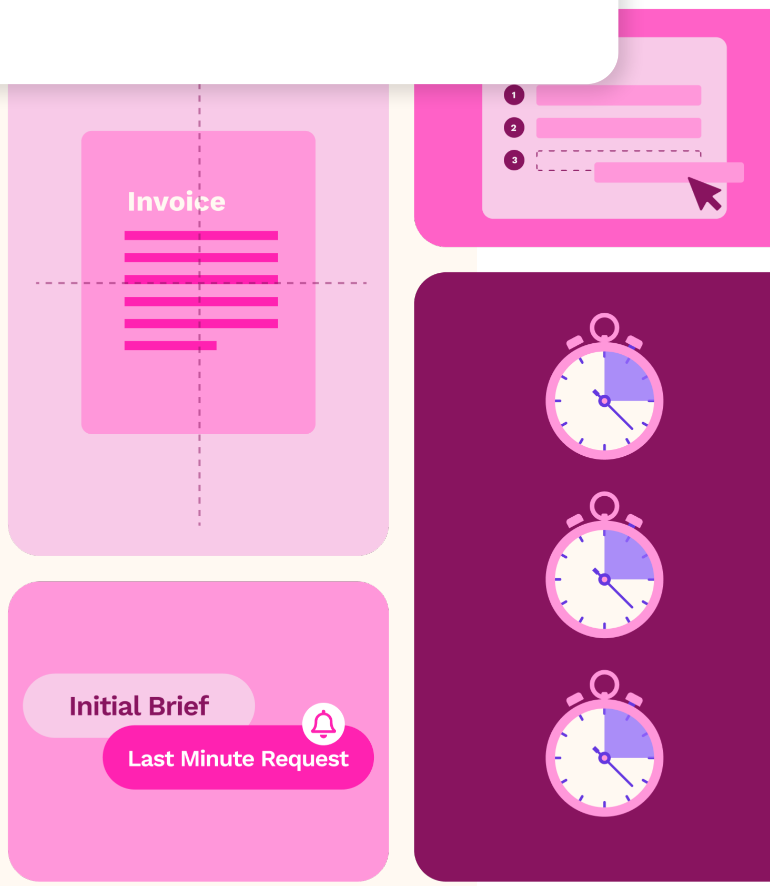
5. Do you have work you can plan for in advance, like long-term projects or clients on retainer?

6. Can you look back at previous projects to see how your team tracked against your time estimates and refine for future forecasting?

Avoiding scope creep

One of the sneakiest and most detrimental hindrances to profitability is scope creep, which happens when clients attempt to add and expand items within an already-agreed-upon scope of work.

Scope creep can erode profits by adding more hours to the project and increasing its overall cost. In addition, it frustrates team members and messes up deliverable timelines.



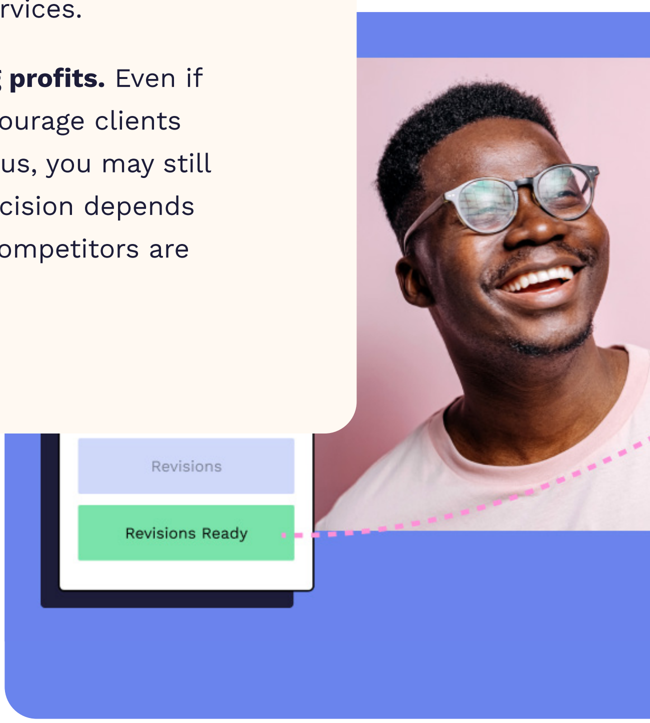
Manage scope creep with these three helpful tips:

- **Always know what your team is currently working on.** Know who's at capacity and who's available to take on more work.
- **Spot and avoid bottlenecks.** Be ready to re-prioritize, or reassign work. Workload planners and resource schedulers are powerful tools to keep you on top of this before issues derail your project.
- **Don't just set accurate delivery timelines, but also stay within the budget you set.** This is often how much time or capacity you thought the project would need, and is necessary for gauging bandwidth for taking on new client work.

Identifying your agency's most profitable projects and services

Agencies should know which products or services are the biggest money makers and which ones have slim margins. This helps structure more profitable deals that bring in more money.

- **Closely analyze profit margins of past projects and service offerings**. Do some stand out as cash cows while others barely break even? If so, it's smart to focus on marketing the more profitable services.
- **Don't automatically ditch services that fail to make big profits.** Even if some services barely squeak out a profit, they may encourage clients to purchase more profitable items from your agency. Plus, you may still need to offer them as solutions to your clients. This decision depends on the popular services clients expect and what your competitors are offering.



PROCESS

Setting up stronger internal processes

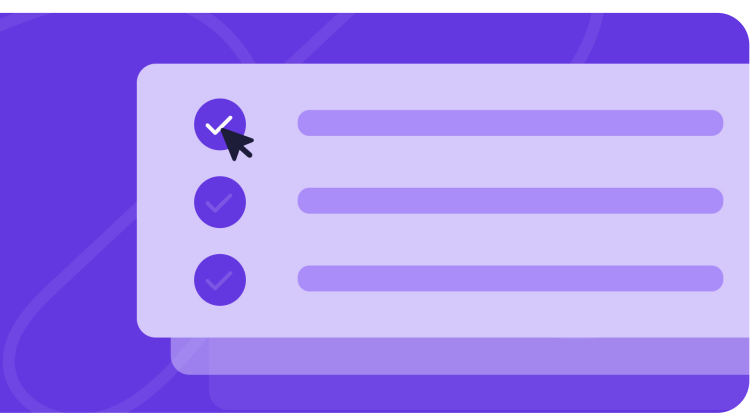
Processes play an enormous role in agency profitability. Setting up and restructuring internal processes can add to your agency's bottom line. Smart process management includes setting and regularly reviewing project budgets, minimizing scope creep, automating manual, repetitive tasks, and making sure you invoice for every billable minute.

Time tracking

"I'm not a fan of time tracking, but I'm a fan of what time tracking can do for you."

- **Ryan Baker**, Founder, Kingly Consulting

One of the most critical components of achieving profitability is time tracking. Even a small percentage of missed time that could have been billed sucks funds off the top of your agency's profit.



But time tracking isn't just about accurate billing and invoicing (though that's important, too!). Tracking billable and non-billable time provides greater visibility into where your team's time is going, so you can understand which of your services, accounts, and team members are the most profitable.

These insights can also help in determining cost rates for each of your team members before a project gets underway. For example, let's say you determine that it costs more to make a video for a client than to write a blog post. In this instance, you might set your video producer's billable rate to $200 per hour and your writer's to $100 per hour to bill your client accurately and not risk leaving money on the table.

Software tools make it easy for agencies to accurately track the time team members spend on projects. By having a way to track how much time each team member devotes to project tasks, clients pay for everything involved with their deliverables. This way, there's less non-billable throwaway time hindering your agency's profitability.

"Time tracking has allowed us to identify which accounts, tasks, and services are most profitable, improving our bottom line."

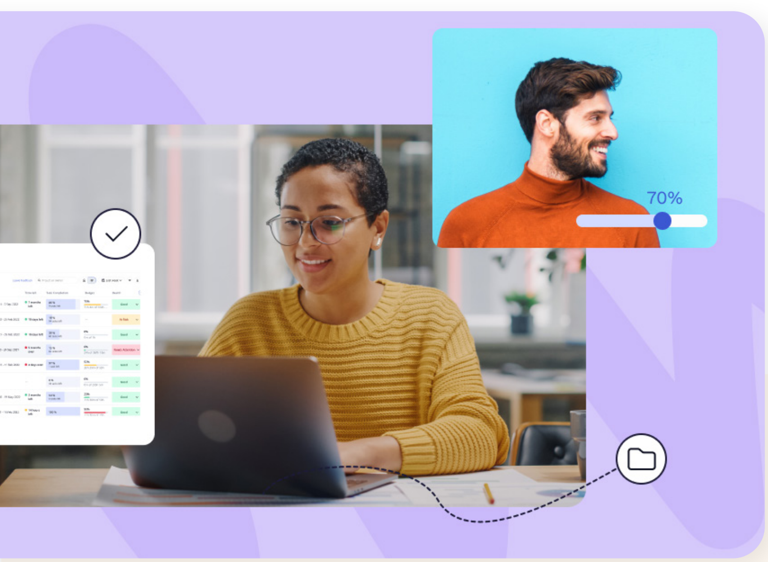
- **Mathew B**, Senior SEO Consultant

Reporting on profitability

Maximizing your agency's profitability means having a way to see what, where, and when you were or were not profitable. Reports are key pieces of insight to help you do that.

Tracking specific elements at the project level is the first step, including:

- Project expenses (labor costs, tools, material costs, software, and other resources needed to complete the project)
- Additional costs and one-off costs
- Logged time by project and by client
- Billable and non billable tasks



Once you accurately track these activities, measuring them gives you a clear picture of the project's profitability. When evaluating spending and profitability, consider the following:

- Planned vs actual budget
- Estimated vs actual resource utilization
- Planned vs logged time for tasks
- Billable vs non billable time
- Breakdown of budget across task lists

As you track this information across multiple projects and clients, you may start to see trends develop:

- Are a few team members consistently overutilized while others are underutilized?
- Do you allocate significant time to hyper-focusing on certain tasks and rush through others?
- Are you using the most cost-effective software and tools to carry projects to the finish line?

Tracking your projects will tell you all of that.

PEOPLE

Knowing when and who to hire next at your agency

As your agency begins to scale, it may be tempting to hire en masse for a fully-loaded team with a dedicated team member to fill every position. While bringing in new staff is an exciting part of growing your business, it needs to happen strategically to maintain (and maximize) profitability.

- **Consider your costs vs. potential profits.** Look at the cost of hiring a new team member compared to the cost of losing potential deals due to lack of bandwidth — this makes the decision easy to quantify.
- **Examine your business pipeline.** If it's full of projects that will overburden your current staff, it may be time to bring on a new person.
- **Determine if there are scope creep and/or overservicing issues.** If there are, addressing those could free up current team member time and help avoid adding another person to the payroll.
- **Consider gaps in your workforce's expertise.** Adding a high performer to your agency could set you up to scale faster and increase profitability.

Focusing on a realistic workload and a comfortable, accommodating workplace is a natural first step. Add a competitive salary and benefits, ample time off, and a culture that encourages a healthy work/life balance, and you have the recipe for keeping your staff happy and engaged. Keeping talent happy and focused on their work is one of the main staples of agency profitability.

A project management tool can help project managers stay on top of everyone's workload. If a team member starts getting overwhelmed with tasks, it's easy to re-assign them to someone with the bandwidth to handle them. (Packed schedules may also signal it's time to hire.) This approach minimizes burnout and helps agencies avoid costly turnover.

TIP:

Understand whether your quotes are accurate by tracking estimated vs. actual/billable hours. If your team consistently exceeds their estimated project hours, it could be a sign you should increase your rates. This can also help you understand how to balance service rates and team utilization to prevent burnout while maximizing profitability.

LET CLIENTS MAKE YOUR AGENCY, NOT BREAK IT

If your agency can find, retain, and successfully serve great clients, you can achieve significant growth and success. On the other hand, losing clients or failing to provide anything less than stellar services can have a devastating impact on your finances and reputation.

Let's explore some of the most significant ways that clients can make or break your agency.

BREAK: UNPROFITABLE CLIENTS

"Nothing can be more demoralizing to a team than a 'bad customer'. Whether that be making unrealistic demands or difficult interactions, it can negatively impact the morale of the team... We're not afraid to have those tough conversations with customers and essentially fire a 'bad customer'."

\- **Megan Bowen**, COO, Refine Labs

Clients aren't created equal. The services they purchase, their personalities, and how hands-on they want you to be all determine which ones are the most profitable and which barely add anything to your agency's bottom line.

Some clients may even drain profits from your agency.

For example, let's say that a client expects tons of updates, wants to make last-minute additions or revisions, and is never satisfied with the finished product. These clients may be more trouble than they're worth. Not only can they hinder profitability, but they can be a major drain on team morale.

If you identify this type of client, you have a few options. Either lay out specific guidelines and expectations, raise their prices to cover the additional headaches and time, or fire them.

Letting a client go may seem extreme or counterintuitive. However, it frees your agency's time up to replace them with new clients who respect your agency's time and professional boundaries. Clients that value your time and respect the contract are less likely to make out-of-scope requests that sabotage the project's profitability.

TIPS FOR IDENTIFYING UNPROFITABLE CLIENTS

- **Look at your reports.** Use your project management tool to see if you're spending more resources on the client than the project covers.
- **Listen to your team.** Do they detest working with the client? Is the client rude, argumentative, and unreasonable? They may be more trouble than they're worth.
- **Review their payment habits.** Clients that are slow to pay or require you to continuously remind them their bill is past due may be dealing with cash flow issues. Continuing to work with them could be risky.

Bonus tip to help increase client profitability: Examine possibilities for increasing their profitability. If a client doesn't look profitable, is there an avenue for changing that? If they'd be amenable to a price increase or looking at additional products, you may be able to increase the profitability of working with them.

Think about how they fit with your agency. If the client isn't in the industry your company specializes in, or isn't the size of organization that fits your mission, they may not be worth the effort to keep them.

MAKE: STRATEGIC UPSELLING

If your good clients aren't using every service you offer, there's a great opportunity to gain more business from them. Hold regular review meetings with clients to make them aware of all your services.

As you communicate with clients about their needs and how you can address them, build the perception that your agency provides a valuable service — because it does! This consultative approach will positively impact your client's perception of you and strengthen your relationship.

Ensure you charge customers for all services by adopting a 'no work for free' culture.

When clients use multiple services, your agency becomes even more of a valued partner. By strengthening the relationship, you also increase the customer lifetime value (CLV) and minimize the risk of losing them. This is a big deal since client retention is a major building block of highly-profitable agencies.

TIPS FOR UPSELLING

- **Meet with clients regularly.** A strong relationship built on trust makes it easier for clients to believe you when you say they need to add services. Whether in person, on Zoom, or by phone, touch in with them regularly to keep the partnership strong.
- **Use a consultative approach.** Avoid hard-sell tactics that only irritate clients. Simply explain the service you want to upsell and how it would benefit them.
- **Showcase a positive return.** Highlight how the upsold service would address a need or eliminate a pain point and the client will be more likely to say yes.
- **Suggest service bundles.** Fold in the new services with what they already purchase from you and create a single price for everything. This tip works even better if there are cost savings associated with using them all rather than purchasing each element on its own (because everyone loves to feel like they're getting a deal).

MAKE: RETAINING YOUR CLIENTS

It pays to hang onto your existing clients: The longer a client stays with your agency, the more profitable they become, spending more on each project. While there's a certain thrill in closing a deal with a new client, if you're focused on long-term profitability, you also need to focus on maintaining long-term relationships.

TIPS FOR RETAINING CLIENTS

- **Prioritize the client experience.** No two clients are the same, so curate experiences uniquely tailored to each client's needs and preferences. Personalize your communications with your points of contact, and treat the relationship as a partnership. This makes the client feel seen and heard, and fosters a collaborative engagement that results in higher-quality deliverables.
- **Incentivize referrals.** Do you reward existing clients for sending new business your way? If not, you could be missing out on a great opportunity to keep existing clients happy and close more new deals — two benefits for the price of one!
- **Be proactive.** The longer you work with a client, the more you understand the ins and outs of their businesses and their goals. Make suggestions that align with their company objectives — even if those objectives weren't part of your original contract discussion. This is an easy way to demonstrate that you're attentive to the client's needs and invested in their success.

ADOPTING A PROFITABLE PRICING

How you price your agency's services is perhaps one of the most significant factors in maximizing your profitability and setting your agency up for long-term growth. But a common mistake is only considering service pricing itself and not the overall pricing structure.

Rather than trying to improve profitability by increasing your prices, you may need to reevaluate your pricing model. Choosing a model that doesn't align with your services, industry, and clientbase could result in lower profit margins. Depending on your preferences, there are six main pricing models you can use with your clients, which we'll cover in more detail below.

HOURLY BILLING

Many agencies opt for hourly rates because of their simplicity. The client pays for the time it takes to deliver their project or service, which seems to be a cut-and-dried approach.

Pros:

- Clients with set budgets like it.
- Scope creep is billable.
- It's easy to track work schedules.

Cons:

- It makes scaling larger projects challenging.
- Longer projects are more profitable, which may shift focus to time rather than efficiency.
- Clients may get frustrated if projects take more time than expected (because that means they pay more).

PROJECT-BASED / FIXED-RATE PRICING

Flat fees are another popular pricing strategy. The client and agency discuss the project and agree on a set, all-inclusive price.

Pros:

- Focuses on efficiency without compromising revenue.
- This model makes it easier to scale large, complex projects.
- It fosters a culture that values productivity.

Cons:

- If the project is under-quoted, it decreases the profit margin.
- This pricing model can easily become a victim of scope creep.
- Some clients don't like the lack of transparency in this type of pricing.

PERFORMANCE-BASED PRICING

Performance-based pricing may be a smart option for agencies delivering projects with measurable outcomes. An example of when this pricing would work well would be for a lead generation campaign, where results are trackable.

Pros:

- It gives clients confidence that you will deliver what you promise.
- It's a competitive approach when vying for clients against other agencies.
- It's a scalable model that works well for large projects.

Cons:

- If the project doesn't deliver results, you lose money on the deal.
- It can be labor-intensive for agencies to tackle this successfully.

VALUE-BASED PRICING

Agencies that bring something unique to a project can use a value-based pricing strategy. Instead of using the hours spent or a flat fee, the client pays for the value the agency creates for them.

Pros:

- It's a true agency / client partnership.
- It elevates value over all other elements of a project.
- It's highly scalable and offers a lucrative profit margin.

Cons:

- Value is difficult to prove, which requires a transparent agreement with the client to avoid dissatisfaction.
- It's only viable for agencies offering a unique product or service.

HYBRID PRICING

Companies can get creative and use two or more pricing models to design a unique, hybrid fee. For example, they may offer a flat fee for a project with the option to add on elements at an hourly rate.

Pros:

- Agencies can give clients exactly what they want.
- Depending on the pricing models used, the method can be highly scalable.
- This method can net a high profit margin.

Cons:

- Multiple fees can get confusing and frustrating for clients.
- Clients on a budget may not find this model attractive.
- If it isn't laid out well on the front end, extra work can drain the profit margin.

RETAINERS: THE PREFERABLE PRICING MODEL FOR MANY AGENCIES

In a retainer model, a client retains ongoing services from your agency. This model is preferable for most agencies because the client pays the fee upfront, either based on a flat or hourly fee per project.

Pros:

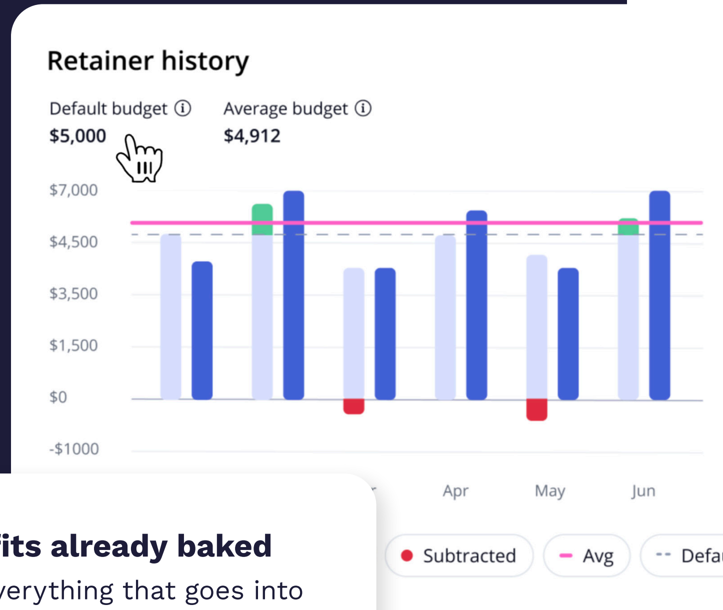
- Pay is continuous and reliable.
- Many clients enjoy the flexibility of having your services available at a moment's notice.
- Gives agencies the ability to work with clients on longer-term strategies.

Cons:

- Scheduling conflicts may mean you'll have to turn down or push back new project requests from other clients.
- It's easy to get comfortable with just a few retainer clients to support you, which can leave you in a predicament if one of those clients churns.

"Retainers are nice because they give you forecastability. Once you're able to build a repetitive offering that can be delivered with a similar quality every single month to a variety of clients, you now have a legit business."

- **Nicole Pereira**
  CEO, Remotish & Advisor, Culturish



HOW TO STRUCTURE YOUR RETAINERS TO MAXIMIZE PROFITS

If your agency operates on a retainer pricing model, there are ways you can tweak it to make it more profitable:

Create retainer packages with costs and profits already baked in. Part of this includes gathering accurate costs of everything that goes into a project (supplies, labor, and one-off expenses). Depending on the client and the services you provide, these packages may be time- or deliverables-based for greater profitability.

Communicate expectations at the start of the relationship. Your clients should clearly understand what their retainer costs include, so they're never in the dark about what they're paying for. Similarly, make sure your agency asks the client about their expectations. This should include any measurable KPIs they're expecting your agency to meet, or any other specific, quantitative criteria.

Allocate resources appropriately. If your agency takes on a labor-intensive retainer that needs all hands on deck for several weeks straight, you'll be double-booking your employees if you take on any additional projects during that time. Using a resource scheduling tool can help ensure that your team members' time and skills are realistically distributed across projects — and can help you determine whether or not your agency truly has the bandwidth to take on another project.

Use historical data reports to build more accurate projections. As you work with more retainer clients, track costs closely and accurately. By understanding previous deliverable costs, agencies can more confidently price future retainer projects. This may require you to make changes as you go to maximize profitability on retainer accounts.

HOW TEAMWORK.COM CAN HELP MAXIMIZE YOUR AGENCY PROFITABILITY

Growing an agency is tough — and getting tougher. It involves juggling multiple projects at once, managing clients, keeping teams productive, streamlining processes and continually improving profit margins.

Teamwork.com is a project management software built to help agencies manage the entire lifecycle of their client work in one place.

The platform provides all of the features you'd expect, plus integrated time tracking and financial management to ensure your projects are delivered on time and on budget, including budgets, retainers, and invoicing.

Get started with Teamwork.com today

to take back control, get organized, and do more profitable client work.

teamwork.com

THE ONLY PLATFORM BUILT FOR SCALING CLIENT WORK.

TEAMWORK.COM