

KNOWING WHEN TO HIRE - RATIOS PROVIDE ANSWERS

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The lists of goals for owners of service firms typically include growth for their businesses, often measured by the number of employees rather than by gross volume or bottom-line profits.

The desire for growth brings several questions, including when to add more people. If the owner hires more people too soon, profits and cash flow are hurt. Wait too long, and service, quality, and morale are at risk.

The first inclination of many fledgling entrepreneurs in the service industries is to resist hiring help until forced to do so. The business owner finally hires an assistant - usually administrative in focus

- when deadlines are being missed, new sales opportunities are being lost, or the entrepreneur realizes he or she is too tired to continue without some help. This resistance to hiring has put many service professionals out of business and in some cases in the hospital.

The other typical pattern of new-to-business entrepreneurs is to respond to employee pleas for more help. First, there is a part-time bookkeeper, then a file clerk, then a database entry clerk, then an errand runner, and then someone to handle the public relations program. This is a dangerous pattern for at least three reasons.

First, the roles mentioned are all part of the overhead costs of a business, and though individuals could be highly productive in what they are doing, the result of their labor does not contribute to the gross volume of the business. These jobs are often called "nonbillable" in "indirect" positions within a service firm.

Second, the addition of these nonbillable positions can create a false sense of growth, especially if several part timers are involved. The office seems busy when sales have slowed.

Third, the "to-do" list at a service firm is endless. Management systems need improvement. Records need to be computerized. Filing falls behind. New approaches to the provisions of service need to be researched. Job descriptions must be updated. Promotional literature and the public relations program need more attention. There will always be enough work to keep a newly hired employee busy.

But hiring enough people to get to the bottom of the to-do list is guaranteed to put a service company into bankruptcy. It is likely you know several entrepreneurs who do not

take home a reasonable draw from their businesses because they are payroll poor.

Pacing the expansion of a service business through hiring is a follow-the-numbers proposition. The owner of the successful, growing service firm hires people to help deliver service, bring in new business, or both. Though the new employees may never

come close to the owner's capacity to sell or deliver billable services, they are contributing to the real growth of the company. These service and sales positions are often referred to as the "billable" or "direct" positions within a service business.

Over time, the experienced business owner develops a feel for the length of time it will take a new employee to reach a reasonable and acceptable level of sales or service delivery. There are industry averages, but every business is different. Some companies have specific, well-spelled-out standard operating procedures and only a few well-defined services. Owners of such companies can realistically expect to beat the industry averages, whereas owners of firms that have built reputations on tailoring services to individual clients should expect to

Business owners can learn how to manage the growth of their firms through the experiences of entrepreneurs in other fields.

have longer training periods for new employees.

After hiring and working with a number of new employees, seasoned business owners know the true cost of training for their firms. And once that true cost of expansion is known, entrepreneurs can better pace future hiring. The business owner focuses on sales projections, and when training money is in sight, another person can be hired. The first set of numbers guiding the pace of hiring is return on investment from true costs of new-employee training.

After entrepreneurs have invested in the expansion of their companies several times, they can also determine the number of billable positions they should have for every nonbillable slot. The direct positions generate gross profit from which indirect salaries can be drawn. This second set of numbers guides the pace of expansion in the successful service company.

But learning through trial and error about the true costs of training and standards for billable vs. nonbillable hours can be expensive and frustrating for new entrepreneurs. Business owners can get a head start on these keys by asking business owners of noncompeting firms about their numbers. Members of local chambers of commerce often exchange such tidbits with one another during lunches or chamber-sponsored seminars. Articles published in trade periodicals often include reference to key business management ratios.

Plus, For example, owners of professional service firms, such as lawyers, doctors, or consultants, should talk with owners of construction companies. They have learned to keep an eye on their overhead, because their margins are so tight, often 5 percent. As a result, their billable/nonbillable ratio has to be as high as 8 to 1 or 10 to 1.

Business owners could learn a great deal from entrepreneurs in the construction field. How do they do it? While observing the operation of a successful construction company, the visiting entrepreneur can reflect on how his or her firm could apply some of the

no-frills approaches that are characteristic of construction companies.

Secretaries in most engineering firms must keep track of the time they spend on each project because they have been included in the contracts for service. Each hour of their time is billed at a rate two-and-a-half to four times the hourly cost of the employee. This way the engineering firms can afford to have its secretaries do administrative tasks, or nonbillable work, for the firm.

In this example, the direct/indirect ratio is monitored within each position. Additional nonbillable secretarial hours can be hired only when a sufficient number of billable hours within the same position can be seen. In the construction business, a second secretary can be hired only when 18 to 20 full time billable employees are busy.

Advertising agencies often include a combination of their billable/nonbillable and true costs of training numbers in their contracts with newly hired account executives. A new account executive cannot expect to earn a bonus or be eligible for commission beyond a base salary until a preset level of sales plus billings is surpassed.

Entry-level associates in some public relations firms can be expected to bill as much as five times the cost of their positions. In other words, an associate earning \$20,000 in salary and benefits may bring as much as \$100,000 into the business. This extra gross profit can be applied to the cost of training new employees or allow the owner of the public relations firm the luxury of an occasional vacation or increased time spent on nonbillable planning activities.

In this example, different billable/nonbillable ratios are applied to each position within the firm. Associates may be expected to bill 90 percent of their time; account managers may be expected to bill 80 percent of their time, and the owner may be expected to bill 33 percent of his or her time. The higher ratios in junior positions buy the firm lower ratios in the senior positions.

Entrepreneurs who do not want the growth

of their businesses disrupted by the sudden loss of key employees need to explain the logic behind their numbers to their employees. Otherwise, workers are left to assume the owner is making profits on their backs. I know one talented market researcher/interviewer who left a reputable firm to form her own business primarily because she had been expected to bring in billings at rate eight times her gross income. She felt it was unfair. I have found that employees can understand billing multipliers of two-and-a-half to three times their gross earnings, but few can comprehend without expanded information how multipliers of five to eight can be justified.

Thus, care should be taken in firms with high-billing multipliers for lower-level positions to moderate the expectations, explain the numbers, and share the benefits when the numbers work. The so-called lower-level employees in the public relations and market research firms mentioned clearly are contributing to the companies' successes. Team bonuses that are not linked to salary levels would probably be appropriate for these companies.

Why so much focus on buying nonbillable time when the level of billable time clearly drives the growth of the business?

In the short run, a business can succeed by selling specific projects and delivering what has been sold. But success over the long haul depends on a company's capacity to use its nonbillable hours effectively. Nonbillable hours are needed for market research, public relations, financial planning, budgeting, product development, and technical innovation. In fact, the sales and service delivery, which are billable hours, become more efficient through the findings and recommendations of analysis done during nonbillable hours.

Knowing the standard ratios within a particular industry can save the entrepreneur much frustration, lost time, and lost profits caused by decisions based on trial and error.

Knowing standard numbers helps a business owner make objective decisions on growth and

afford more nonbillable hours. When faced with the numbers, entrepreneurs who would otherwise be reluctant to do so may be more willing to hire people. Other entrepreneurs, who are susceptible to employee complaints or have lengthy to-do lists, can control their urges to hire too many people by matching industry averages. They may have to face the need to cut back, be more efficient with positions they have, or experiment with billing multipliers and position-specific billable/nonbillable ratios.

Successful entrepreneurs buy valuable nonbillable development time by experimenting with higher billing multipliers and position-specific billable/nonbillable ratios. They learn from others and explain their logic to their employees.

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