



Developing a Financial Health Self-Assessment

How Are Your Agency's Economic Vital Signs?

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sjk advisory group

sjk advisory group has provided specialized financial management services to companies and their principals in the advertising, public relations, digital marketing, and media service industries since 1996.

Steve Koskela, Managing Principal, has years of senior financial executive experience in high profile advertising agencies blended with the credentials of a Big Four CPA firm background. Visit our website at www.sjkadvisory.com for further details on services and illustrative examples of client engagements. E-mail contact: skoskela@sjkadvisory.com

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Evaluating Overall Agency Performance

Management's Core Focus Areas

- **New Business Development Skills**
- **Quality of Service Offerings/Work Product**
- **Ability to Recruit, Retain, and Evaluate Talent**
- **Competitive Positioning/Differentiation**
- **FINANCIAL AWARENESS**

Financial Self-Assessment Process

- **A Forced Discipline**
- **Beyond the Basics**
- **Clearing the Clutter**
- **Diagnosis and Prospective Treatment Plan**

Financial Self-Assessment Fundamentals



Financial Self-Assessment Fundamentals

- **Three Key Barometers from the Basic Financials**
- **Aging Reports – What Can They Tell You?**
- **Monitoring Your Revenue Sources – Makeup and Trends**
- **Adopting a Liquidity Mindset**

Self-Assessment Fundamentals

- Barometer # 1 (from the Balance Sheet and Op Plan Forecast)

Working Capital Strength:

of Months' Operating Expense Coverage

Working Capital = Current Assets minus Current Liabilities

divided by

Avg. Mo. Operating Expenses

= Working Capital Coverage Factor

Self-Assessment Fundamentals

- **Barometer # 1 (from the Balance Sheet and Op Plan Forecast) – con'd**

Healthy W/C target = 2x to 3x Avg. Mo. Operating Expenses

Illustration:

Current Assets	\$2,600,000*	Annual Op Ex \$2,700,000
Current Liabilities	<u>\$2,300,000*</u>	Avg.Mo.Op Ex \$ 225,000
Net Working Capital	\$ 300,000	
W/C Target @ 2x= \$ 450,000		W/C shortfall (\$150,000)

* **Current Ratio = 1.13**

Self-Assessment Fundamentals

- **Barometer # 2 (from the Income Statement)**

% Total Staff Costs to Total Net Revenue

Staff costs include: Payroll

P/R Taxes

Employee Benefit Costs

Freelance Costs (in lieu of permanent staff)

Total Staff Costs *divided by* Total Net Client Revenue

Self-Assessment Fundamentals

- **Barometer # 2 (from the Income Statement) con'd**

Healthy Total Staff Cost to Revenue Target = $\leq 60\%$

Illustration:

	<u>6 Mos. Thru 6/30/17</u>	<u>Target @ 60% or less</u>
Total Net Revenue	\$1,000,000	
Total Staff Costs	\$ 700,000	\$ 600,000
Staff / Revenue	70%	
	\$ YTD Over Target	\$ 100,000

Self-Assessment Fundamentals

Barometer # 3 (from the Income Statement and Operating Plan Forecast)

An Obvious Key Metric

Net Operating Profit to Net Revenue = Operating Margin %

Net Operating Profit (EBIT) *divided by* Total Net Revenue
= Margin %

Self-Assessment Fundamentals

- **Barometer # 3 (from the Income Statement...and Operating Plan Forecast) – (con'd)**
- **Healthy Margin Target - ??**
- Target Margins set in the operating forecast
- The magical **20%** “industry standard”
(Major holding company ranges – 12 to 21%)
- Crucial to understand / analyze variance from YOUR plan

The Classic Agency Operating Model



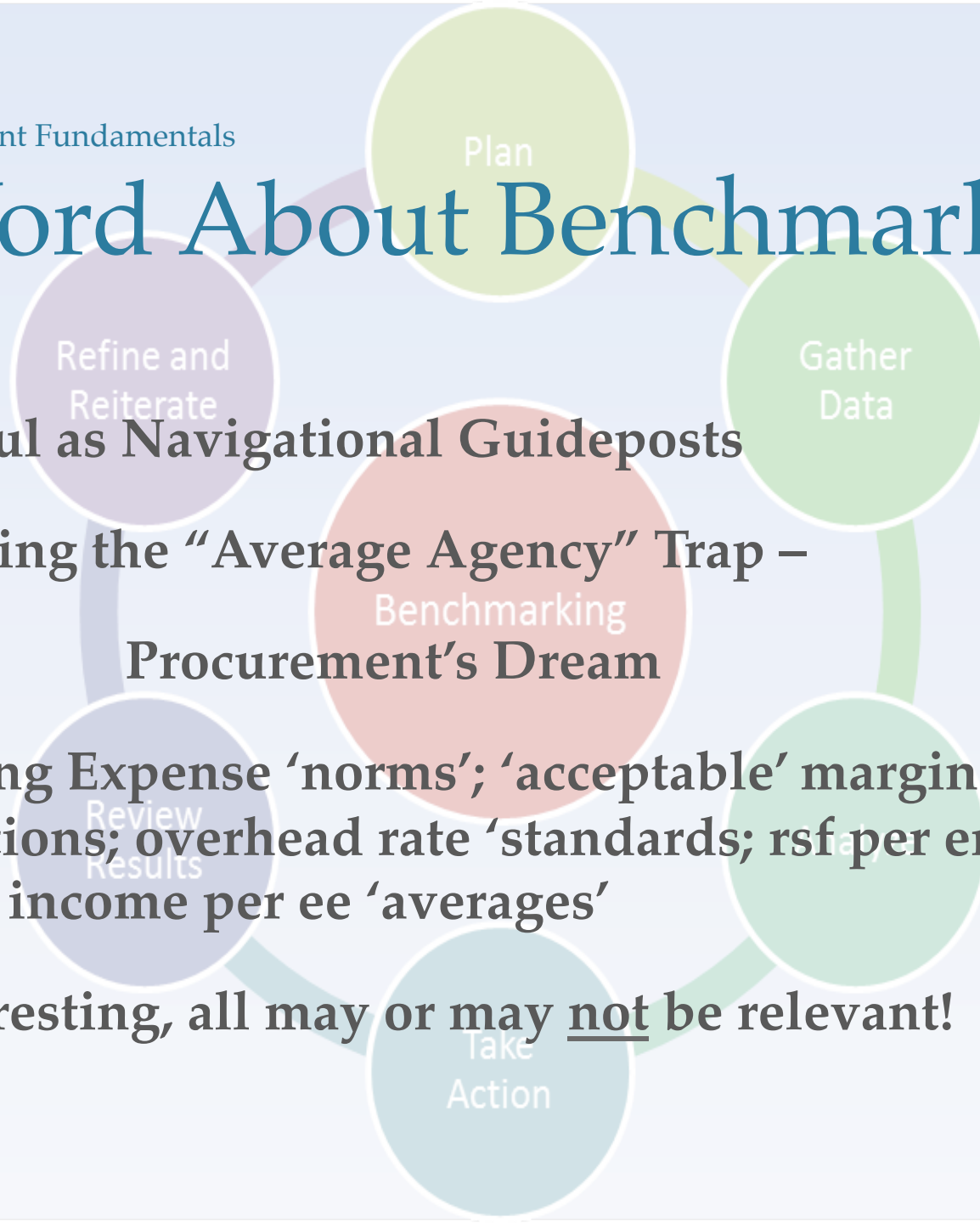
Client Net Revenue	100%
Total Staff Costs	60%
All Other Operating Costs	<u>20%</u>
Net Operating Profit	<u>20%</u>

A Word About Benchmarking

- Helpful as Navigational Guideposts
- Avoiding the “Average Agency” Trap –
Procurement’s Dream

Operating Expense ‘norms’; ‘acceptable’ margin expectations; overhead rate ‘standards’; rsf per employee or gross income per ee ‘averages’

All interesting, all may or may not be relevant!



Aging Reports – What Can They Tell You

- Typically highlight looming collection/billing issues
- Valuable tools to forecast & manage cash flow timing

A/R and WIP >>>> inflows

A/P >>>> outflow

- Use comparative periods to highlight aging trends

Collections slowing?, Vendor terms optimized?

Monitor Revenue Sources and Trends – CONTINUALLY!

- **Forecasting, Tracking, & Revising– Difficult, but Essential**
- **Rolling 12 month forecasts (by month) are preferable**
- **Variance analysis imperative : timing v. permanent differences**
- **Understand Client AND Service Line sources**
 - **Client Concentration – diversification goals in mind?**
 - **Service Line Sources – what are the business drivers?**

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Adopting a Liquidity Mindset

Cash IS King and the Lessons of Bedford Falls



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Adopting a Liquidity Mindset



Adopting a Liquidity Mindset (con'd)

- **Consider the Critical Questions:**
 - Client Contractual Terms and Billing Policy**
 - Vendor Terms/Relationships Optimally Leveraged**
 - Client Credit Policy – Vetting/Customized Terms**
- **Advertising/Marketing, not the “Bailey Building & Loan”**
- **Cash Flow Forecasting = Financial GPS for Agencies**

“Dashboarding” Your Performance

- **Stick to a Routine : Format and Timing**
- **Less Is More – Focus on the Keys/Clear the Clutter**
- **Define Follow Up Actions and Timetable for Review**

“Dashboarding” Performance - An Illustration

1 of 3



Financial Dashboard

6 Mos. Ended 6/30/2017

Money Maker Advertising, Inc. Operating Performance Highlights

	<u>FY 2017</u> <u>6 Mos Actual</u> <u>Results</u>	<u>% Rev</u>	<u>FY 2017</u> <u>6 Mos Budgeted</u> <u>Results</u>	<u>% Rev</u>	<u>FY 2017</u> <u>6 Mos</u> <u>Actual v Budget</u> <u>Variance</u>	<u>FY2016</u> <u>6 Mos Actual</u> <u>(prior year)</u>	<u>% Rev</u>
Client Revenue	5,100,000		5,250,000		(150,000)	4,345,000	
Staff Costs	3,451,500	67.7%	3,255,000	62.0%	196,500	2,665,000	61.3%
Other Operating Expenses	1,050,000	20.6%	1,050,000	20.0%	0	905,000	20.8%
Total Expenses	4,501,500	88.3%	4,305,000	82.0%	196,500	3,570,000	82.2%
Net Operating Margin	598,500	11.7%	945,000	18.0%	(346,500)	775,000	17.8%
Net Margin %	11.7%		18.0%			17.8%	
Target Margin \$ @ 20%	1,020,000		1,050,000			869,000	
Net Op Margin \$ (Shortfall) Surplus (vs. Target)	(421,500)		(105,000)		(316,500)	(94,000)	

“Dashboarding” Performance – An Illustration

2 of 3



Financial Dashboard

As of June 30, 2017

Money Maker Advertising, Inc.

Liquidity and Balance Sheet Barometers

	<u>As of 6/30</u>	<u>Prior Mo.</u>	<u>Prior Year</u>
Net Working Capital Position	750,000	700,000	500,000
Avg. Mo. Op Expense	358,750	358,750	297,500
Targeted W/C @ 2.5x	896,875	896,875	743,750
W/C Surplus (Deficit) vs. Target	(146,875)	(196,875)	(243,750)

Accounts Receivable Trends:

\$ Balances Over 90	40,000	35,000	70,000
% of Total Over 90	5.7%	4.7%	11.7%
\$ Balances 60 to 90	100,000	80,000	60,000
% of Total 60 to 90	14.29%	10.67%	10.00%
Turnover	4.76	4.27	4.00

“Dashboarding” Performance – An Illustration

3 of 3



Financial Dashboard

Six Months Ended 6/30/17

Money Maker Advertising, Inc.

Client Net Revenue Recap

Client	Current Mo. Actual	Current Mo. Budget	Current Mo. Var	YTD Actual	YTD Budget	YTD Var	Full Year Budget	YTD Actual % - Full Year
Acme Bicycle	25,000	41,667	(16,667)	150,000	250,000	(100,000)	500,000	30.0%
Bay Street Boogie Boards	110,000	100,000	10,000	660,000	600,000	60,000	1,200,000	55.0%
Caring Dog Sitters	0	5,000	(5,000)	15,000	30,000	(15,000)	60,000	25.0%
Deep Fried Health Foods	10,500	3,500	7,000	10,500	21,000	(10,500)	42,000	25.0%
Experts in Training	5,000	5,000	0	30,000	30,000	0	60,000	50.0%
Totals	150,500	155,167	(4,667)	865,500	931,000	(65,500)	1,862,000	46.5%

For a more complete revenue source analysis, prepare similar actual v.budget & variance review by discipline or agency service line.

Agency Financial Health Self-Assessment Blueprint

- Clearly Identify and Define YOUR Agency's Financial Bellwethers
- Outline a Manageable Reporting and Review Routine and COMMIT to It
- Finally,

Elevate the Significance of FINANCIAL AWARENESS in Your Organization

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