

# STUDIO MANAGEMENT BY THE NUMBERS

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**A**re your financials as elegant as your designs? Many studios have effective design and marketing processes. However, cost accounting and financial analysis are often seat-of-the pants endeavors or done using marginally effective methods. In this article I discuss the financial feedback you need to manage, build and expand your firm and profit from your work.



## Profitability Analysis

We can determine the profitability of your studio by using the following formula:  
 $\text{fee income} - \text{fixed costs} - \text{variable costs} - \text{selling expense} = \text{profit (or loss)}$ .

Fixed costs are those that do not vary with the amount of work being done in the studio. They include rent, insurance and some selling and administrative costs. They usually also include costs that we've fixed ourselves, such as permanent studio staff. Variable costs are all those costs that are job dependent, such as freelance labor, materials and samples.

It's usually better to have as few fixed costs as possible so you can scale all costs to the current level of studio activity. The same work may be able to be done by a salaried person or a freelancer. Freelancers are easily scalable to studio activity levels, while salaried personnel are not. You also have to pay the rent regardless of whether or not there is adequate work in the studio.

Your decisions to incur fixed costs should be considered carefully. Costly facilities and consistent permanent staff may be desirable and even add to the quality of your work. However, you need to understand the effect of their fixed nature on your profit. We all know that rent and payroll must be paid, even if we don't have enough business to afford it. Proper planning, budgeting and follow-through are, therefore, important to the process. Like a great recipe, they're the key to terrific results.

Another way to look at profit is:

$\text{fee income} - \text{job costs} - \text{overhead} = \text{profit (or loss)}$ .

Job costs contain the fixed and variable costs that go into a particular project. As previously described, they include salaries, materials and freelance services, as well as research, survey fees and other job-related expenses. In the short run, your overhead should decrease as a percentage of all costs, as fee income and job activity increase.

The aforementioned profit formulas provided plenty of grist for the discussion mill for accountants as well as economists. Therefore, as a designer, you should be aware that there are no set rules for their application. Overhead for design studios will on average be equal to design labor costs, depending on individual requirements. Each situation requires its own mixture, but your results will improve with experience.

An accountant with design studio experience is a valuable resource, helping you establish benchmarks as well as financial analysis templates tailored to the particulars of your studio. Your accountant can also develop systems to budget, estimate and determine your results; help you crunch the numbers and teach you to do the analysis that will provide the financial feedback you need. You can use the profitability formulas to gauge the results of your studio as a whole, by client or by project. My clients keep a job book that details the results of all jobs. The book is kept permanently and is continuously updated. It's used as a guide for budgeting and proposals for new work. These year-to-year comparisons are also helpful when evaluating the results of studio operations.

### **Proposals and Pricing**

We've all heard the caveat: Past results are not a guarantee of future performance. Well, if past results were bad, it's a good thing. If you've kept a job book, you now know what was good and bad in the past and, therefore, have the tools that are required to prepare proposals and budgets for the future. The best practices will help you prepare budgets and proposals that are always improving and keeping up with the changes in your operating environment.

There are some important questions to discuss as you prepare your proposals. Here are a few to consider when basing your price on prior jobs: Was my profit adequate in the past? Has my overhead increased or decreased? What changes are there in my variable costs?

Critical concerns include overhead, staffing costs and other direct costs, such as prototypes and models. The concept of staffing and other direct costs is relatively intuitive. However, it's important that you remember to consider that all fixed costs will be absorbed by your jobs. If you run one job during a given period, it will absorb all the fixed costs incurred during that time; if you run 10 jobs during a period, they will share all the fixed costs. Therefore, the more jobs you can complete during a given period, the lower your fixed costs per job will be. And the lower your total costs are, the higher your profit.

Changes in fixed costs can include rent, machinery and equipment acquisitions, and the addition of salaried (versus freelance) labor. Variable costs, such as direct labor and materials, usually change more frequently with going market rates.

### **Concentrations and Risk**

My own accounting firm began with the signing of a couple of the proverbial "big accounts." (One was a well-known and respected design firm.) I now had a firm of my own, my name on the door and enough business to earn a living. I couldn't be happier. But of course, as loyal as any firm's client base is, turnover is inevitable.

As I built my firm, I expanded my client base with a target principle that no individual account would exceed 20 percent of billings. I have found that this strategy works well for design firms, too, and I encourage you to follow it when possible. It's

healthier for your studio when clients do not have too much leverage. The loss of a large percentage of business can be devastating. The demands of clients with an undue amount of influence can also have a negative effect on the operation, growth and working environment of your studio.

The best management accounting systems operates as simply as possible while providing timely and relevant financial information. Some studio managers and owners have an intuitive sense for cost and profitability. A properly structured system will add accuracy and credibility to back-of-the-envelope calculations. For those less inclined, a well-designed system will provide you with the tools to maintain built-in profitability.

The bottom line? Time is money. A well-designed financial system will give you more time to develop and market the innovative products that surround us.