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## PRACTICE MANAGEMENT DIGEST



This issue of the PM Digest is sponsored by:

### Letter from the Editor

By David B. Richards, AIA

In this issue of the Practice Management Digest we consider the value of an architect's services from several points of view. We start with an article by Frank Stasiowski, FAIA of PSMJ Resources that explores *Why Value Pricing is the Only Way to Survive*. In the article Frank notes that only about half of design firms still "sell hours" (down from 90%,) as opposed to the often more profitable, value based lump-sum agreements. From another point of view, in his article titled *Is Commoditization a Problem? Or a Potential Opportunity?*, Rich Friedman of Friedman & Partners discusses the commoditization of architectural services and the positive impact of differentiating your services from your competition, even in a commodity type market. A link to Deltek's *Clarity Architecture and Engineering Industry Study* is also provided. As the value of services is considered, understanding performance averages can help us all determine our position in the market.

Value is also considered from the perspective of how we solve problems. Rich Friedman of Friedman & Partners explores how we handle adversity and how we add value with a culture that makes the most of a bad situation in his article, *Culture Matters: Is Yours 'CYA' or 'Embrace the Problem'?*. Our staff is key to providing valuable services. The recent a/e ProNet Scholarship Competition asked the question, "What are the qualities that would make this firm a likely choice for those in the millennial generation?" The

As the Practice Management Knowledge Community, our mission is to advance the practice of architecture through discovering, generating, organizing, and sharing insights, resources, and tools that enable architects to practice more effectively.

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respondents were generally millennials, telling us what is important to millennials when they are seeking employment. David Richards, AIA of ROSSETTI has compiled a summary of the responses in the article, *Attracting Millennials*.

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## Features

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### Why Value Pricing is the Only Way to Survive

*By Frank Stasiowski, FAIA*

In order to stay competitive in today's marketplace, design professionals must price their design services according to value, not cost. Who do you think is better prepared to survive into the 2020s: the cut-rate shop, or the one that offers service and value so extraordinary it has to turn customers away?

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### Is commoditization a problem? Or a potential opportunity?

*By Rich Friedman, Friedman & Partners*

Everywhere I go, it seems, I'm privy to what is becoming a never-ending debate: whether A/E/C and environmental consulting services are becoming commoditized. Is this ongoing debate on whether we are in a race to the bottom helping—or hurting—the industry?

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### Deltek Clarity A&E Industry Study

*Megan R. Miller, part of the Deltek's A&E Clarity team, is a senior product marketing specialist with Deltek, Inc.*

The Deltek Clarity Architecture and Engineering Study provides a comprehensive resource on financial performance and market outlook for A&E firm leaders. For the 36th edition, study topics were expanded to include business development and project management. The metrics developed from the survey provide a good basis for comparing the key financial performance indicators of a firm with those of the industry; especially high performance firms.

[Read the 11-page summary »](#) or [Get the full report »](#)



The information in the report is enhanced with broader participation. You can join Deltek as they put together the the 37th Annual Deltek Clarity annual study. The study will detail A&E firm project management, financial and business development performance in 2015. Register at this link and Deltek will contact you for updates on the report: <http://more.deltek.com/2016-Clarity-AE-Industry-Study>

### Culture Matters: Is Yours 'CYA' or 'Embrace the Problem'?

*By Rich Friedman, Friedman & Partners*

The strongest firms out there are those who are not only prepared to respond when things go wrong, but welcome and create the opportunity. After years of seeing this play out, I know one of the best things that you as a leader can do for your firm is to instill a culture of viewing problems as opportunities. In this article, I share two examples of how it's done.

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& PARTNERS

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## Attracting Millennials

*By David B. Richards, AIA*

This past year's a/e ProNet Scholarship Competition asked applicants to share how firms can attract millennials to their workforce in the midst of current hiring challenge. Most of the responses noted that a strong web and social media presence, a meaningful work experience, opportunity for growth, brand and environment were the things that would attract them to a firm.



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## Contribute to the Digest!

The next issue of the Practice Management Digest will discuss Business Development issues and approaches. Led by Karen Courtney, AIA, FSMPS, several Fellows of the SMPS will share insight to capture planning, the importance of PM's bringing in work, working with non-technical BD professionals and BD for start-up firms.

We are developing the editorial calendar for the Practice Management Digest for 2016/17 and would like to hear from you. If you have topics related to practice management that you would like to see explored or articles that you would like us to consider, please contact David Richards, AIA at [drichards@rossetti.com](mailto:drichards@rossetti.com).

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## Best Practices

The Best Practices are a compendium of relevant knowledge gained from experience that is immediately applicable to a task at hand. The articles are distilled to their essentials, packed with usable information, linked to related resources and kept relevant and up-to-date by inviting feedback from practicing professionals.

### Securing Credit for Your Work -- BP 06.03.10

Securing basic credit and even modest visibility for design projects is a frequent frustration for architects. If your firm does not have the resources for a high-impact publicity campaign, a few simple steps can still help you receive appropriate credit. The process does not have to be time-consuming or expensive, but it does require a little creativity and follow-through.

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### Monitoring Earned Value -- BP 10.03.06

Best Practices are freely contributed articles written by practicing professionals, allied professionals, strategic partners, and industry consultants. The Best Practices are an opportunity for AIA members and other allied professionals to contribute to the advancement of the practice of architecture and the profession. As noted above, the intent is that they be kept relevant and up-to-date. In other words, each article should be viewed as a living document, and additional, timely and relevant articles are constantly needed. This Best Practice provides information on how to submit an article.

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## News and Events

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### David W. Lakamp a/e ProNet Scholarship

**Applications due March 1, 2016**

Initiated by a/e ProNet in 1990, this scholarship was renamed for David W. Lakamp in honor of his legacy of professionalism and integrity in the field of insurance services. Are you an architecture student pursuing a NAAB accredited professional degree program? Apply now for this scholarship focused on real world issues in risk management.

[Apply Now at bit.ly/pmkcpnetlink »](http://bit.ly/pmkcpnetlink)



**2016 Call for Applications**  
Deadline: March 1, 2016

**a/e ProNet  
David W. Lakamp  
AIA Scholarship**

**Apply: [bit.ly/pmkcpnetlink](http://bit.ly/pmkcpnetlink)**  
Questions: [pmkc@aia.org](mailto:pmkc@aia.org)

### Webinar: Continuing Challenges of Employment Practices



**February 10 at 1:00 pm EST | Earn 1 AIA LU | [Learn more »](#)**

A one-hour webinar sponsored by the AIA Trust in conjunction with Victor O. Schinnerer & Co. will address how architecture firms should handle the complexity of their employment conditions and practices. Hear about the current rules and latest case law that guide professional service firms in their treatment of employment conditions and practices.

### Webinar: The Business Model of Custom Tools

**February 16 at 2:00 pm EST | Earn 1 AIA LU | [Learn more »](#)**

This seminar will explore how AECO firms are developing custom-built tools to improve the design, construction and management of buildings. The expansion of bespoke technology solutions has created new business markets where offices can sell and support proprietary tools and processes to the broader design and construction industry. Examples drawn from practice will illustrate how the development of these tools has provided new business opportunities through innovation in

architectural practice.

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## Why Value Pricing is the Only Way to Survive

*By Frank Stasiowski, FAIA*

In order to stay competitive in today's marketplace, design professionals must price their design services according to value, not cost. This is a concept known as value pricing. In value pricing, price is determined partly by the value the client perceives in the service to be delivered, and partly by your cost and profit considerations.

Value pricing doesn't mean low-ball pricing—that's a losing strategy. In fact, more than 40 percent of your competitors have raised their prices in the last 12 months, and they're getting what they ask for. Who do you think is better prepared to survive into the 2020s, the cut-rate shop, or the one that offers service and value so extraordinary it has to turn customers away?

If you aren't one of those shops, then your firm will flounder in this decade unless you are willing to change. Doing the same old design work and charging clients the same old way, for the same old level of profit (or less), is simply a path to doom.

You must be prepared to radically realign the way you do business, if you are to succeed into the 2020s.

### **The Successful Design Firm of the Future: What's in, What's Out**

Value pricing isn't obvious at first glance. No A/E firm declares itself a "Value-Priced Shop," and no client says "This job's important to us and we're willing to pay value prices." Instead, value pricing is the "secret sauce" that enables one A/E firm to prosper over another.

The future is yours to control, but only if you aggressively mold your pricing, business development, and service structure using the tactics necessary to prosper in this decade. Your firm must develop a strategy for its own prosperity that does not knuckle under to economic and societal forces, but takes advantage of them.

**Isolation is Out. Alliances and Networking are In.** If there is a firm that has an absolute lock on a given practice and in a given geography, I don't know of it. The traditional design-bid-build model is giving way to more collaborative models like design-build, integrated product delivery (IPD) and public-private partnerships (P3)s. Designers and engineers are on equal footing, sharing risk, rewards, accountability and liability. Smaller, specialized firms are making alliances with larger ones.



**Consulting is In, and Traditional A/E Practice is Out.** The 2010s and 2020s will see successful firms move out of design production and into client consulting. Firms that have weathered the economic storms of the last 20 years did so in part by tackling a variety of smaller, more “non-design” study projects helping clients in hundreds of ways heretofore unheard of by most design professionals.

**Chameleons Will Prosper.** Clients’ demands and the rapid shifting of market needs have propelled a new breed of design professionals into existence in the 2010s and 2020s. The “chameleon firms” capable of switching services, people, markets, and geography are emerging as the firms of first choice. This is not a matter of trying to be all things to all people, which is a losing strategy. Nor am I denigrating the power of finding a niche; every firm should have a niche, a market or service in which the firm is the clear expert and the de facto choice for clients. Rather, a chameleon firm adapts its strategies to invent a continual stream of new services for clients, and attunes its strategies to every whim of their clients.

**Time-Plus-Cost is Out.** About half of design firms still operate on a time-plus-cost basis, and that model is doomed. Efficiency killed it. Every best practice we developed and every productivity tool (e.g., computer-aided design [CAD] and building information management [BIM]) enabled us to work faster, which means fewer hours to sell on a given job. That in turn has created a time pressure from clients who know how productive a firm can be, so expect faster and faster delivery.

While about half of firms still sell hours, that is considerably down from the early 1990s when about 90 percent of them did. The other half (and generally the more profitable half) has moved on to lump-sum agreements. Among those firms is a small but growing number that are bold enough to turn away clients who refuse to sign those agreements. They can afford to be that bold. They are full-service consultants who provide inarguable value. Fortune favors the bold, quite literally.

**Fewer Firms, Shifting Share, Strength in Networks.** The number of design firms is shrinking. In the five-year period leading up to 2013, it plummeted from 150,000 to 138,000 (U.S. Census Bureau statistics). With about 1.3 million employees across 138,000 firms, those firms have an average of nine employees. That suggests a high number of sole proprietors and small shops, but these are not minnows, swimming among sharks.

With no more overhead than a high-speed Internet connection, and broad networks of contacts from which they can cherry-pick talent for a given project, sole proprietors and micro-shops are well-equipped to design a perfect team and snatch clients away from a larger, more bureaucratic shop.

They successfully sell the idea that their small size means more value to the client. For the price-sensitive client, a small firm with its minimal overhead (perhaps it has gone virtual and has no office) can handily underbid a larger, overburdened competitor. Clients value small-firm responsiveness and speed, and pay for it.

**Trust is All.** Clients are not cheap; they are willing to pay for excellent design and service. But their criteria for excellence are high, and include predictable cost and delivery. Delivering value ensures success, and predictability (and by extension, trust) represents value to a client.

Service is no longer just an essential element for the small firm; in order to stay competitive, firms of every size must provide nearly incredible levels of service to their clients.

When you're valued, you can charge more because clients know that you're top-notch, that you deliver, that the service you provide is far beyond that of any competitor around. That's because you've done the research to make sure it is.

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*About the Author: In his 35+ years leading PSMJ Resources, Frank Stasiowski, FAIA has authored dozens of books and manuals serving the business needs of the A/E industry, including eight best sellers on management. His recently re-released The Value Pricing Imperative for Design Firms details what A/E firms need to do to develop and implement a competitive pricing strategy today, and in the future. In addition to being the Founder and CEO of PSMJ, he is a frequent speaker at numerous prestigious A/E industry events on matters such as project management, marketing and business development, strategic planning, and more.*

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## Is commoditization a problem? Or a potential opportunity?

*By Rich Friedman, Friedman & Partners*

Everywhere I go, it seems, I'm privy to what is becoming a never-ending debate: whether A/E/C and environmental consulting services are becoming commoditized. In this issue of the *Friedman File*, I want to explore this topic in a different way.

First off, when we say the industry is becoming commoditized, what do we really mean by this? Is it a perception that clients see firms and services as identical except for the price? Is this true, and if so, is standardization always a negative thing? More important, is this ongoing debate on whether we are in a race to the bottom helping—or hurting—the industry?

Dan Rowe, president of 95-person **Treanor Architects** (Lawrence, KS) doesn't think it's helping. "I think our industry's preoccupation with commoditization has turned into a crutch for some firms," Rowe says. "It's an excuse for losing and a reason why they have not found a way to differentiate their firm."

Every customer, no matter what they are buying, wants to get good value, and fees are an inevitable part of that discussion, says Rowe. You need to price your services competitively, based on the value that you provide.

"Commoditization is a red herring in our industry because it implies that the client gets less value by certain aspects of the marketplace being more standardized or cost-driven," says Alissa Rupp, President of 50-person design firm **The Portico Group** (Seattle, WA). "I'm not certain that's the case."

### **Making commoditization work for you**

There are highly successful firms that decide to play in so-called commoditized market sectors, and there are successful firms that leverage commodity pricing as a way to provide value to their clients.

For example, when designing a zoo, The Portico Group must meet clear standards for animal holding facilities. Sometimes, those elements can be achieved by a pre-manufactured building. "We might get less fee, but we spec that building instead of designing it, using our expertise to determine the specifications," says Rupp. That frees up dollars for the client to focus on the segments of the project where a customized design will have greater value, she says.

There's no doubt that commoditization is real, says Eric Nichol, president of 600+-person engineering and infrastructure firm **Moffatt & Nichol** (Long Beach, CA).

"Price matters. As more people can do the work, clients become more cost-conscious," says Nichol. "Cash flow and capital budgets aren't what they used to be, so I understand the client focus on price."

However, that's not necessarily a bad thing. Competing for price-sensitive work can help firms improve cost effectiveness and efficiency in *all* of their work, benefitting the firm as a whole, he says. It can also help a firm dig deep to discover which other professional services their clients are willing to pay a premium for. It's a strategy that Moffatt & Nichol has employed in its work with ports and marinas, becoming one of the world's largest specialized maritime planning and engineering firms and cementing their role as a trusted advisor to modern ports.

When wharf engineering services became increasingly price-sensitive, Moffatt & Nichol decided to move up the value chain by adding planning for ports. Soon, they recruited economists to their staff and developed an economics and financial forecasting group. More recently, as clients were asking how to make container terminals more efficient, the firm hired programmers to create specialized operations simulation software.

Of course, providing multiple services can create conflicts, so it's important to be strategic about your goals and about which work you pursue.

"It's not typical for a heavy infrastructure firm to have economists or programmers, but the more services we offer, the more trust we build," says Nichol. "If we do just structural engineering, we won't be unique. Now, we're often dealing with decision-makers beyond those who would hire us for straight engineering. We are no longer a 'me-too' firm."

### **Ask a better question**

As with many things in business, the experience you're having— and the results you're achieving— can depend on which questions you're asking.

"Rather than asking how to avoid commoditization, we should be asking, 'How true are we to our brand?'" says Rowe.

Do clients understand your firm's brand? How is that being communicated to them? Where is your firm providing added value and expertise worth paying for?

Rupp suggests taking a hard look at why clients are choosing a lower fee consultant. Can the quality and service required be provided without a customized design? Is it because there is insufficient money to warrant spending on customized designs? Is it because there's so much competition that the market is flooded and competitors will potentially undercut your price?

Nichol suggests listening to clients. What do they need? How can you provide a service that will solve their next problem? "If you listen to your clients, they are always telling you what they need," he says. "You can't be afraid to broaden the services you provide to them."

If you're gnashing your teeth about being in a market that's cost-driven, it's essential to analyze why, not spend your time bemoaning why someone else is charging a lower price. It's time to look at what needs to change.

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*About the Author: Rich Friedman is Founder and President of Friedman & Partners, a marketing and management consultancy that crafts and implements growth strategies for A/E/C firms. Reach him at [rich@friedmanpartners.com](mailto:rich@friedmanpartners.com) or 508.276.1101.*

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**Deltek** Know more.  
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# Architecture and Engineering Industry Study

36<sup>TH</sup> ANNUAL COMPREHENSIVE REPORT • 2015

# Executive Summary

The *Deltrek Clarity Architecture and Engineering (A&E) Industry Study* is the oldest and longest-running study of its kind. This study provides the industry's most comprehensive resource on financial performance and market outlook for A&E firm leaders.

For the 36<sup>th</sup> edition, we expanded the study topics to include business development and project management. This report is based on 2014 fiscal year data provided by 386 U.S. and Canadian architecture and engineering firms. The study was conducted in collaboration with the American Council of Engineering Companies (ACEC), Association of Consulting Engineering Companies | Canada (ACEC Canada), and the Society for Marketing Professional Services (SMPS).



## Financial recovery steady, but room for improvement

Almost every A&E financial indicator improved again in 2014, but five years into the current economic recovery, the industry has yet to return to its pre-recession financial strength. To get to the next level, leaders will need to pay attention to financial metrics that still have considerable room for improvement. Most key performance indicators inched ahead in 2014, but the rate of improvement is slowing. Operating Profit rose to 11.8%, the Utilization Rate increased marginally to 60%, and the Overhead Rate dropped to 160%. The Net Labor Multiplier declined slightly to 2.97. In addition to optimizing the traditional KPIs, A&E firms should keep a close eye on the rise in Total Employee Cost, Employee Turnover, and Fixed Asset investments.



## Firms challenged by competition, limited time for business development

A&E firm leaders are quite optimistic about their prospects in 2015, but will only be able to turn their projections into reality by implementing effective business development strategies and addressing the industry's greatest business development challenges—competition and limited time. Earlier and better identification of opportunities and strategic networking for teaming are two ways that firms are meeting today's challenges. Win Rates have increased in the last two years in nearly half of firms. While the "seller-doer" model of business development is alive and well in the A&E industry, use of dedicated business development staff is widespread, especially in large firms. A&E firms believe the Water/Wastewater/Storm Water, Commercial, and Roads & Bridges markets will be the hottest in the coming year.



## Project management pitfalls point to big bottom-line impact

For the first time, this year's Clarity study examined the A&E industry's best practices in project management, and the results reveal a mixed report card for project data accuracy and visibility and project management maturity. Accurate project cost forecasting (52.3%) and collaboration and communication (47.4%) were the top ranked project management challenges. In the average firm, only 75% of projects were currently on or under budget. Nearly a third of participants said their project management capabilities are somewhat or very immature. The average A&E firm has 37% of its revenue tied up in just three clients.

# About the Deltek Clarity Architecture and Engineering Industry Study

A total of 386 U.S. and Canadian Architecture and Engineering firms submitted a valid response to one or more sections of an online survey conducted between February and April 2015. Of these responses, 347 firms submitted a valid response to all of the sections. Where possible, this year's responses were aggregated with data from past Clarity studies to analyze trends.

## Firm Type

We use the term Architecture & Engineering (A&E) to refer to *all* Architecture, Engineering, and allied design firms included in the study. We also break out two broad segments for comparison:

**Engineering (E) or Engineering/Architecture (E/A)** firms are either pure consulting engineering firms or engineering dominant firms that also provide architectural services. E/A firms are also known in the industry as "big E, little A" firms. In this edition, 62.5% of participants are Engineering or E/A firms.

**Architecture (A) or Architecture/Engineering (A/E)** firms are either pure architectural design firms or architecture dominant firms that also provide engineering services. A/E firms (not to be confused with A&E, which refers to all design firms) are also known in the industry as "big A, little E" firms. In this edition, 27.7% are Architecture or A/E firms.

**Other** refers to the many firms in the industry that don't fit into the traditional definitions of A or E. This year, 9.8% of participants are other types of design or consulting firms, including landscape architecture, interior design, and environmental consulting.

## Firm Size

When looking at the size of the participating firms, 45.0% are small firms (1–50 employees), 45.8% are mid-sized firms (51–250 employees) and 9.2% are large firms (251+ employees).

## High Performers

As in past Clarity A&E studies, we broke out a group of High Performers for additional analysis. We started with firms that have a Net Labor Multiplier of 3.0 or higher and an Operating Profit rate of 15% or higher (pre-tax, pre-bonus on net revenues). High Performers constitute 25.5% of all participants. Throughout this report, we contrast High Performers with "All Other Firms," which consists of all participants *except* High Performers, and which should not be confused with "All Participants."

## Study Notes

When we refer to "average" in this report, we use the median value, which is the middle of the data set—half the firms are higher and half are lower. Top Quarter and Bottom Quarter refer to the top and bottom quartiles—25% of firms were equal to or higher than the top value, 25% were equal to or lower than the bottom value, and 50% fall between the two.

Per employee ratios for Income Statement items are calculated using the average number of employees during the year, while per employee ratios for Balance Sheet items are calculated using the number of employees at the end of the year.

## Data Profile

At the end of the report are comprehensive tables including all the financial metrics from the study broken down by firm size, type, and performance.

## SECTION ONE

# Finance & Accounting

## Introduction

The Architecture and Engineering industry's slow, sustained recovery from the worst recession since the Great Depression continued in 2014, and growth has firmly taken root after years of struggle. The proof is here in the 36<sup>th</sup> annual *Deltek Clarity A&E Industry Study*.

Yet while A&E firms have much to celebrate, our study also found that five years into the current economic recovery, the industry has yet to return to its pre-recession financial strength. A&E firms have a positive outlook for 2015, but in order to achieve their desired results, leaders will need to pay attention to several financial metrics that still have considerable room for improvement.

Operating Profit increased for the fifth consecutive year, reaching 11.8%.

Net Labor Multiplier, Total Payroll Multiplier, and Utilization have all recovered from recession lows.

Average Collection Period remains high at 75 days, seven days slower than it was 10 years ago.

The average Employee Turnover rate jumped almost two percentage points in 2014.

## Key Performance Indicators Rising, Still Room for Improvement

Based on Deltek's analysis of detailed income statements and balance sheets from hundreds of U.S. and Canadian A&E firms, the industry's Key Performance Indicators look better almost across the board. Operating Profit, Utilization Rate, Net Revenue per Employee, Total Payroll Multiplier, Staff Growth, and Average Collection Period all showed year-over-year improvements. Meanwhile, balance sheets also grew stronger on average, with better Return on Equity and steady Debt to Equity ratios.

A closer look at the data reveals, however, that some flattening of Key Performance Indicators is beginning to occur, and several metrics remain stubbornly short of their 10-year highs:

- The Net Labor Multiplier remains stuck below the 3.0 threshold achieved in the years before the recession.
- The Total Payroll Multiplier has been relatively flat since 2011, fluctuating between 1.74 and 1.77, off from its 10-year high of 1.84.
- Although the A&E industry's Utilization Rate of 60.0% is at its highest point since 2006, it still lags its 10-year high of 61.5%.
- A&E firms reported improved profitability for the fifth consecutive year, but at 11.8% it is still short of the 13.9% reported in 2006.

## Improvements Needed to Meet 2015 Goals

Study respondents are optimistic about their prospects for growth in 2015 and forecast that their Operating Profit rate will match the 10-year high of 13.9%. However, based on the experiences of Deltek's industry experts, firms will have difficulty achieving their ambitious goals without improvement in several financial performance metrics that remain industry weak spots.

Average Collection Period, for example, remains poor at 75 days—seven days slower than it was in the mid-2000s. Even worse, nearly a quarter of firms have Average Collection Periods greater than 100 days. The good news is that Average Collection



Period is one metric that firms have considerable control over. By improving their capacity to quickly prepare and track invoices, streamline cumbersome approval processes, alter ineffective collection efforts, and speed up communication with slow paying clients, firms can significantly reduce average collection days which increases working capital and reduces the need to borrow. The quarter of study respondents that have Average Collection Periods below 58 days prove that significant improvement is achievable.

Net Revenue per Employee, an excellent indicator of a firm's operating performance, hit an all-time high in 2014 at \$129,689, after increasing for the third year in a row. When adjusted for inflation (U.S. CPI), however, the news is not as rosy since the figure would need to have been \$140,899 to match the previous high from 2008. Increasing fees is one strategy A&E firms can pursue to drive Net Revenue per Employee higher, although that can be difficult in extremely competitive markets. Another is to improve talent management in order to recruit, retain, and develop more productive workers who can push Utilization Rates higher.

### **Fixed Asset Investments, Employee Turnover Will Require Vigilance**

As the A&E industry continues to invest in increasingly sophisticated computer systems, software, and field equipment, firms will need to place a greater premium on asset management and keep a more watchful eye on their total fixed asset expenditures, which averaged \$6,922 per employee in 2014. In addition, beyond simply payroll and

bonuses, A&E firm leaders will also need to monitor their payroll taxes and group health/life insurance, which made up 16.3% of Total Employee Costs in 2014. Group health/life insurance expenditures have been on the rise, increasing 12.2% from 2012 to 2014, and tracking health care expenses will take on greater importance in 2015 as the Internal Revenue Service begins to require employers to report on the status of health care coverage of their employees.

As industry optimism grows and unemployment rates continue to fall, A&E professionals are feeling more secure and willing to jump ship, either to another A&E firm or outside the industry. One study found that 51% of workers who currently have a job are either actively seeking or open to a new job. The talent war is heating up once again, as seen in the rise of Employee Turnover among study respondents to 13.7% in 2014 from 11.8% the prior two years. Employee Turnover is costly in terms of lost productivity, management time, training dollars, and recruiting fees, so forward-thinking firms will need to keep a close eye on this metric while improving retention by investing in training and talent management systems.

Rising chargeability has contributed to the recent drop in the A&E industry's Overhead Rate, which in 2014 registered its lowest number (160.0%) since the beginning of the recession. However, if the industry drives down its Overhead Rate at the expense of proper investments in capital, employee benefits, marketing, and training, it will find its long-term financial health at risk and, ultimately, its ability to finally return to pre-recession levels in jeopardy.

**Study respondents are optimistic about their prospects for growth in 2015, but will have difficulty achieving their ambitious goals without improvement in several financial performance metrics that remain industry weak spots.**

## Operating Profit on Net Revenue

2014 Average

**11.8%** +0.7

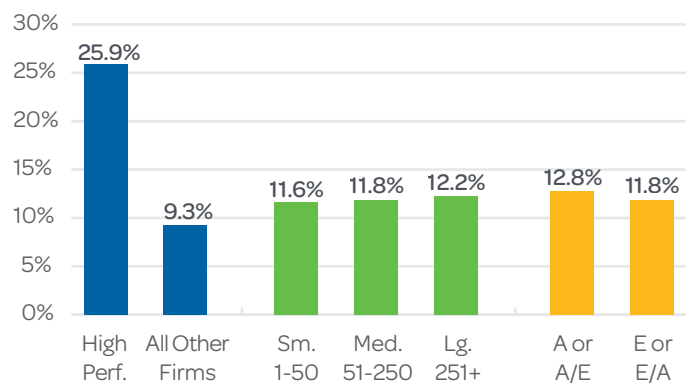
Operating Profit (pre-tax, pre-bonus) on Net Revenue is generally the preferred measure for an A&E firm's profit rate because it omits pass-through expenses from the top line as well as taxes and discretionary distributions from the bottom line.

Operating Profit rates have been rising for five years now at a very steady rate, but have yet to reach their pre-recession highs. Profits were slightly higher for Architecture and A/E firms than Engineering and E/A firms, and also a bit higher for large firms than small firms. Firms whose primary contract type was fixed fee had an average profit rate nearly four percentage points higher than firms whose primary contract type was hourly (13.2% vs. 9.4%). The most profitable firms in the study again achieved operating margins greater than 40%.

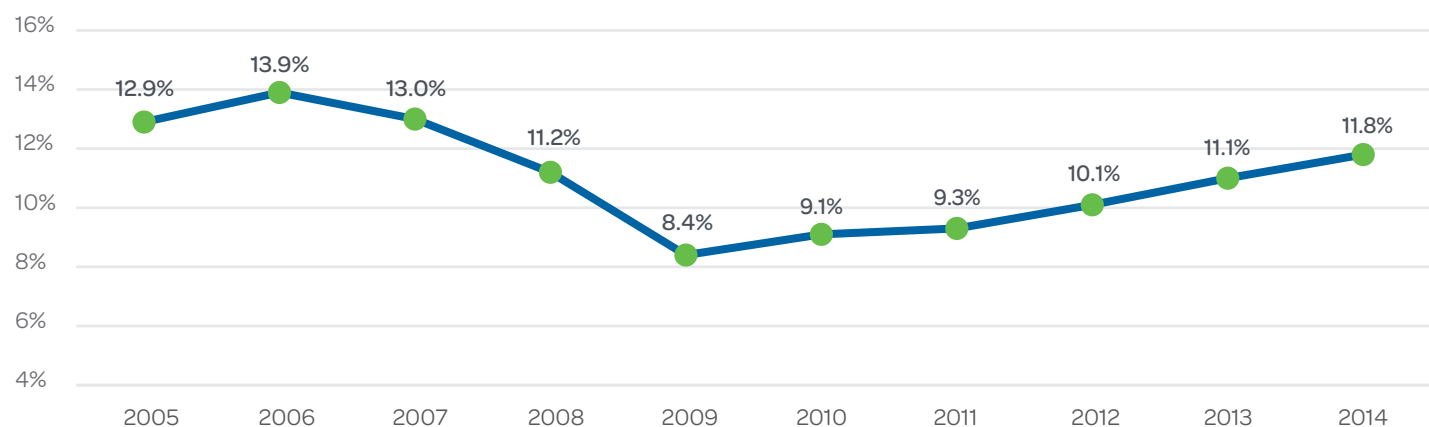
*Operating Profit on Net Revenue is calculated by dividing pre-tax, pre-distribution profit by Net Revenue (total revenue minus consultants and other direct expenses, both billable and non-billable), and multiplying by 100.*

	2014	2013
Top Quarter	18.7%	17.8%
Average	11.8%	11.1%
Bottom Quarter	6.2%	5.2%

### How Firms Compare



### Ten-Year Trend



## Utilization Rate

### 2014 Average

**60.0%** +0.6

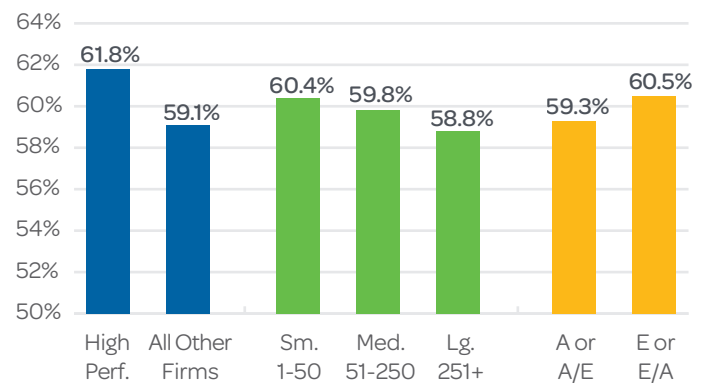
The Utilization Rate (also known as Chargeability) measures the percentage of total staff labor charged to billable projects. Although some A&E firms track utilization on hours or remove vacation, holiday, sick, and other paid time off, measuring by dollars and including paid time off shows the clearest picture of labor cost utilization and has become the industry standard. Utilization Rates may be subject to “gaming” by employees and managers, depending on the incentives in place.

Utilization inched ahead in 2014, but in the bigger picture has been stuck in a 1% range for three years now. Half of participants were between 55% and 65%. In past recoveries, average utilization has risen as high as 65% in 1999 and 2000 and 61.5% in 2005. There were no dramatic differences in utilization by firm size or type, although small firms had slightly higher utilization than mid-sized or larger firms. High Performers had higher utilization rates than other participants.

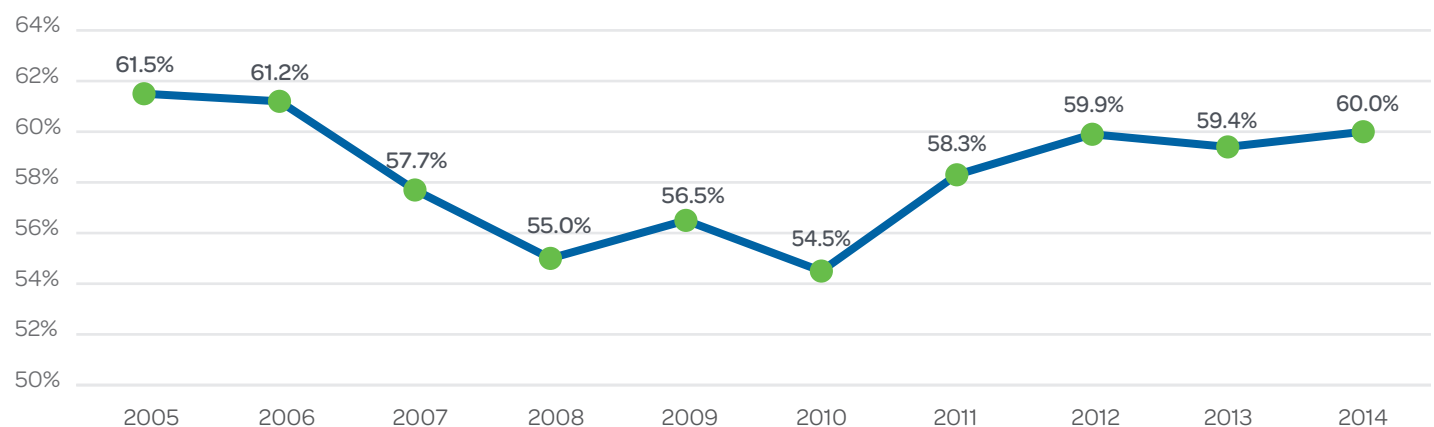
*The Utilization Rate is calculated by dividing the cost of Direct Labor (labor charged to projects) by the total labor cost of the firm, and multiplying by 100.*

	2014	2013
Top Quarter	65.4%	65.0%
Average	60.0%	59.4%
Bottom Quarter	55.8%	54.9%

### How Firms Compare



### Ten-Year Trend



## Net Labor Multiplier

### 2014 Average

**2.97** -0.02

The Net Labor Multiplier is a measure of the actual mark-up on labor costs. It should not be confused with the "Target Multiplier," which is a firm's goal (but not actual) for labor mark-up. Within a typical A&E firm, Net Labor Multiplier and Utilization Rate usually work in opposition; when one goes up the other goes down. The exception to this rule seems to be during the early phase of a recession or a recovery.

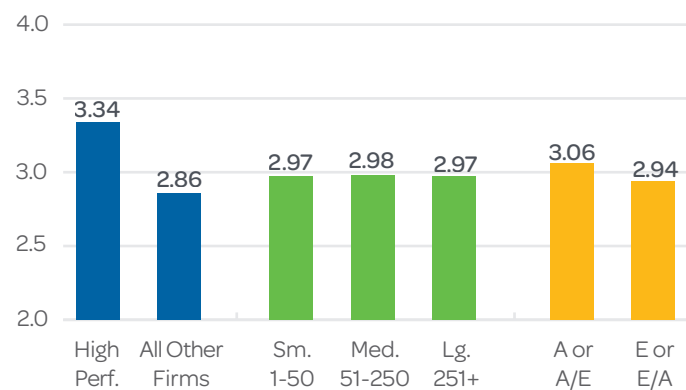
True to form, the average Net Labor Multiplier dipped a bit in 2014, while Utilization rose slightly in counterbalance. Last year, the story was the opposite, but neither change was very significant and it seems that firms are settling into this level of productivity for now. Half of firms were between 2.73 and 3.31, a range that hasn't varied much in the last three years.

Net Labor Multiplier was much higher than average in High Performers, of course, since high multipliers are built into our definition of high performance.

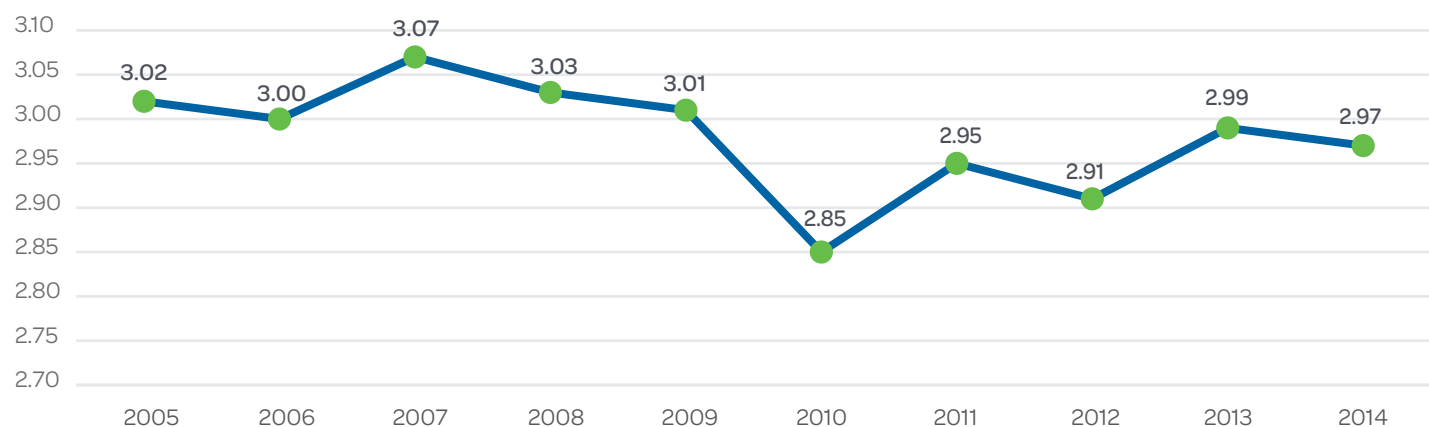
*The Net Labor Multiplier is calculated by dividing Net Revenue by Direct Labor, the cost of labor charged to projects.*

	2014	2013
Top Quarter	3.31	3.27
Average	2.97	2.99
Bottom Quarter	2.73	2.73

### How Firms Compare



### Ten-Year Trend



## Total Payroll Multiplier

### 2014 Average

**1.77** +0.03

Total Payroll Multiplier is the most consistent single indicator of an A/E firm's operating performance. By directly relating revenue to total labor, it cancels out the push and pull between Utilization and Net Labor Multiplier and shows how efficiently a firm converts labor to revenue.

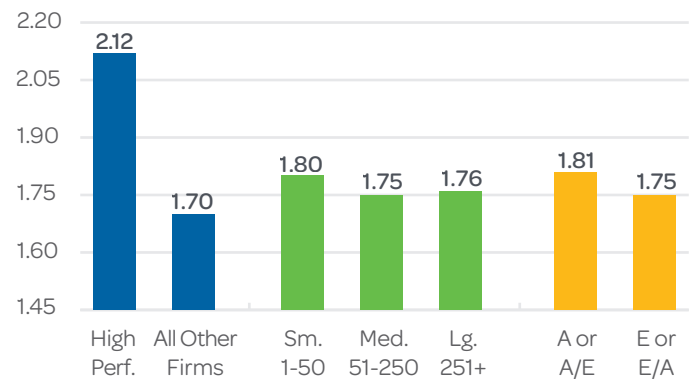
Total Payroll Multiplier increased to 1.77 in 2014, but hasn't advanced significantly since 2011. Based on historical data, there is still room for improvement in the Total Payroll Multiplier, if firms can overcome competitive pressures on fees and improve resource planning and project management.

As we've seen in past Clarity studies, firms with higher than average Total Payroll Multipliers includes High Performers, small firms, and Architecture or A/E firms.

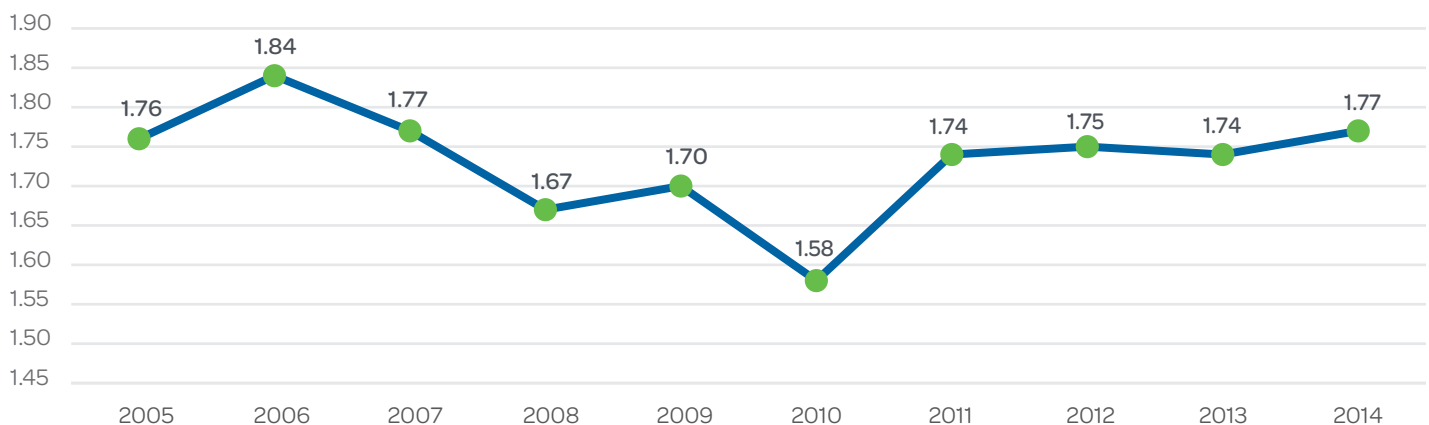
*The Total Payroll Multiplier is calculated by multiplying Utilization by Net Labor Multiplier, or by dividing Net Revenue by Total Labor.*

	2014	2013
Top Quarter	1.93	1.94
Average	1.77	1.74
Bottom Quarter	1.63	1.61

### How Firms Compare



### Ten-Year Trend



## Overhead Rate

### 2014 Average

**160.0%** -1.1

The Overhead Rate (excluding bonuses) shows the relationship of a firm's non-chargeable costs—including non-billable professional time, facility costs, and corporate expenses—to Direct Labor. When it comes to firm-wide Overhead, lower is generally better.

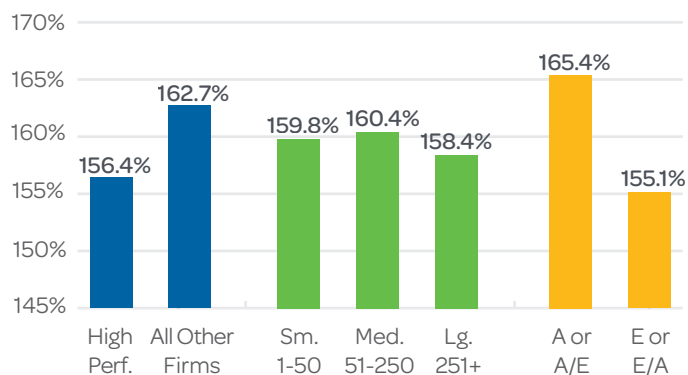
The Overhead Rate was virtually unchanged in 2014, and we're not seeing any indication that it's returning to the 150% levels. The largest component of overhead is indirect labor, so firms will need to continue improving utilization, while watching corporate overhead and employee benefit expenses.

Overhead Rates were surprisingly consistent across different size ranges this year. Engineering or E/A firms were lower than Architecture or A/E firms. High Performers had lower than average Overhead.

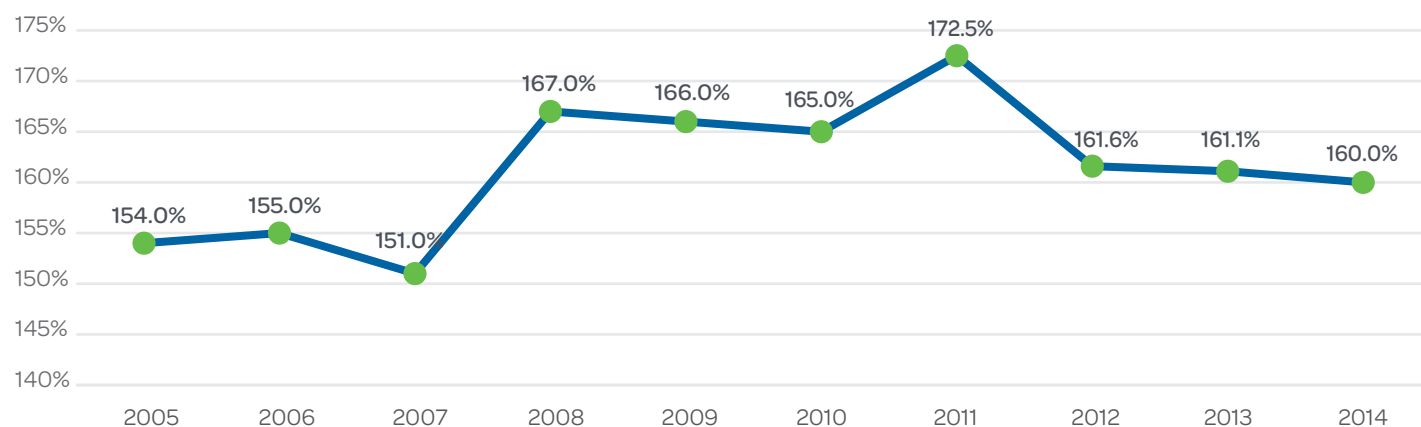
*The Overhead Rate is calculated by dividing Total Overhead (before distributions) by Total Direct Labor Expense, times 100.*

	2014	2013
Top Quarter	184.7%	183.5%
Average	160.0%	161.1%
Bottom Quarter	134.0%	135.2%

### How Firms Compare



### Ten-Year Trend



## Net Revenue per Employee

2014 Average

**\$129,689** +2,591

Net Revenue per Employee is an excellent indicator of a firm's operating performance compared to its peers. High Performers almost always have higher revenue per employee and this year is no exception. In addition, this number should generally rise over time with inflation.

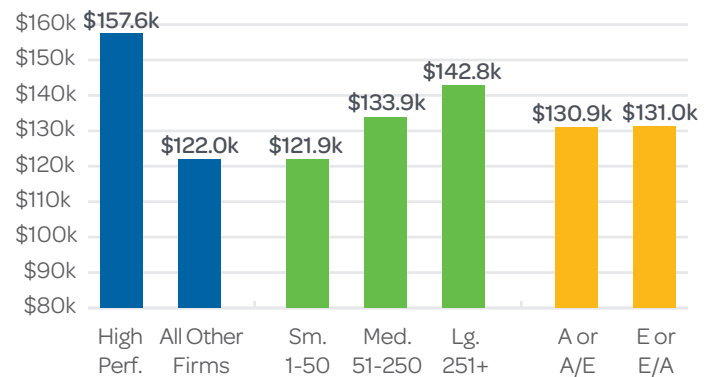
Net Revenue per Employee rose for the third year in a row to \$129,698, but adjusted for inflation it is still below its pre-recession highs. This ratio can vary among firms from less than \$100,000 to more than \$200,000; half of participating firms were between \$113,692 and \$149,705. If and when the supply-demand balance swings back from the client's to the A&E firm's advantage, Net Revenue per Employee will begin to rise more dramatically as seen in previous recovery cycles.

High Performers reported an average Net Revenue per Employee nearly 30% higher than other firms. Large and mid-sized firms' Net Revenue per Employee was also higher than average, while in small firms it was significantly lower.

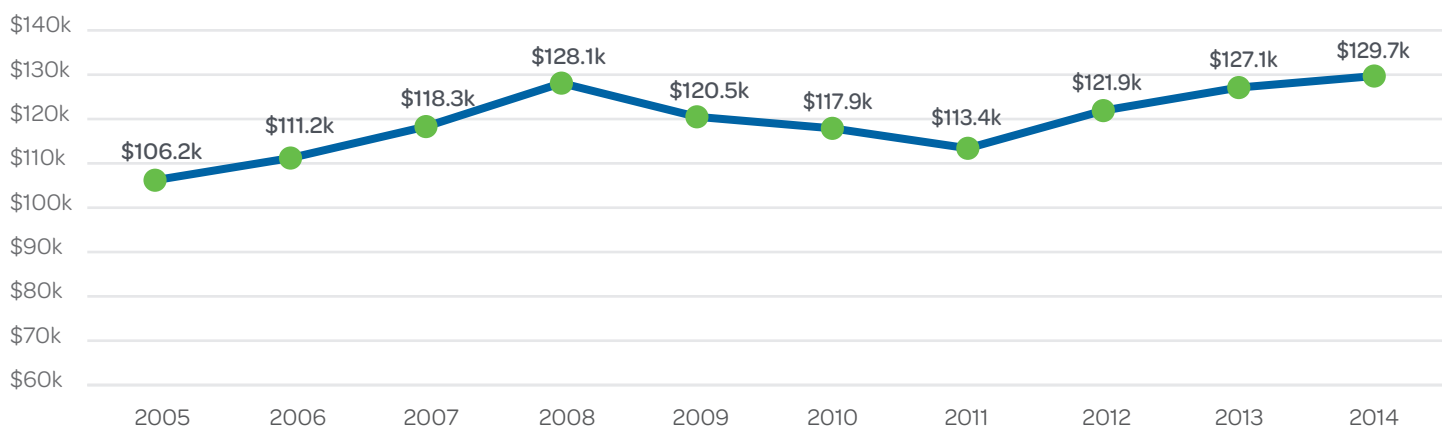
*Net Revenue per Employee is calculated by dividing annual Net Revenue by the average total number of employees during the year, including principals.*

	2014	2013
Top Quarter	\$149,705	\$144,027
Average	\$129,689	\$127,098
Bottom Quarter	\$113,692	\$111,130

### How Firms Compare



### Ten-Year Trend







## **Culture Matters: Is Yours 'CYA' or 'Embrace the Problem'?**

*By Rich Friedman, Friedman & Partners*

It's often been said that you can tell a lot about a person by how they handle adversity. In my experience, this is also true of A/E/C and environmental consulting firms. The strongest firms out there are those who are not only prepared to respond when things go wrong, but welcome and create the opportunity.

After years of seeing this play out, I know one the best things that you as a leader can do for your firm is to instill a culture of viewing problems as opportunities. In this article, I share two examples of how it's done.

### **Perils of the CYA culture**

Should a problem—such as a project going south— really be embraced?

In some firms, the mindset is that no news is good news, or what we don't know won't hurt us. Firms like this embrace what I call the "CYA Culture." Here are a few indicators that this could be happening:

- PMs and senior leaders do conduct client surveys and interviews, but they stack the deck with clients that they know will provide glowing feedback.
- Project snafus are swept under the rug, or discussed in a flurry of reply-all emails that diffuse responsibility and accountability.
- The firm culture penalizes those who have documented problems on a project or an unhappy client, so you don't always hear about them.
- Offices and P&L centers are pitted against one another instead of allocating the best technical resources for a client, no matter where they're located.

When you sweep problems under the rug (or worse, try to evade responsibility for them), you eventually lose credibility, clients and money.

But when there is a genuine desire to know what your clients, partners and prospective clients are thinking, even when you might not hear what you want to hear, the outcome can be very different.

### **A tale of two clients**

Consider the experience of a large engineering and environmental consulting firm that was unsuspectingly on the verge of being fired at the time I conducted an independent third-party assessment with their Fortune 500 client. The interview revealed that this client was unhappy with their performance and the perceived value for the cost on a long-term project.

Senior management and the project team reviewed the bad news and met with the client right away to understand where expectations were not met. Working together, they made changes to correct performance deficiencies. Not only did the firm *not* get fired, they won an additional \$5 million in work and the client's value rating jumped from 5 out of 10 to 9.5 in a follow-up interview one year later.

In another case, I conducted a client satisfaction interview on behalf of an *ENR* 100 firm with one of their key clients, a client the firm was about to target with \$75K of business development initiatives. The interview did not go as expected.

Again, the client was unhappy with the quality of services provided and value imparted. It was clear that this organization would not be hiring the firm again, and had already hired another consultant.

What did my client do? The feedback was immediately shared with the CEO and the project team. Then, the CEO contacted the client personally to discuss their feedback. After that discussion, the firm decided to refund their full fee.

What happened? Their client was won over by such a powerful response to negative feedback. It renewed their trust in the firm's desire to fix and not repeat its mistakes. It also netted the firm an introduction to potential opportunities in other parts of the organization.

### **Going from bad to good**

What does this look like on a day-to-day basis? How can you instill a culture that makes the most out of a bad situation?

- Be willing to initiate and reward having difficult conversations, so that you can address problems before it's too late. Train your senior leaders and project leaders to do this effectively.

- Establish a regular system for gathering feedback from your clients, prospects and partners (and not just the ones who love you). For example:
  - Loss (and win) debriefs to improve future chances of winning
  - Client and prospective client perception studies
  - Ongoing project performance measurement
- Consider using an experienced and independent third-party researcher to ensure that client interviews are more probing, more revealing and more comfortable for the client to speak their mind.
- Make your client's perception your new reality. The fastest and most effective way to change how an unhappy client sees your firm is to identify and correct the problem. It's futile to argue with someone's perception. They're entitled to that based on their experiences. How you respond is what matters.
- In addition to solving immediate concerns, analyze the client data you have collectively to look for trends or systemic issues that may be impacting your firm's performance.
- Share success stories of turning around a challenging situation for professional development and learning. Build a climate of continuous improvement.

It's a rare firm that is already doing all it can to turn challenging client situations into gold. Which strategies will your firm commit to in 2016?

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*About the Author: Rich Friedman is Founder and President of Friedman & Partners, a marketing and management consultancy that crafts and implements growth strategies for A/E/C firms. Reach him at [rich@friedmanpartners.com](mailto:rich@friedmanpartners.com) or 508.276.1101.*

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## **Attracting Millennials**

*By David B. Richards, AIA*

For several years now a/e ProNet, a network of brokers dedicated to the insurance needs of design professionals, has sponsored a competition for students of architecture entering graduate school. Entrants must provide a written response to a practice related question. a/e ProNet established the scholarship to recognize and reward students who are committed to improving private practice efforts to mitigate potential liabilities. This past year's a/e ProNet Scholarship Competition featured the following question:

In anticipation of a significant increase in their design workload, a group of partners is strategizing an approach to finding qualified architectural staff. During the economic downturn that began in 2007 unemployment reached an all-time high and hiring by architectural firms plummeted. Correspondingly, anyone entering the architectural profession (and the construction industry in general) faced serious challenges finding employment. Firms are now challenged to find and recruit professionals with 3 – 5 years' experience.

What are the qualities that would make this firm a likely choice for those in the millennial generation? How should the firm present those qualities to best appeal to millennials? What else could the firm do to deliver the increased workload?

The respondents were generally millennials, telling us what is important to millennials when they are seeking employment. Most of the responses noted that a strong web and social media presence, a meaningful work experience, opportunity for growth, brand and environment were the things that would attract them to a firm.

Almost all of the respondents stressed the importance of a strong web and social media presence. Patrick Daniel Cory, stated, "The millennials have technology and a world of information at their fingertips and an innate sense of how to use it." Sarah Marie Wahlgren said, "The millennial generation responds to social media above more traditional marketing channels." Christopher Michael Brockhoff noted, "If the firm wishes to hire innovative thinkers, the firm must present itself as a progressive, forward-thinking company."

Edward J Palka, stressed that it important to market with the intent of attracting employees; not just clients. He, “would quickly launch a social media initiative focused on the creative culture of the firm; highlighting current work” and would, “encourage and incentivize my young staff to use their social media contacts to extend this dialogue and express their own opinions.

The Website is often the candidate’s first impression of the firm. Alyssa Renee Tope noted, “firms need to make themselves stand out amongst the crowd. A quality website is very important in attracting millennials because it is likely the first place they will look for information.” Julia Ruth Hartman stated, “Updated company websites and populated social media outlets are necessary, as these form the candidate’s first impression of the firm’s culture.” Jonathan William Shaffer, “in order to attract professionals, the firm would have to build up and cultivate a strong digital platform to market themselves. Meaning that their website and social media must be up-to-date; full of relevant, high-quality content that shows a more personal and intimate side to the office culture.”

Jeremy Scott Dollar summed it up, “I would reach out to them where they are, on social media.”

Another common theme related to the importance of a meaningful work experience: one that had a positive social impact. “The millennial generation wants to be a part of something bigger than themselves.” according to Christian A Labbe. Alyssa Renee Tope notes that, “Millennials want a career that allows them to make an impact on the world...millennials have diversified interests and therefore desire a job where they can combine architecture with fields such as sustainability, technology, marketing, and science...and work on projects that are fresh and innovative.” “We’re ambitious and want to contribute to making the world a better place,” says Abbye Nicole Torgerson.

Jonathan William Shaffer stated that, “millennials, are searching for work that has meaning. In order to appeal to this, the firm would support an organization, such as Habitat for Humanity, to offer an outlet for volunteering within the office culture.” Sasha Marie Bachier, “Millennials have a great appreciation for architecture firms that have an experimental air about them, and this young generation of designers wants to contribute to that process of discovery.”

Career, the opportunity to grow professionally and advance in responsibility along with the opportunity to learn on the job are all important to these emerging professionals. “Knowing that you have the ability to advance is very important to future architects,” Christian A Labbe. Abbye Nicole Torgerson, “We’re also a generation obsessed with learning, we can’t wait to get our hands on more knowledge.”

The brand and environment of the office are also factors that the respondents indicated as important to millennials. Juliann Sy Chen noted that, “millennials love that small personal touch.” Marlena Deidre McCall said that, “Image is crucial to recruiting millennial generation professionals. Branding, website, and software are key.”

“Creating a relaxed environment is definitely something the new generation seeks.” Christian A Labbe. Christopher V Le said that, “This generation lives on instant positive feedback.”

The 2015 a/e ProNet Scholarship Competition resulted in about 20 considered responses. Those responding clearly said that having a quality website that speaks to prospective employees and not just clients, one that demonstrates how the firm's work has a significant impact on society and architecture in general is essential in attracting millennials. The website should show how the work of the firm, and the effort of the employees of the firm, has meaning beyond the project. Expressing a culture of learning, experimentation, research, a design focus and opportunity to grow in the firm will help attract this generation.

Essays submitted by Alyssa Tope and Edward Palka were selected as the winners of the competition. Their full responses may be reviewed at <http://network.aia.org/practicemanagement/home/pronet>.

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*About the Author: David B. Richards, AIA, LEED AP, PMP is the Chief Operating Officer and a Principal of ROSSETTI, an international leader in sports architecture design. David is the 2016 chair of the Practice Management Knowledge Community, a member of the AIA Best Practices Committee, and a contributing author to the Architect's Handbook of Professional Practice, 15th Edition.*

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