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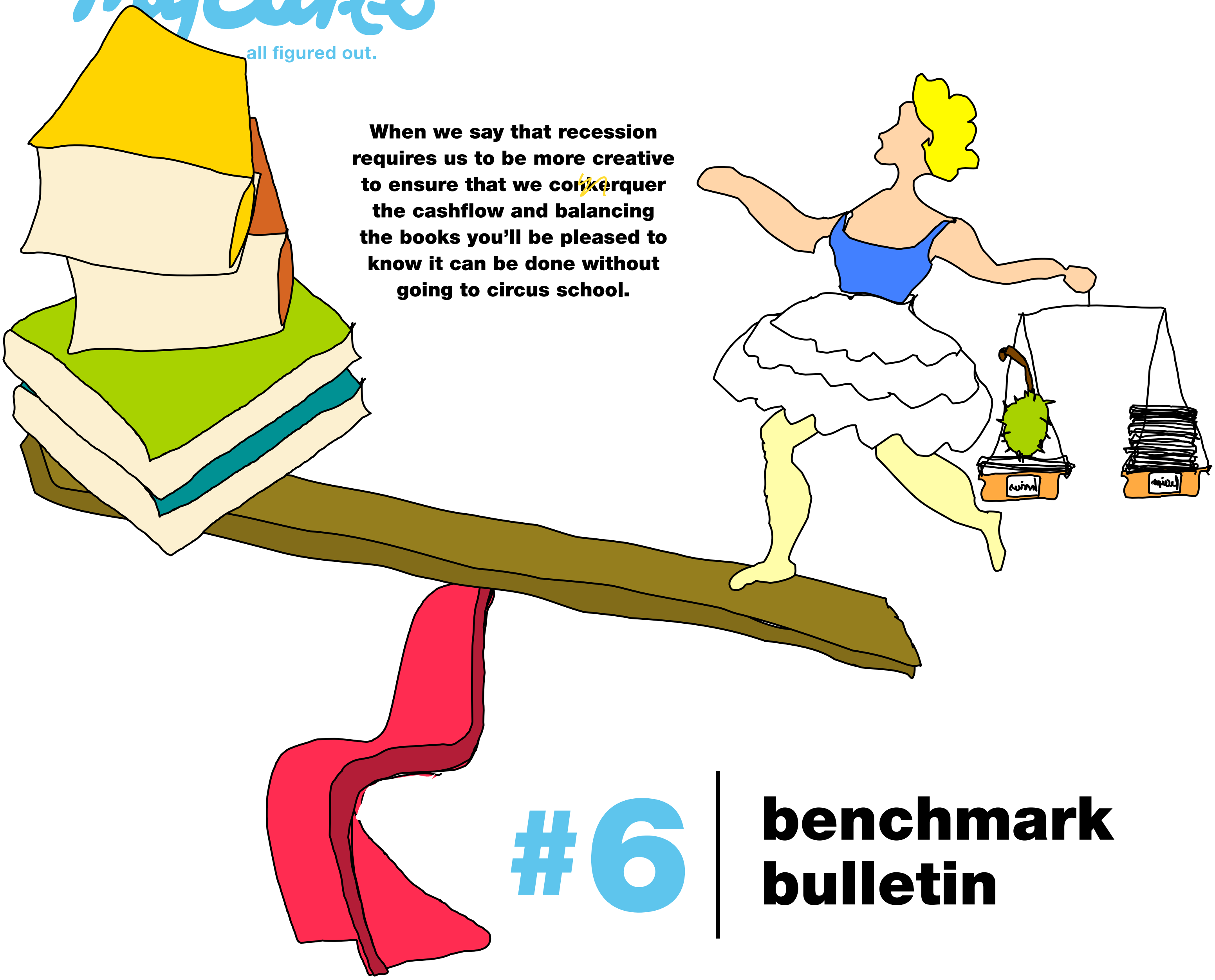

When we say that recession requires us to be more creative to ensure that we conkerquer the cashflow and balancing the books you'll be pleased to know it can be done without going to circus school.

#6 | benchmark bulletin

In this bulletin we are continuing with our comparison of 2008-9 to 2009-10 (hereafter referred to as 2009 and 2010 respectively) both in terms of the overall picture and how it splits out for product based vs. service based businesses.
In bulletin 5 we looked at the income data and the direct costs. In bulletin 6 we will focus on the indirect costs and in particular those areas where you need to maintain a spend if you are to earn your way out of recession and position your company to take advantage of recovery and growth.

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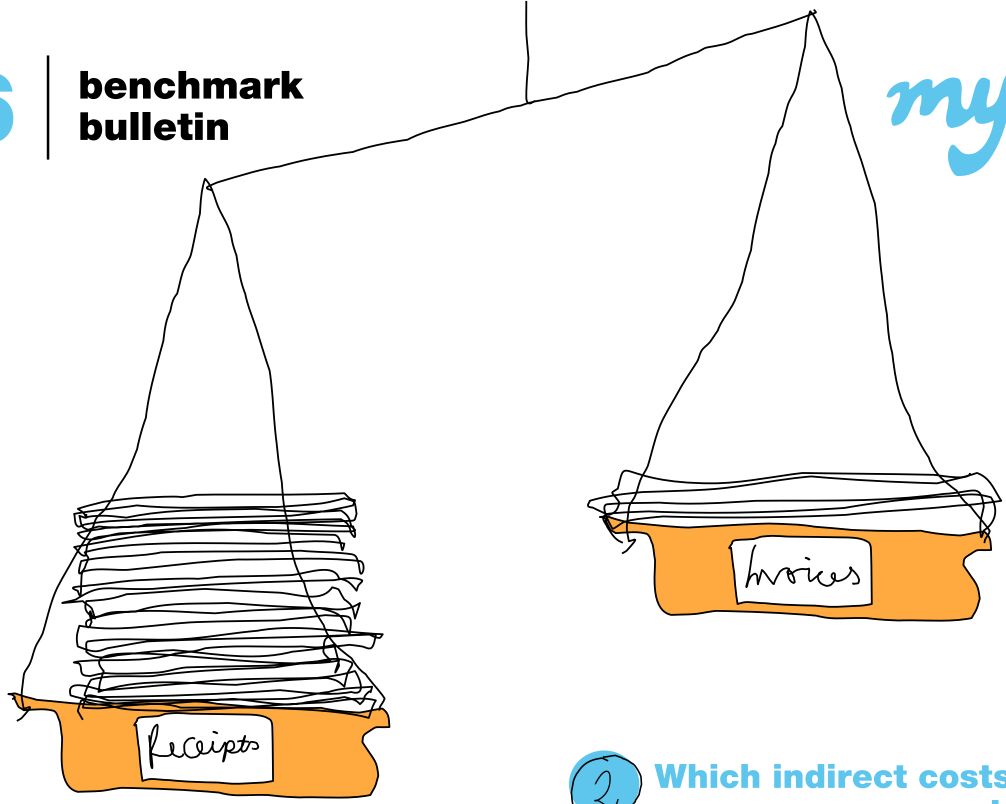


Indirect costs:

1 Labour

For many creative firms, especially those who are service rather than product based, this is one of, if not the largest, cost line in a Profit & Loss (P&L) sheet. How then have creative firms been handling the impact of the recession (and the associated drop in overall revenue) on their ability to retain and motivate key staff and the need for certain minimum levels of day to day staff capacity in order to bid for work and deliver to clients?

The MyCake data shows that in addition to reducing the expenditure on freelancers and outworkers (by 20-30% on average) the total spend on the staff has also dropped. The good news is that the directors are sharing the pain rather than just cutting the team.

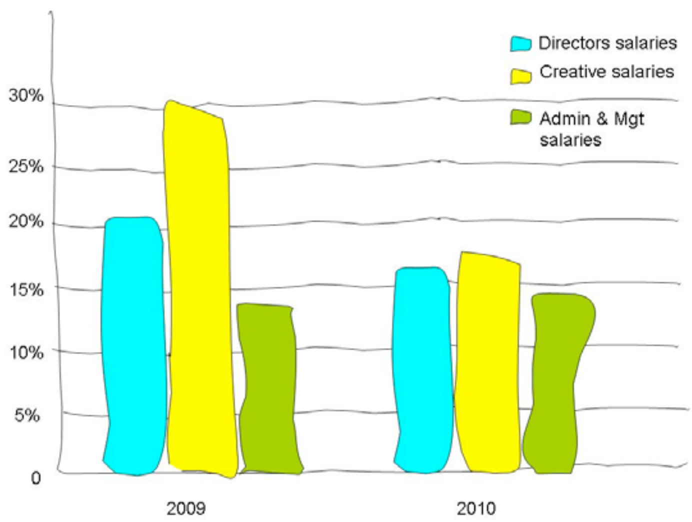
Clearly cuts have been made in the creative teams and fairly substantial ones at that. If the business has seen a reduction in turnover then the headcount is going to drop. We would expect to see a reduction in terms of full time staff but we thought we'd also see a rise in freelancing and contractors as companies need to maintain a staff pool and seek to reduce the committed monthly costs. But we have not. Perhaps we'll see this in next year's figures but for now, at least, the more common reaction is simply to reduce headcount and total staff cost. Whilst there has been a slight increase in expenditure on administration and management this is probably not significant and just reflects the fact that other costs are being reduced.

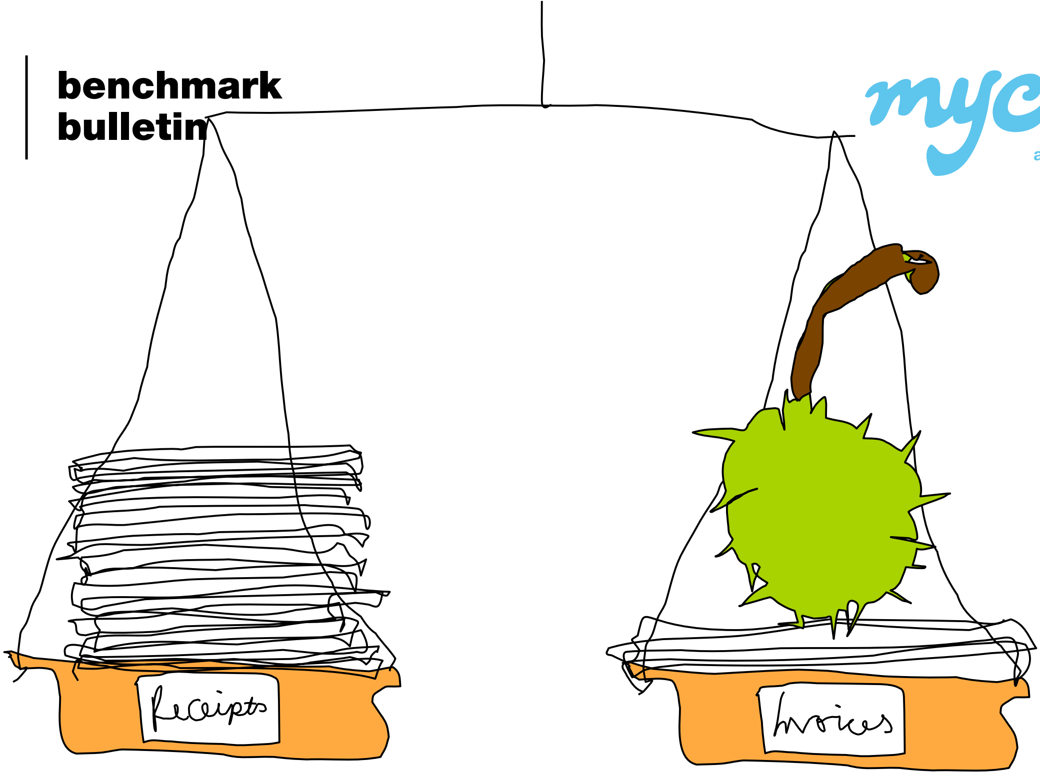
2 Which indirect costs will help me earn my way out of recession?

In order to not simply survive the recession but to come out of it stronger and with better client relationships there are a number of areas of expenditure which you need to ensure you continue to fund. We would suggest that the following are worth looking at in detail:

- marketing
- transport and travel
- training

So what does each of these add to your business and how do you decide what it is worth spending on them even when profit margins are slimmer and cashflow requires careful management?

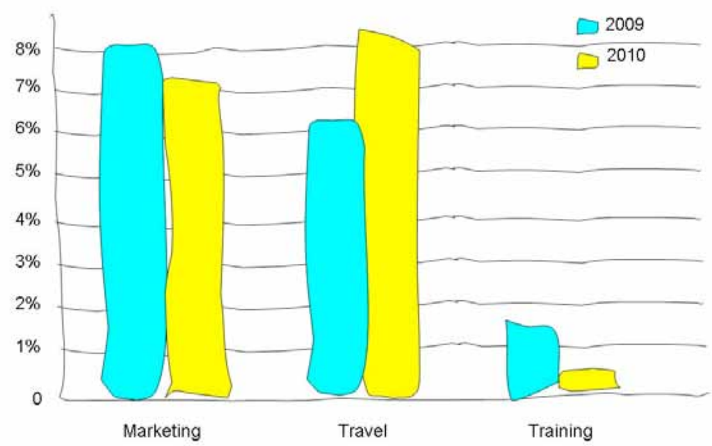


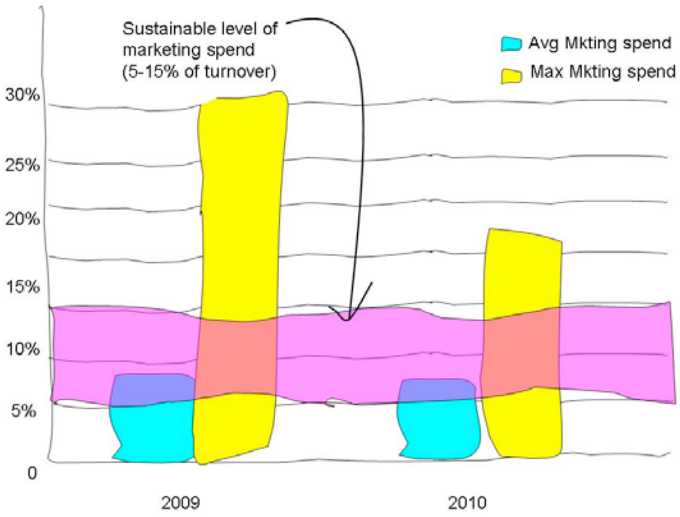


3 Marketing

– various studies have been done by folks in business schools which demonstrate that those companies who continue to make expenditure on marketing tend to emerge from a recession stronger and with greater market presence. Part of the reason for this is that marketing is often one of the first budgets to be cut as, in some sectors at least, you can live without it in the very short term without seeing a drop in sales. By contrast though if you maintain presence in the market when others are going quiet then your brand will be front of mind for a greater proportion of potential customers. Furthermore those companies selling marketing opportunities (trade fairs, advertising space etc) will be hard hit by reduced marketing spend and will be prepared to offer you far better deals on price than they would do in the boom years. Consider what sales growth you could expect to achieve with a 5-15% of turnover spend on marketing and also consider the areas of spend. Could you redeploy the funds to better effect? What can Facebook and Google Adsense offer that is more cost-effective and more targeted than mass advertising or even trade press adverts? You should certainly be looking to get more from the spend but it is not wise to cut out marketing spend altogether.

The MyCake data shows that whilst there has been a reduction in the expenditure on marketing with the average dropping from 8.1% of turnover in 2009 to 7.2% in 2010 clearly creative businesses are still investing in this area. The maximum spend has dropped more markedly though from 36.3% to 22.6% though both of these figures are still very high and likely to come from businesses either in start up phase or in a growth/launch phase. As a very rough rule of thumb you should be spending between 5-15% of turnover on this area depending on where you are at in your business growth cycle.





Yeah,

4 Travel

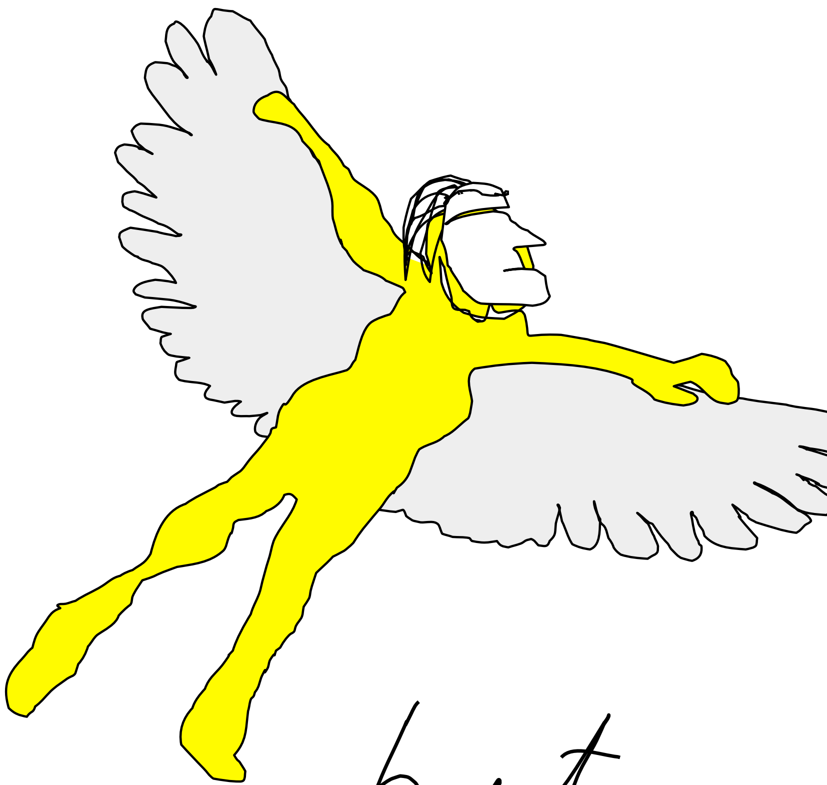
– not to the moon, nor even abroad necessarily, but to the places where you can meet more and new customers …. trade fairs, conferences etc. You don't have to take a stand or be on the speaker list but being present and setting up meetings with clients during the course of the event all helps to remind your existing customers that you are around and are still trading. If you cut costs in this area then your absence may or may not be noticed but the business is more likely to go to those who are doing the meet and greet.

The MyCake data shows that there has been an increase in travel costs from 6.3% of turnover in 2009 to 8.3% in 2010. This seems like a reasonable level in that it won't break the bank but creative businesses are making sure they are being seen. Of course we're not looking at the effect of inflation here or price increases in rail or petrol costs, just making a straight comparison of expenditure

5 Training

– The argument here is that if you invest in your staff, even in the tough times then you increase staff loyalty, maintain or increase staff happiness and these all help you reduce the rate at which staff leave, which in turn reduces recruitment and training costs over the long term. The flip side of the coin is that you could choose not to invest in training because hey, people want to keep their jobs in a recession so you just work them a bit harder but don't pay them more or invest in them. In the short term this may well reduce your overhead base but it won't do you many favours long term.

The MyCake data shows that spend on training drops from 1.6% in 2009 to 0.5% in 2010. Lets see what the next year of data shows, hopefully this isn't a trend!



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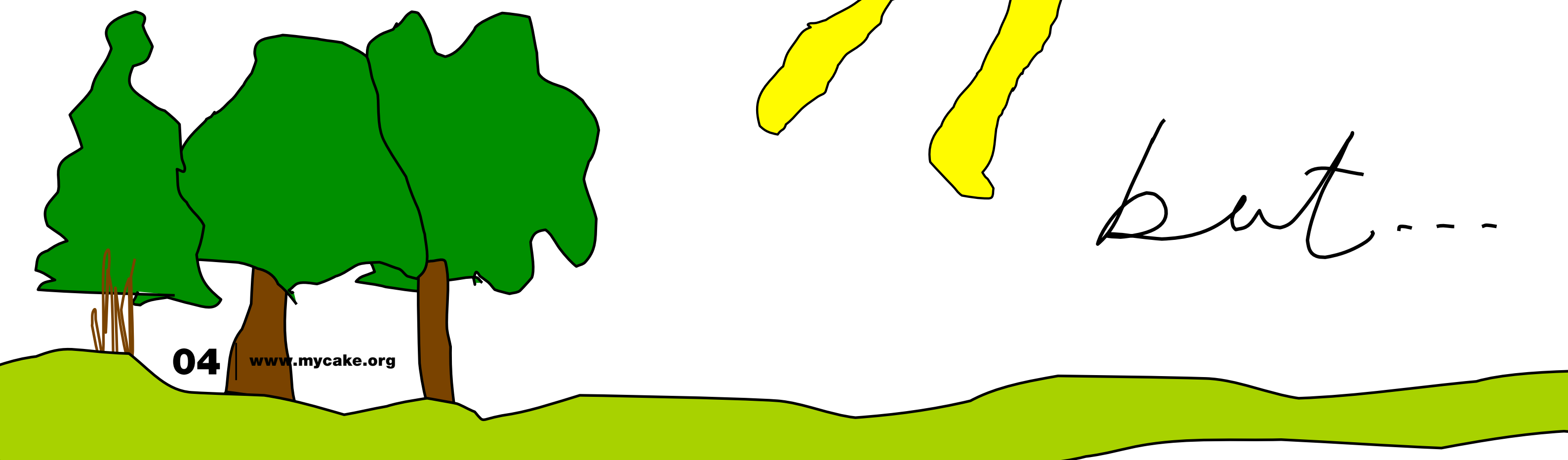

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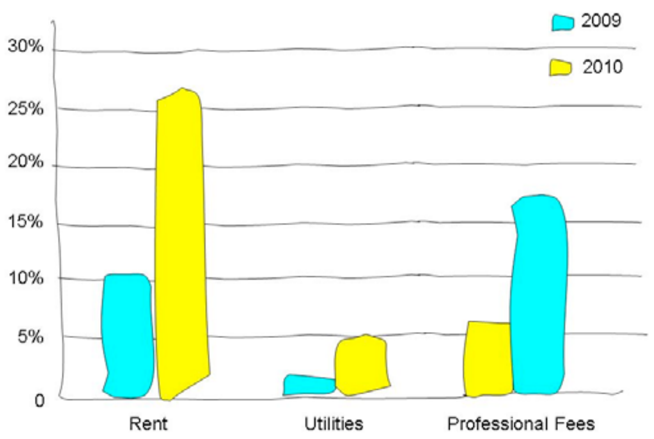
— — — I'm only just Starting

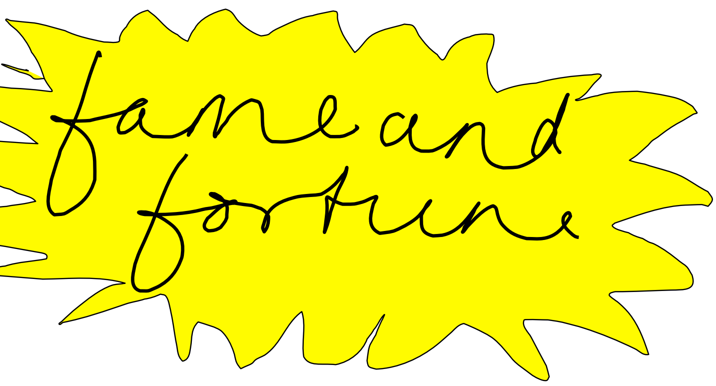
⑥ Which ones add least value?

Well now there's a subjective question if ever we asked one! So, at the risk of folks pouring scorn on a simplistic view of the world (and lack of appreciation for their beautiful studio/utility bill/accountant) we'd like to propose that the following areas are least likely to add huge value to your business and therefore the costs associated with them should be tightly managed especially in times of recession.

- rent
- utilities
- professional fees

Why do we think this? Ok, lets take them one at a time.

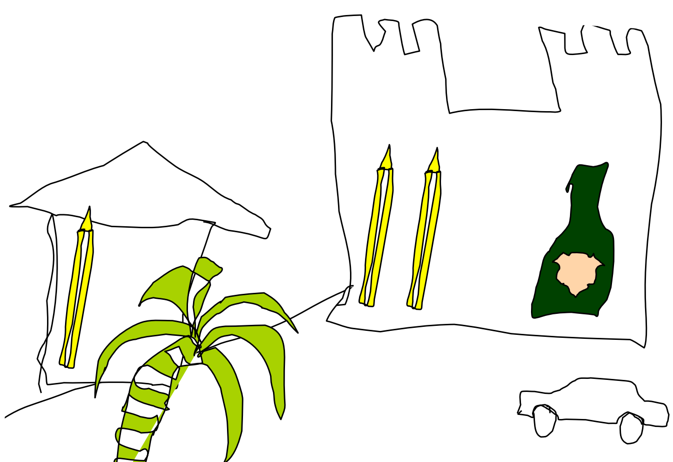




⑦ Rent

– well sure you need a space that means that you and your team are productive and happy. And no, underground airless unheated bunkers don't suit many of us but in our opinion there is not a strong argument to support the idea that spaces have to be in premium (and therefore expensive) locations. We would hold to this opinion even if your clients come to you (rather than you go to them). Particularly in times of hardship use of inexpensive space will be more likely to be regarded as prudent rather than a sign of a failing organisation. For the occasions when only the best will do – key presentations, seminars, conferences etc then by all means rent this space for the time that it is required. We would also suggest that the ability to downsize rapidly because you're based in a set of spaces where you can move into larger or smaller spaces as required with perhaps only a 1-3 month notice period is the sort of thing that will help you manage your cost base. This is certainly something that you can expect of the larger work space providers. Of course you may well pay a slight premium for the freedom to change or end your lease with only a short notice period vs. the price per square foot that you'd pay if you commit to a five year lease so of course these are the things you need to weigh up for your business individually.

The MyCake data shows that spend on rent as a percentage of turnover has shot up from 10.4% in 2009 to 26.1% in 2010. This is a clear indication that whilst revenues have decreased companies have chosen to stay in the building they're in rather than downsize. There may of course be lease clauses that prevent them moving quickly but it's certainly an issue if we see this again in the following year.



8 Utilities

– this is a good time to shop around. Even if you need to buy the green option to be credible there are still deals to be done and it is always worth ringing your provider and negotiating with them, particularly if you can go armed with competitor prices and are prepared to change supplier if they don't offer you a reason to stay.

The MyCake data again shows a significant increase here from 1.4% of turnover in 2009 to 4.6% of turnover in 2010.

9 Professional fees

– again this is about making sure you have the best deal on lawyers, accountants etc. However these will be people that you know personally so it is more a case of making the most of the relationship rather than threatening to go elsewhere (which would mean starting a new relationship and losing the knowledge that the current folks have built up about you). So lets assume that you want to continue to use their services but you want to get more value from them without seeing your bills increase. One area worth considering is whether they are giving you counsel and advice or simply executing tasks for you. Any accountant worth their salt will have views on things you could improve upon, after all they see a lot of sets of books for a variety of companies and will have learnt a few tricks of the trade along the way. It is surprising therefore how rare it is for accountants working with small businesses to provide the types of 'advising accountancy' services that are commonplace in the larger firms. Perhaps it is because the entrepreneurs don't ask, perhaps it is because they are busy with the tasks you give them and don't consider looking at the wood rather than the trees. But most will give advice if you ask, even more will if you take a couple of hours out to have lunch with them and pick their brains.

Again the MyCake data shows an increase here from 6.3% to 16.6%. Even if some of this spend is on project related consultants rather than annual accountants and lawyers fees, it is still very high.

Summary:

So, in conclusion, the MyCake data for 2009 and 2010 shows that several of the key cost areas which add relatively little value but which are often on long term contracts (e.g. space leases) have become a larger part of the overall cost base whereas variable costs such as marketing, training and staff which add value to the business in both the short and the long term have been reduced. Even if we take account of the long timescales for moving buildings and the short timescales for reducing marketing spend this picture is not a rosy one …. it simply will not help creative businesses to grow their way out of recession. And cost cutting alone will not balance the books if you've seen a 30% drop in revenue. We hate to end this bulletin with the voice of doom but to be ready as the economy starts to grow again it is very important to reverse the steps that were taken out of short term financial necessity and start investing in your business.

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In the 7th Benchmark Bulletin we'll look at the 2011 data and see whether the Creative Industries are starting to emerge from the recession.