

AGENCY LEADERSHIP HANDBOOK

Project Budgeting

First Edition

Introduction

Individual client projects represent the basic building blocks of a successful public relations or marketing agency. Ensuring that those foundational elements generate the right margins makes the difference between a firm that operates at its full potential and those that may struggle to make ends meet.

Many agency leaders believe that their highest revenue clients contribute the most to the bottom line. In working with many agencies to examine their project profitability, it often becomes readily apparent that is not the case.

The only way to operate profitably is to control costs and price client engagements correctly.

What to Expect

This Guide provides the framework for creating and managing realistic project budgets that will help deliver maximum results for clients while also providing sustainable profit margins for the business.

In the following pages, you will find step-by-step guidance on how to set and follow budgets that work, including:

- Calculating employee labor costs
- Determining gross and net profit margins
- Empowering project managers with budget accountability
- Balancing transparency and legitimate confidentiality needs
- Educating all employees to be better stewards of agency money
- Using budgets to set effective pricing

Companion Budget Template

To facilitate your own project budgeting process, an Excel template is available that includes everything you need to get started. It incorporates simple formulas for calculating hourly labor costs, factoring in overhead expenses, and determining gross and net profit margins.

Why Project Budgets Matter

You manage what you measure, so when it comes to project management you need to measure not just your results for clients but also for your agency business itself.

Setting and tracking effective budgets doesn't just ensure profitability. Good budgets have additional benefits including:

- Facilitating better pricing
- Improving employee morale by setting guardrails against over-servicing
- Empowering employees by providing valuable information and insight
- Assisting resource allocation
- Forecasting cash flows
- Enhancing business development through better ideal client definitions

Without effective project budgeting, you will inevitably invest your resources incorrectly, seek out the wrong clients, and erode overall productivity and profits.

Project Budget Basics

In the agency world, project budgets are pretty straightforward. While labor costs typically represent the most significant expense, there are other factors to consider.

All good planning and budgeting starts with a shared understanding of what goes in to the final product, so let's review key terms and concepts.

Key Terminology

- **Project Revenue.** The amount of money a client pays to the agency, including reimbursable expenses.
- **Project Expenses.** The amount of money that the agency spends to service that specific project.

- **Overhead (G&A) Expenses.** The amount of money that the agency spends on non-project specific activities, including marketing and business development expenditures plus general and administrative (G&A) costs like human resources, rent, office supplies.
- **Gross Profit.** The total project revenue minus total project expenses.
- **Net Profit.** The total project revenue minus the sum of total project expenses and an allocation for pro-rata portion of agency overhead expenses.
- **Gross Profit Margin.** The ratio of gross profit to total project revenue.
- **Net Profit Margin.** The ratio of net profit to total project revenue.
- **Material Expense.** What is “material” to a project or agency budget will vary depending upon size. A \$100 expense would be considered material to a \$1,000 project but not to a \$100,000 one. Understanding what is material is important to avoid getting bogged down in minutia when building a budget.

Revenue

Most agencies will have several different types of revenue that should be accounted for in each project budget, as appropriate.

It is important to reflect these different types of revenue separately in the project budget for clarity and better management.

- **Recurring Revenue (Retainers).** The traditional agency model has relied upon clients paying a set amount each month for a bucket of hours or services.
- **One-Time Revenue.** Some projects may not involve set payments each month and could instead be fixed-fee or hourly-billing projects.
- **Payment for Reimbursable Expenses.** Although reimbursable expenses don’t impact profit margins directly, they need to be accounted for both on the revenue and expense sides of the project budget since they have an effect on cash flow.
- **Payment for Markup on Reimbursable Expenses.** Traditionally, many agencies have charged a percentage of total reimbursable expenses as a management fee (or “markup”). This additional revenue has a positive impact on profit margins.

Expenses

The primary expenses to track in a project budget are those that are only incurred because of that project. In other words, if the client goes away, you should be able to stop that spending. All other spending would be accounted for through the Overhead allocation (discussed below).

- **Non-Reimbursable Expenses.** If the agency pays for something out of its own pocket and can't charge it directly back to the client, it is considered non-reimbursable. These are the costs that directly impact the project profit margin.
- **Reimbursable Expenses.** For some projects, the agency may temporarily incur the expense but later receive reimbursement from the client. Examples typically include items like advertising or third-party production costs.

In your project budget, the expenses should be broken out into logical line items, much like you would for an agency-wide business Profit & Loss statement. In fact, the project budget categories should correspond to those used by the Finance team to track overall business expenses so that they can “roll up” the costs and present them in a logical, consistent fashion.

Overhead (G&A)

A common mistake made by agency leaders is to calculate the cost of a project without accounting for a share of non-project-specific expenses. This can dramatically understate the cost of a specific project.

All of the client project work that an agency performs depends upon a wide range of general and administrative (G&A) expenses.

Overhead expenses typically include things like the cost of:

- Acquiring new clients (sales and marketing)
- Keeping the agency's doors open (rent, utilities, telecommunications, and the like)
- Providing basic administrative services like human resources and finance
- Providing tools used across multiple clients like project management software

Typically, these overhead expenses are represented as a percent of the total non-reimbursable expenses incurred in completing the project (see below for how to calculate the correct percentage).

Profit Margins

The result of your budgeting process will be determining both the gross and net profit margins for that piece of business. Every agency should have minimum standards that they strive for when pricing a project to ensure that the overall agency profitability falls within the desired range.

In comparing budgeted expenses to actual spending, there can be a temptation to massage the numbers to get the “right” result in terms of profit margin. Nothing could be more damaging to the agency business than failing to accurately track and report project expenses.

Building the Project Expense Budget

Now that you understand the basics of the budget process, it’s time to dive into what needs to be included and how to determine the allocation of certain expenses, including shared costs and labor hours.

Expenses to Include Directly

- **Employee Time.** The biggest number for most agency projects will be the cost of staff salaries devoted to a particular project. This needs to include everyone who touches the project and all of the time that they spend on it, including in internal meetings.
- **Freelance/Contract Labor.** As more agencies leverage the support of contractors to perform client work, it is especially important to accurately capture the amount of money that will be spent with these individuals.
- **Subcontractors.** As more agencies become specialists, it is more common than ever for an agency to subcontract to another agency or vendor to get a portion of a project performed.
- **Media Monitoring.** Most public relations and marketing firms use a service to track media coverage of their clients. Sometimes this cost can be directly determined for a project, but more often it will need to be allocated in a shared manner across multiple projects (see below on shared allocations).

- **Media Analysis and PR Measurement.** In addition to tracking coverage, it often makes sense to evaluate the impact of that coverage on the client and its objectives.
- **Media Databases.** Public relations firms and influencer outreach efforts may require the use of third-party databases to identify and contact targeted individuals.
- **Primary Research.** Surveys, focus groups, and other forms of primary research are often deployed on their clients' behalf and should be clearly accounted for in the budget.
- **Travel.** Even in the age of easy and affordable online video conferencing, face-to-face meetings still have value and should be included in the budget when appropriate.
- **Client Entertaining.** Most agencies take clients out for lunches and dinners or engage in other forms of relationship management that involve direct costs.
- **Printing.** While much of what agencies do today is digital, printing costs may still be involved for some projects.
- **Event Registrations.** Whether you are sending staff to a conference to work directly for a client or as part of broader client outreach efforts, that cost should be captured in the appropriate project budgets.
- **Software and Services.** Just because it is in the cloud doesn't mean it doesn't cost money. Be sure to factor in any software licenses or subscriptions that are used specifically for that project and not captured in the agency overhead expenses.

Don't Overlook These Costs

Some of the most common costs that get overlooked in the project budget process include:

- **Senior Staff Time.** It's easy to forget that the agency owner sits in on monthly or quarterly strategy meetings with the client. It may even feel as if this shouldn't be a material expense, but for a small client or project, it might well be.
- **Administrative Support.** If you have junior staff not regularly assigned to a project help out for events, during major outreach efforts, or at other times, be certain to include this in your cost estimates. If the work they are doing – even for a short period of time – is entirely devoted to servicing a single project, it should be included in the budget and not just lumped into overhead costs.

- **Internal Meetings.** If you have staff brainstorming sessions on a project or coordination meetings targeted to a specific project, be sure to include those in your cost estimates.
- **Travel and Entertainment.** Many agencies want to put travel to visit with clients off as an overhead expense instead of counting it toward the individual project cost. The test you should use is whether that visit is more about servicing the account and maintaining the relationship or more about pitching for a contract renewal or upsell. The former should be charged to the project while the latter might qualify as a business development expense. When in doubt, count it toward the project.
- **Seasonal Cost Differences.** This primarily occurs with travel, but if you have any expenses that fluctuate throughout the course of the year, make sure that you predict actual costs as accurately as possible.

Calculating Hourly Labor Costs

Building a budget for staff costs can be tricky. If you get too granular and focus on the to-the-penny cost of each individual, you will never finish the budgeting process.

A better approach is to break your staff costs into several representative “bands” (or levels) of employees at your agency. This will allow you to get a pretty accurate picture without bogging down.

As a starting point I recommend 3 bands: Junior, Mid, and Senior.

The trickier part is assigning an hourly cost to each group. The accompanying Excel template includes a worksheet that enables you to quickly build your cost model based on the following approach.

1. **Assign average salaries to each band.** For each of the bands you choose to utilize, determine a representative salary. For example, you might determine that in your agency junior staff earn an average of \$40,000, mid-levels come in at \$80,000, and senior staff make about \$120,000.
2. **Add a percentage of base salary to the total to account for benefits.** The true cost of an agency employee includes not just the salary, but also benefits and taxes. Those amounts will vary from one individual to the next, so you will need to determine the right multiplier for your business. If you don’t know what to use and are based in the United States, 33% is generally a comfortably safe number to start with.

3. **Determine the average number of hours worked per year.** You will need to estimate the actual number of hours an employee *in each band* works in a typical year. This number may vary from Junior to Senior roles. It should also account for the amount of vacation/holiday time you provide your team. If you don't know the best number to use for your agency, you can generally start with 1,750 hours annually.
4. **Calculate the hourly cost.** Now that you know the total annual cost (salary plus the multiplier for benefits/taxes), you can divide that by the number of annual hours to get the hourly cost for that employee band.

EXAMPLE: A junior employee at Acme Agency has an average salary of \$40,000. Using a 33% tax and benefit cost, that comes out to an annual total cost of \$53,200. Dividing that by 1,750 hours worked in the year gives us about a \$30 per hour labor cost.

A few important caveats to consider:

- This calculation gives you the **hourly labor cost** not the **hourly billing rate**. You generally want to bill out an employee's time at 2 to 3 times the hourly cost.
- The number of **hours worked** is different from **billable hours** or **utilization rates**. For the purpose of determining hourly costs, you need to lump together all of the employee's time, including both internal and client-facing work.
- The fewer **employee bands** you have, the easier it is to complete the budget. On the other hand, it also makes the final number a little less accurate. Do your best to come up with representative bands that make sense for your own agency's staffing model.
- In general, you should create a staff cost budget based on which level of employee should be performing the work. If you're adding a new client and temporarily plan to use a junior person to fill a mid-level role (or vice versa), budget it for the level you plan to get to sooner rather than later. Use your best judgment about what is likely to happen with the project staffing and make sure the budget represents that reality.

Allocating Shared Costs

Not all agency costs fall neatly into individual client or project budgets. Most agencies have some tools, services, and other expenses that benefit some clients more than others.

Shared costs that benefit all clients roughly equally (like project management tools without a per-project cost) should simply be included in the Overhead percentage.

But what about expenses like ad management tools or media monitoring services that may not have a fixed per-project cost but also don't benefit all clients equally?

In those cases, you will need to determine how to allocate those shared costs.

There are several different ways to accomplish this process.

- **Assign a fixed per-project cost.** Even though a service may not technically incur a fixed cost per project, you can assign them that way for budgeting purposes. For instance, you might determine that the “cost” of media monitoring is \$100 per month per project based on the average monthly agency expenditure in that category. This is the simplest but least accurate way of assigning shared costs. The downside is that it usually ends up with the total amount “charged” to each project not matching the actual amount spent by the agency.
- **Pro-rate the actual per-project cost.** Each month, you can take the amount spent on a service and divide it equally (or as a project size-based percentage) to each applicable project. This tends to be more precise than fixed per-project costs, but it can also cause the monthly actuals to fluctuate significantly, even though it has nothing to do with the actual management of that individual project.
- **Transfer the cost to the Overhead category.** For non-material expenses, this can be the best solution because it doesn't have a significant impact on gross profit margin and simplifies the overall budgeting process. Resist the temptation to bury too many expenses in the Overhead category, however, as eventually all those little expenses add up.

Determining Overhead Expense Ratios

The simplest way to add in Overhead (G&A) expenses to your project budget is by assigning a percentage of non-reimbursable costs. The most accurate approach is to look at your agency's overall financial reporting to determine what the actual percentages are.

If you need a starting point, 20% can often serve as a representative Overhead “charge,” but it really is best to determine the economics of the individual agency.

EXAMPLE: If your agency's total non-reimbursable client expenses is \$500,000 and your total General and Administrative costs are \$150,000, then your Overhead percentage would be 30%.

Using Project Budgets to Set Prices

If your agency frequently does custom work for clients, it can be very helpful to start the pricing process by working up an actual budget. If you wait to build the budget until after the prospect has accepted the proposal, there's a good chance you didn't price it correctly.

Using this approach, you would use your Project Budget Template and start by filling out the Expenses section first. Only after you have assigned all of the anticipated costs would you look to the Revenue portion of the spreadsheet.

Knowing what your expenses will be, it becomes much easier to test different pricing options, including a combination of monthly and one-time fees to ensure that you have pricing that can deliver on the client's objectives, while also providing a healthy profit margin for the agency.

IMPORTANT NOTE: If your prospect asks you to come back to them with a lower price, be sure to use your budget document to figure out which costs you can reduce or eliminate to make certain that the new price is appropriately profitable.

Benchmarks for Project Profit Margins

Every agency business is different, and you will need to establish your own internal guidelines for appropriate profit margins.

In general, agencies should target at least a 20% agency-wide profit margin, meaning they should aim a little higher than that for each individual project (to account for cost overruns, projects that come in under that number, and other unforeseen circumstances that impact every business).

If you really don't know where to start, set the following goals initially:

- Gross profit margin of at least 50%
- Net profit margin of at least 25%

Managing Project Budgets

Congratulations! You won the business at a good profit margin and you have your budget document in place. Now you're all done, right?

Wrong. That's really just the start of the Project Budget process. Now comes the tough part: managing within those budget guidelines while continuing to deliver excellent client service.

Cost Tracking & Reporting

Every month, agency leaders and individual project managers should review the actual costs associated with each project and compare it to the established budgets.

This means that the entire team must be working diligently to record relevant costs, including:

- **Time tracking.** Agencies must have every employee provide a complete accounting of their hours each month. Since labor costs represent the largest line item for most agencies and projects, getting this number wrong destroys the accuracy of the whole process.
- **Vendor invoices.** As soon as project managers or other employees get invoices from vendors, they need to be shared with the Finance team and tracked in the appropriate accounting/bookkeeping system. Better yet, make sure your vendors send invoices directly to Finance to avoid the middleman.
- **Expense reports.** If employees are putting expenses on their own credit cards or company cards, those need to get entered into your tracking system as quickly as possible. An employee who sits on months' worth of expenses can greatly distort the accuracy of project cost reports and deny leadership of the ability to adjust the project quickly enough.

A Word About Transparency

Too many agencies withhold budget information from the team members responsible for managing the day-to-day relationship with the client. Senior leaders like to keep financial information to themselves, but that makes it difficult for employees to service the account correctly.

The reality is that most agency employees end up finding out sooner or later how much the client is paying. Too often, they dramatically underestimate the cost, however, so the chances are they think the work is far more profitable than it actually is.

At the same time, agency leaders have legitimate concerns about sharing certain information with rank-and-file employees, especially surrounding the labor costs portion of the budget. Again, employees tend to have some idea how much their colleagues make – and to the extent that they guess wrong, they usually guess too high.

All of this argues for greater transparency with agency employees, especially project managers running the bulk of the client service activity for a project. If they don't know what parameters they're supposed to be operating within, they won't be able to do it effectively.

NOTE: This is another benefit of using bands for employee costs instead of actual salaries. It gives enough accuracy for good budgeting without disclosing confidential salary information.

Empowering Project Managers with Budget Accountability

Every project should have a day-to-day project manager. That person should be held accountable for delivering excellent client service while also living within the bounds of the budget.

While it is easy to see this as burdensome to the typically more junior individuals who handle the daily work, it actually empowers them. Helping the project manager to understand what the plan is for a client and how the management of resources impacts the overall business health starts to bring that individual into the overall agency team more fully.

Project managers who don't have access to planned budgets or actual costs will almost always overspend, though some will actually become overly cautious and pinch pennies to the point that they jeopardize the client relationship.

Agency leaders need to demonstrate trust in project managers and provide them with the financial planning and reporting tools to manage resources and results effectively.

How to Educate Agency Staff About Budgets

None of this talk about transparency and empowerment means anything if the project managers and other employees aren't educated about the role budgets play in the organization.

It is the responsibility of all agency leaders to increase the team's awareness of not just what the budget is, but also why it matters.

Help employees to understand the relationship between project budgets and agency health.

Show them how attaining targeted profit margins can have a positive impact on their own compensation.

Explain how accurate cost tracking will help ensure that they aren't overworked by identifying what additional resources may be required – or which projects have crept out of scope.

As agency teams become more aware of the overall business, they almost always start to make better decisions for the future of the agency.

Have More Questions?

If you have any questions or need a little extra help, just email us at contact@smallagencygrowth.com

Notes

About the AIM-GET Framework

The AIM-GET Framework for Agency Success was developed by Chip Griffin to help agency owners make key business decisions needed to generate meaningful results.

It establishes a planning and implementation process that ties personal and business objectives together.

The six pillars of the Framework are:

- Ambition
- Identity
- Management
- Growth
- Execution
- Talent



The first three pillars (AIM) act as a compass, pointing the agency in the right direction by establishing the vision and taking a 30,000-foot view of the business.

The second set of pillars (GET) transitions into the day-to-day work it takes to build a sustainable agency that continues to deliver results.

More information can be found at <https://www.smallagencygrowth.com/aim-get>

About SAGA

SAGA works with public relations and marketing agency owners to build better businesses. Through hands-on consulting, training, and advice, Chip Griffin uses his decades of experience to help agency owners achieve their goals.

To learn more about SAGA and how it serves the agency community, please visit www.smallagencygrowth.com.