

#5

benchmark bulletin

How are creatives holding up through the recession?

One of the questions that we are asked on a regular basis is how are creative entrepreneurs weathering the recession? So, this bulletin is dedicated to answering that question. We're interested not only in what the average position is but also how the top quartile (the best 25%) are doing ... how are they doing better? Is it by a large margin or a small one? How can we all learn from their successes and apply this to our own businesses going forward?

The MyCake benchmark analyses anonymous data from its user base to produce reports and comparisons across the creative industries. Now that the MyCake benchmark is into its third year we can start comparing across years as well as looking at a single year.

In this bulletin we are making comparisons between the 2008-9 (from here on in we'll refer to this as 2009) financial year and the 2009-10 (2010 from here on) to see if we can spot trends in how creative businesses are reacting to the recessionary climate and to offer suggestions as to how to weather the storm better.

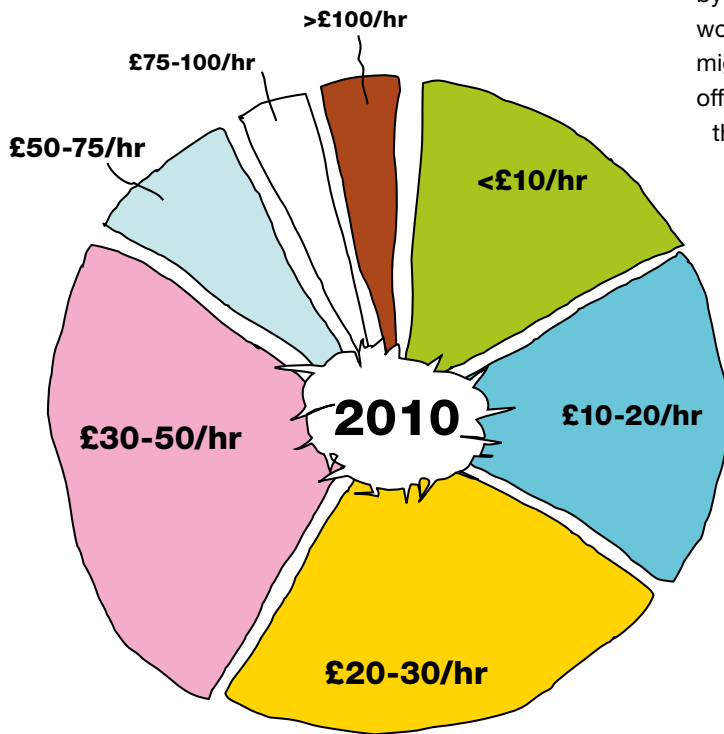


Income and the price of time

We start by looking at income and the price of time because these have the most direct and obvious connection to the actual (and potential) income of the company or individual. The data tells us that the headline here is that creative entrepreneurs are seeing an average of a 30% drop in income and are also seeing a drop in the market price for their time. This means that they are working more hours but achieving less income than prior to the recession.

Let's look at this issue in a bit more detail, first overall income. The average income across all MyCake users has dropped from £105,173 in 2009 to £74,547 to 2010 – this is the thirty percent drop in income men-

tioned above. Second the average hourly rate is stable at £36/hr (or just shy of £300 a day) the top quartile have seen a reduction in their rates by up to 10%. For a little more detail here's a comparison of the 2009 and 2010 hourly rate bands:



Actually what strikes us first is how little is changing from 2009 to 2010. The only noticeable change is in the slight decrease in the £50-75/hr crowd and given that the slack is being picked up by the <£50/hr range we can reasonably assume that there is a slight reduction in rates for this clutch of businesses.

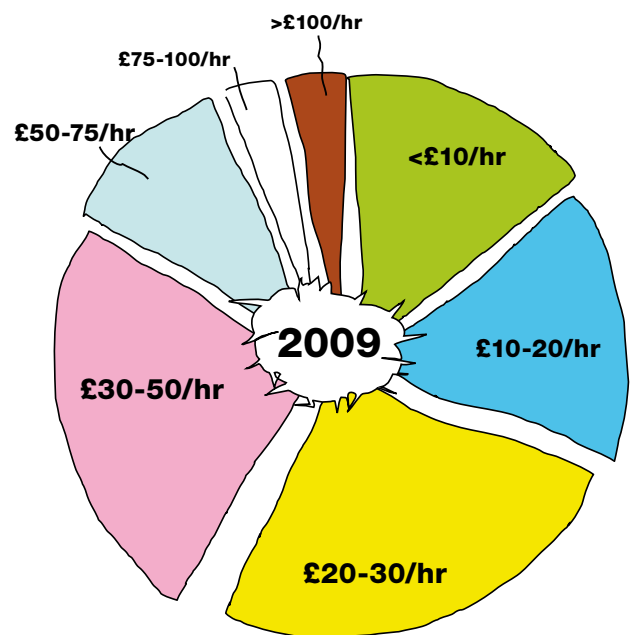
Perhaps this is not surprising ... the shift being the middle ground ... the folks who are already keenly priced are not increasing their rates, those who are expensive are not dropping them (but perhaps doing more unbilled or extra time) but those in the middle are being forced to jump one way or the other and they can't see an opportunity to put rates up so they put them down with a view to being more competitive.



What does this data mean?

Anecdotally the comments have been that people are spending more time winning the business than they used to. This impacts the overall capacity of the sales team if every job takes longer to win. In addition there is a greater chance of being undercut on a tender by younger firms or individuals who are hungry for the work and trading on price. Whilst previously clients might not have felt they had to go with the lowest price offer for the work they are more susceptible to this in the current climate and are willing to break long term relationships in favour of a lower price.

Of course the counter argument is that in tough times you want to make sure you have working relationships you can rely on to deliver the goods. So if your products and services to the clients are critical then should they really be risking them? Here you can negotiate a way forward that ensures stability of supply whilst being as keen on price as possible (don't be tempted to under price as this is not sustainable. It makes it harder to stay in business and can prove to be a very false economy).

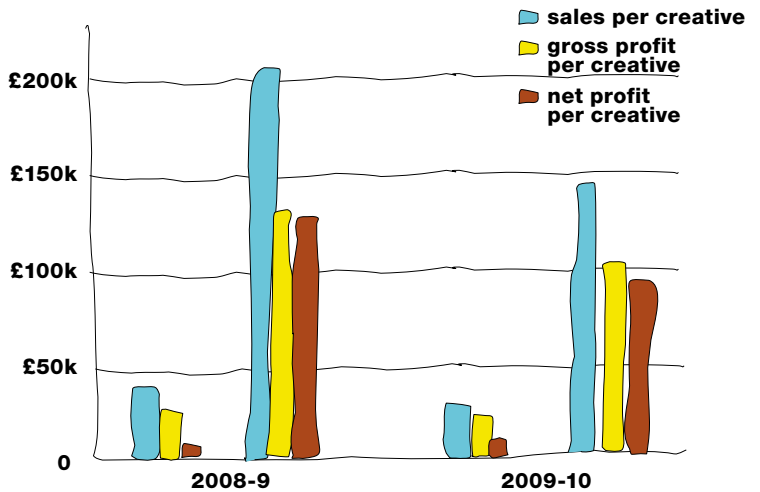


2 Is the cost base changing?

We see another perspective on the welfare of creative businesses during a recession when we look at how the cost base is changing to accommodate the drop in income. If the income shows a 30% drop it is reasonable to expect that there have been changes in the cost base. The greatest cost in service based businesses is almost always the staff payroll cost; the greatest cost in product based businesses is almost always the production costs of the range, so lets look at these two first. The great majority of MyCake users are sole traders and small enterprises with a low number of employees (<10). It's actually quite hard to tell whether there has been a reduction in the number of employees without doing a more detailed staff and salary survey however, based on the profile data of users it looks like there has been a slight reduction in staffing levels and also a slight reduction in the monies spent on freelancers and outworkers (a reduction of 2.5% of revenue from about 22.5% to 20% for the average user). However when we look at the ratios such as the sales per staff member or sales per creative staff member (you can see this for yourself in the spreadsheet section of the MyCake benchmark results in your account) we can see how this plays out in hard cash.

*When I said we need
to find both profit and
cost savings ...*

The chart below shows a drop in all the ratios from 2009 to 2010.



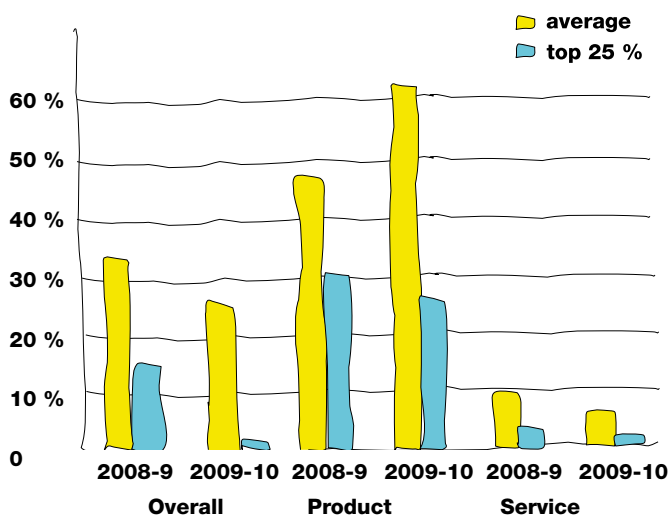
Whilst there is a pretty dramatic drop in the sales/head (-21%) and sales/creative (-28%) the slightly rosier news is that companies have certainly been watching their direct costs as these have been managed to reduce the impact on gross profit (a drop of 9-12%) than the straight sales. Costs have also been cut in the indirect costs which resulted in a growth in net profit/creative of some 40% so even if there have been some reductions in headcount (which would push this figure up) there are clearly savings being made. This is consistent with the shift in overall profit from 18.1% of turnover in 2009 to 26% in 2010. Short term savings will of course have to be balanced in the long run with investment in the company, planning for capacity to take on new or bigger projects as the economy recovers but it is certainly sensible to tighten our belts in some areas of expenditure in order to retain profits and stay in business.



In the next two sections we move from looking at the overall figures to two particular segments ... those who make products and those who make services.

3 Product based businesses in 2009 & 2010

This is the section of the Creative Industries that has been the hardest hit amongst the MyCake user base. The root of the problem is that in 2009 the direct cost of producing the goods was already too high – on average 45.9% of turnover though the top 25% (the top quartile) were managing to cut this down to a more manageable 20-29% of sales. A further 47.8% was spent on indirect costs leaving only 6.3% profit. The top quartile were again keeping these costs under better control with indirect costs not exceeding 20.9% and delivering a profit of 43-65%.

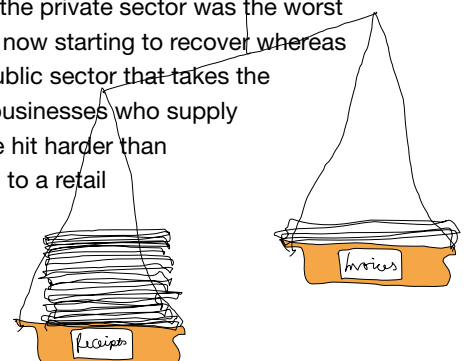


This means that even prior to the recession the average profitability of these businesses simply wasn't high enough and that growth using these ratios would lead to greater problems not greater riches. It should also be noted that there were a number of loss making businesses in 2009 and whilst some were start ups investing in their future a number were businesses which had been around somewhat longer.

The main message at this point, pre-recession, was that in order to have a successful business not only did the entrepreneurs in the top quartile develop sales but they also carefully managed the cost of production both in terms of raw materials used and time from themselves and their outworkers. The 2010 data shows the recession impacting creative entrepreneurs

and their reactions to it. Sensibly we see a drop in the expenditure on materials and outworkers. This probably means that fewer orders for materials or production were placed and that stocks were emptied before being replaced. This is a reasoned response in that there is no point having too much money tied up in stock and materials in these conditions and it is far better to run on low stock levels and maximise income from existing materials. It is likely that stock replacement orders were also smaller than previously but it is hard to be sure without looking in far greater detail at ordering habits.

The average expenditure on direct costs dropped from 45.9% to 38.4% and the top quartile kept it between 20-25.1% (again a drop from the 20-29% of the previous year). We would still make the point that direct costs of much over 30% are going to make it difficult to make good profit margins and that the goal is that achieved by the top quartile of the 20-25% range. Of the loss making businesses (approximately 10% of the MyCake users and often the youngest businesses that haven't yet reached critical mass) in 2009, 81% were product based and in 2009 this drops a little to 75%. When we look in a little more detail we see that those product based businesses making losses in both 2009 and 2010 had a cost of sales in the region of 60% of turnover ... there's just no room in here for a profit and clearly not even enough to cover overheads! It is reasonable to suggest that product based businesses will need to continue to manage their direct costs closely during the rest of 2010. Ideally they should be seeking to get paid by customers before they pay out to suppliers. This is particularly important if we consider that retailers are going bust and that therefore the risks of not being paid at all are higher in these economic conditions than in the boom times. It is also worth remembering that many commentators are of the opinion that the private sector was the worst hit in 2009-10 and it is now starting to recover whereas in 2011 it will be the public sector that takes the hit and that therefore businesses who supply to these sectors will be hit harder than those who sell through to a retail and consumer market.



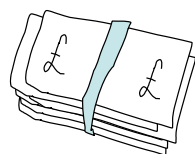
4 Service based businesses in 2009 & 2010

Hourly rates have taken a hit in this part of the creative industries too. From an average of £54/hr in 2008-9 we see a drop to £40/hr in 2010. This is due in part to lower minimum rates (the worst we can see is £9/hr down from £15/hr) though again we suspect that even those with higher rates are putting in more work unpaid either before winning the work or simply in order to maintain separation from the young, discounted market entrants.

Average turnover is also down by approximately 22% from £93,957 to £73,579 this is despite the maximum turnover for this crowd increasing by 30% because we have some larger service businesses participating in the benchmark now (which you would expect to skew the figures upwards).

So, the message here is that the recession is having an effect on both the income of service based businesses and the number of hours they have to put in to earn it. We had expected to see a rise in spending on freelancers and other outworkers and a drop in staff costs as a means by which businesses can reduce their cost base. However the opposite is actually the case, we see a slight increase from 5.3% of turnover to 6.5% in 2010. This is counterbalanced by a cut in other direct costs so that gross margins actually rise from 2009 to 2010 by 2-4%. A drop in indirect costs between the two years means that the net profit rises by a total of 12.8% - a significant achievement in these conditions.

We will look at where costs are being cut (for good and for bad) in the next bulletin but on the topic of labour costs – often the greatest cost to service based businesses – we can see that the directors have certainly been part of the mechanism for reducing costs to the business in lean times. In some cases there is as much as a 50% drop in directors' salaries. This is exactly as it should be but rarely how it is. As directors have the most to gain in the good years they should also be the first to take the hit in the lean times. Whilst it is tempting to reduce the number of Indians it limits the capacity of the firm far more quickly than if you gold being paid to the chiefs.



*now, that
growth
strategy...*

5 What can you do about this?

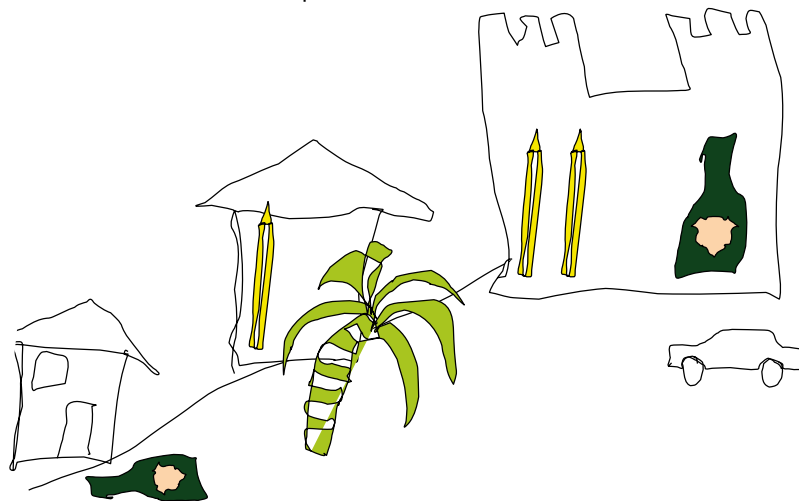
We have a couple of suggestions as to tactics you can employ that don't involve dropping your rates and are aimed at retaining your current clients (on the basis that acquiring new clients takes five times the effort of retaining an existing one). Firstly we'd emphasise the need to ensure that your clients are very clear on the value that you deliver for the price paid. This is a combination of being clear on your unique selling point (USP) and understanding where your work fits in to your clients overall business. Is what you offer to them translating into their own core products and services and how visible is your contribution in the end product bought by their key clients? That is to say if they stopped working with you would their clients notice? If the answer to this is yes or even maybe then you have a case to make with them that you are a business critical supplier and that they would be foolish to risk this in a recession. Our second suggestion is perhaps a little counter-intuitive. We are fans of being expensive, more expensive than the majority of the competition. Our reasoning is that if you are too cheap there is a definite risk that you will lose credibility - along the lines of they can't be any good at that price - and that you will be competing against all and sundry in the average priced crowd. If however you are noticeably more expensive than the rest then it will make people stop and think about what it is that you offer that could be worth the price and whether you might have

something so good that it will contribute to their own competitiveness. Furthermore a high price will sort the wheat from the chaff, those who immediately say thanks but no thanks when they hear the price are the ones that you don't need to spend time trying to win business from, let them go to the cheaper alternatives and let people fight for the business and any small margin of profit that it may contain.

You can focus your attention on the customer segment that hasn't lost sight of their own strategic goals and has the ability to see how working with you will help them achieve them. A variation on this theme is to have a range of products or services which require less

of your time to deliver them and can therefore compete with the rest of the suppliers on price but you have a range of higher priced work that you don't compromise price for volume. This should help you retain a healthier profit margin whilst maintaining a presence in the main market.

In conclusion, think before you drop your prices, it will be hell to get them back up again so the short term wins may not be balanced by the long term impact (though of course you have to be able to stick around in the short term to get to the long term!).



In the sixth bulletin we'll look in more detail at how creative entrepreneurs are managing their cost base and cover topics such as

- **Shifting the balance of payroll staff : freelancers and outworkers**
- **Which areas you need to keep spending if you are to earn your way out of the recession ... you can expect marketing to feature heavily here!**