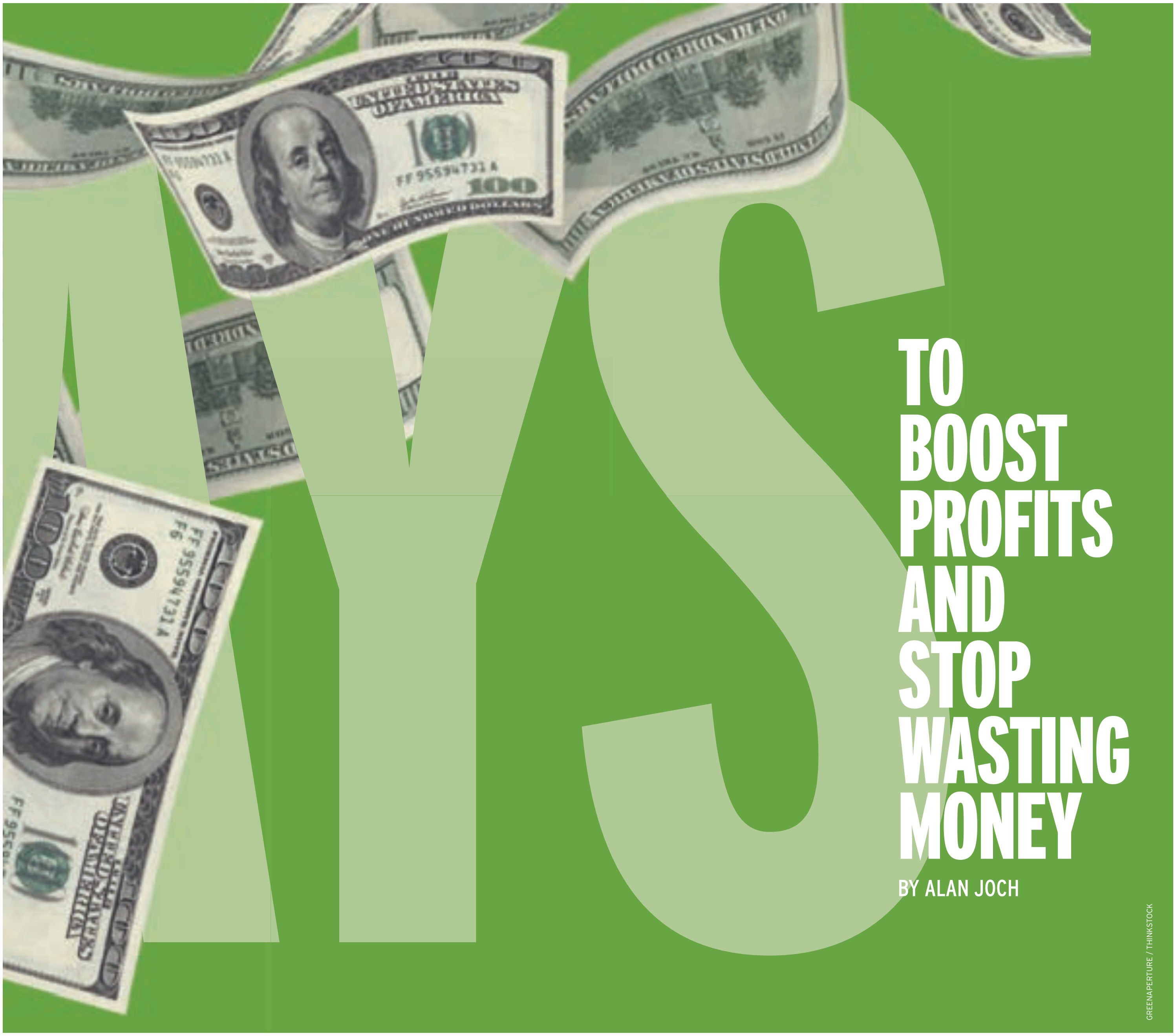
Industry financial experts reveal how engineering firms can upgrade their business plans to fuel higher margins and plug revenue leaks

In today's post-recession marketplace, the business flow for engineering firms can be impacted by shifting client demands, digital innovation and onboarding of new talent. In the day-to-day crush of juggling these challenges, it can be easy for leaders to miss growth opportunities or overlook cost drains that are diluting profits. Fortunately, there are ways around these missteps.

By refreshing business strategies to address today's new realities, engineering executives can attract higher margin contracts and grow the value of their companies. According to leading industry financial experts, there are eight key areas engineering firms should consider as they position their firms for ongoing success.



TO BOOST PROFITS AND STOP WASTING MONEY

BY ALAN JOCH

GREENAPERTURE / THINKSTOCK

1 OPEN THE BOOKS TO ALL EMPLOYEES

Industry executives and consultants say there's value in sharing a comprehensive picture of a firm's financial status with all employees, not just those with an equity stake in the business. "We feel that sharing our financials with employees every month generates a healthy competitive spirit, and the transparency contributes to keeping us profitable," says Chuck Kemp, CFO at POWER Engineers, a company with 2,200 employees, 375 of whom are owners.

The results can be impressive. A client of Ty Kicklighter, president of the Kicklighter Group, a consulting firm, measures the percentage of phases that are profitable within long-term projects. After implementing a financial transparency strategy, it saw those percentages rise from about 50 percent to 86 percent over a four-year period. "Employees started looking at how they could work more effectively," Kicklighter says. "They began negotiating better fees for contracts and asking for adjustments when they saw project scope changing. When employees understand how the firm operates and what their individual impact is, they become more motivated to improve the company's health."

What are the first steps on the path to greater transparency? "I ask executives to first write down all the ways that profits help employees, clients and the firm become more successful," says June Jewell, president and CEO of AEC Business Solutions and author of the book *Find the Lost Dollars: 6 Steps to Increase Profits in Architecture, Engineering and Environmental Firms*.

Items to include on the list range from higher compensation and better bonuses to enabling the firm to open more offices or acquire other companies, which may create additional leadership roles.

Many employees will also need training to fully understand what the financial statements are showing them, she adds. The training should cover accounting terminology, financial management and tax policies, along with how these can impact the success of the firm.

"When firms share information, they have much more engaged employees," Jewell says. "It's difficult to hold people accountable if you don't give them the tools and information they need to manage their projects."

2 DOUBLE DOWN ON PROGRAM MANAGEMENT

Disciplined program management can be the difference between achieving the desired profit potential of a contract and watching margins dissolve unexpectedly. "A strong program management culture and approach that gives us flexibility and agility really helps drive accountability," Kemp says.

One key metric is how quickly clients pay based on milestones and deliverables. Commercial software applications can apply this level of oversight, but some firms, including POWER Engineers, have developed their own programs for real-time reporting of project status.

"Good clients realize that firms need to be paid for the work done within a reasonable time of it being completed versus dragging you along." Kemp says, "When clients see where projects stand along the way, they're likely to pay their invoices more quickly."

POWER Engineers has Power360, a program management application, which it makes available to clients who want to monitor their internal performance, Kemp adds.

3 RETHINK PRICING STRATEGIES

Time and materials contracts have long been a mainstay of the engineering industry, but experts say this venerable model is due for a change. Engineering firms should consider moving to value-based pricing, which has the potential to attract higher margin work. "Clients today are more open to innovative approaches that will lessen their risk and reduce the overall construction schedule and costs or long-term operating expenses—and they're now more willing to pay for it," says Gerry Salontai, president of the Salontai Consulting Group.

However, this requires resolve, especially when competing against firms with low time and materials bids. "If you focus on long-term client relationships and use those deep relationships to have conversations about pricing, you'll increase your chances for signing value-based contracts," Salontai says.

This involves pursuing projects with potentially high-value prospects, and understanding their goals and requirements for the project. This can head off misunderstandings that ultimately cause

"Clients today are more open to innovative approaches that will lessen their risk and reduce the overall construction schedule and costs or long-term operating expenses—and they're now more willing to pay for it."

GERRY SALONTAI | SALONTAI CONSULTING GROUP

scope creep and client conflicts. For example, it's common to believe a low price is important to all clients, but that's not always the case.

"Maybe a client is more concerned about construction costs down the road or other factors," Jewell points out. "That's why it's so important to get clients to reveal upfront what's most important to them."

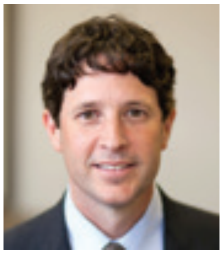
4 CHASE PROFITS, NOT REVENUES

Routinely offering low-priced bids sets other profit-draining traps. Instead, accept new business that aligns with margin goals and improvements to the bottom line. "The minute you focus on revenue growth over margins, you start accepting jobs that don't meet your margin expectations," Kemp says. "You may be winning work, but chances are it won't be profitable enough to be accretive."

A high-volume, low-margin mentality is a holdover from the recession when work was scarce, consultants say. Firms took any jobs they could get just to keep their employees on staff. But even after the recession ended, firms didn't stop doing this and kept taking terrible projects, Jewell says.

She also warns company leaders to avoid low-margin bids in the hopes of getting through the door of a new client and setting the stage for more lucrative, follow-on contracts. "Once they're in, it's very difficult to raise prices, and firms get stuck with bad client and low-value work," she says.

Being selective about clients and projects also helps firms optimize their most valuable resources, such as human capital. "Firms need leadership and talented people to move into a new business or new market or to pursue new service offerings," Salontai says. "And because the best companies know that talent is a precious resource, they continually assess what part of their existing business needs to be improved or divested of when evaluating new strategic alternatives."



"When employees understand how the firm operates and what their individual impact is, they become more motivated to improve the company's health."

TY KICKLIGHTER | KICKLIGHTER GROUP

5 DON'T LET SCOPE CREEP ERASE PROFIT

Not every contract lives up to its potential. Little by little, firms add services that weren't in the original budget. If program managers don't stop the bleeding or aren't tracking performance closely, scope creep can turn an anticipated 20 percent margin into a 6 percent disappointment. That's not the only danger. Leakage also undermines backlog estimates, which means executives make business decisions based on inaccurate estimates of workforce levels and returns. "Backlog reporting is a critical leading indicator for the health of your business. Firms really need to be able to peel back the onion by understanding their leakage/funding not captured in determining how accurate their replenishment rate truly is," Kemp says.

Jewell advises training project managers to estimate project costs more accurately and write contracts with contingencies that account for scope creep. For example, contracts should set a limit on revisions for drawings. "If clients come back to request more revisions, you can have discussions to help them understand that they will need to pay more," Jewell says.

6 UPDATE MARKETING PRACTICES

Engineering firms may miss out on profit opportunities because of outdated sales processes that rely on requests for proposals and legal notices for new business. "It's a solicitation mindset that progressive companies are leaving far behind," says Douglas Reed, president of FosterGrowth, a business consulting firm. "Instead of thinking that clients are hiring you, decide what types of clients are most profitable for you to work with and then go after them."

An inbound marketing strategy is the modern approach that replaces cold calls and promotional mail. Reed advises firms to use social media tools, such as Twitter, LinkedIn and blogs, to display the firm's brand, core values and visible experts to browsers that connect them to the firm's digital sites. Reed also suggests using consultative email campaigns, YouTube channels and paid search ads to motivate viewers to sign up for a webinar or a consultation. This action then reveals who they are and indicates they have an interest in the firm. The overarching goal is to encourage potential clients to seek out your firm.

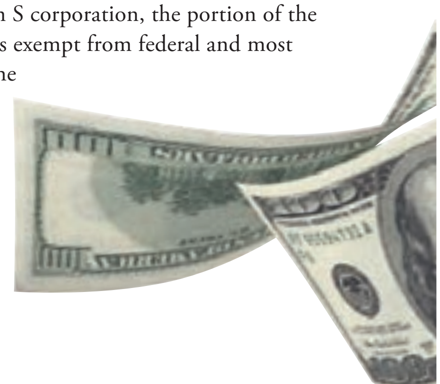
To succeed with inbound marketing, many engineering firms will benefit by investing in marketing-automation software and talent, which includes but is a dramatic expansion of Client Relationship Management platforms. These platforms and talent are largely found outside the engineering industry where more progressive sectors are leading the way.

"Most marketing departments in engineering firms are not given direction to identify and attract inbound marketing and sales operations specialists," he says. "Once my clients understand what progressive marketing and sales is, they often conclude that instead of a marketing department, they have a proposal production department."

7 TAKE A BITE OUT OF TAXES

Employee Stock Ownership Plans (ESOPs) can help firms reduce their tax liability and thus free up capital for strategic initiatives, says Chris Staloch, managing director at Chartwell Financial Advisory.

With traditional ownership models, employees may be able to buy an interest in the firm, but they would do so using after-tax dollars, he explains. Because ESOPs are classified as qualified retirements plans, organizations fund them with tax-deductible contributions. "In an S corporation, the portion of the company owned by the ESOP is exempt from federal and most state taxes," Staloch says. "So, the holy grail of ESOPs from a tax standpoint is a 100-percent ESOP-owned S corporation. Then the company no longer has to make any tax distributions to its shareholders, and it can retain that cash to fund growth in the company."



8 USE DEBT STRATEGICALLY

Interest rates have begun to inch up, but they remain at historic lows. This means engineering firms still have an opportunity to borrow money at cheap rates and reinvest it for market-expanding acquisitions, to purchase productivity-improving technology or attract high-quality talent. First, many executives must overcome their aversion to taking on debt. "Engineers are by nature conservative, so many have been reluctant to take on debt to capitalize their companies," Staloch says. "But their firms may be undercapitalized as a result and not grow at rates that are otherwise possible."

To avoid the inherent risks of taking on debt, company leaders need an accurate estimate of how the borrowed money will pay off. "The goal is to utilize less expensive capital—bank financing—to fund an acquisition or other initiatives that will generate much higher returns for your shareholders," Staloch says. "That requires a well-thought-out business strategy." ■

Alan Joch *is a business and technology writer based in Francestown, New Hampshire.*