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Preparing for a rebound: How architectural firms can make the most of today's economy

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After experiencing one of its most difficult years ever, the Boston area's architectural industry appears to have bottomed out and is showing signs of recovery. However, DiCicco, Gulman & Co. LLP's (DGC) 2010 Architectural Study showed that firms in the greater Boston area suffered through a difficult 2009 where there were very few bright spots.

Consider some of the numbers from the DGC study, which is based on data from 32 Boston area firms with gross billings ranging from $1 million to $40 million:

* Profits plummeted to just 43 cents per direct hour in 2009 after achieving profit per direct hour of $11.98 in 2007, and $8.44 in 2008.

* More than 90% of firms were forced to layoff employees, reduce salaries or both. The average hourly wage rate decreased approximately 5%, indicating deflation in wages.

* The utilization ratio - the percentage of total hours worked that are billable to clients - dropped to 58.9% in 2009, down from from 64.6% in 2007 and 60.4% in 2008. This was the lowest rate in decades.

* Backlog levels decreased dramatically, with few new projects starting and many projects put on hold as the construction industry felt the full impact of the recession.

* Net fee income dropped 23%, while the workforce was reduced by 35%.

* The average break even multiple increased to 3.2 times direct labor dollars, and the overhead rate per direct hour increased to $73.11 per direct hour; both all time highs. Major contributors to the increase in these overhead statistics were the decrease in billable hours and increases in the areas of health insurance, bad debts, and severance pay. Many firms also found themselves paying excess rent as they are saddled with too much space after downsizing to a smaller firm size.

Despite these negative results, there were some bright spots in the DGC survey as the average firms direct labor billing multiple improved to 3.28 in 2009; an increase over the 2008 multiple of 3.20. The direct labor billing multiple represent the net fee income a firm earns in relation to the direct labor dollars spent on project services. During 2009 the billing multiple just barely exceeded the break even multiple. Assuming firms can maintain reduced levels of overhead in 2010 and achieve the same billing multiple, profits should improve significantly in 2010.

The DGC study also revealed that the average firm was able to preserve enough working capital to support the levels of net fee generated in 2009. Working capital, which measures the excess of a firm's current assets over current liabilities, increased to 26.9% of net fee income in 2009 from 23.9% in 2008. Working capital of 20% to 25% of net fee income is generally considered to be a measure of a properly capitalized firm with sufficient liquidity.

Whereby this is a positive indicator going into 2010, the average number of days it took to collect accounts receivable during 2009 increased to 124 days, up from 115 days in 2008. Therefore, a typical firm has to have enough working capital and cash on hand to survive more than three months before being paid. Firms will need to focus on improving the time period it takes to collect for its services to improve cash flow and the quality of working capital in 2010.

New Ways of Doing Business

If adversity creates opportunity, theses are times of great opportunity for architectural firms.

Firms that are succeeding are recognizing the recession as an opportunity to improve the way they do business. For example, many firms are adopting new technology and process improvements. Already, 59% of firms surveyed are using Building Information Modeling (BIM), which is three-dimensional, real-time, dynamic building modeling software that can increase productivity.

Some architectural firms are leaping even farther ahead of the competition by using Integrated Project Delivery (IPD). IPD enables all parties - an entire team - to work as a unit on the same BIM software, so that all aspects of a project can be designed concurrently. Rather than each party focusing on an individual part of the project, the team focuses on the finished building.

IPD enables projects to be designed much faster and at a lower cost. Close collaboration also reduces waste and encourages creativity. IPD involves not just process synchronization, but an agreement among all parties involved to share liability for the outcome. As such, underwriting is difficult, but insurance covering IPD is now being offered.

Brett Gough, senior vice president/partner at Ames & Gough in Quincy, believes BIM and IPD will be like the design-build trend 15 years ago. Virtually every firm will soon be using them, but, given the cost and time commitment required, he believes the shift will be driven more by owners than by design firms.

Preparing For a Rebound

Other than accelerating adaption of BIM and IPD, what can architectural firms do to prepare for the next economic rebound?

Diversify. In business, as in investing, diversification reduces risk. Firms that rely on business from one sector are affected by the stability of that sector. For example, architectural firms that practice in the government, education, healthcare or life sciences sectors are faring better today than those focusing in other sectors.

Differentiate. What can your firm offer than no one else can? Why should anyone hire your firm over another bidder? If you can't answer these questions, neither can your potential clients.

Price sensibly. Many firms are seeking to fill capacity by dropping their prices. While it's important to price competitively, no firm wants to become known as the low-price bidder. In addition, be careful not to enter into long term contracts at low profit margins that will hurt your firm in future years.

Market aggressively. DGC's study found that firms are spending 7.7% of their time on marketing, up from 7% in 2008 and 5.9% in 2007. You'll need to do the same just to keep up, but marketing more aggressively than your competitors can help differentiate your firm. Initial 2010 time statistics show that marketing time is up to 10% of total time in many firms, as there is a major push to build up backlog.

Monitor financial trends. Be sure to pay close attention to key financial metrics. Make certain cash flow is sufficient to pay bills in a timely manner and avoid taking on more debt than you can safely handle. Do your best to get costs under control, but be certain you have the right people in the right positions to take advantage of opportunities as the economy recovers.

Maintain adequate working capital and keep a good relationship with your lender. Meet with your tax advisors early and plan appropriately. Watch your receivables and start the collection process early.

Plan ahead. DGC estimates that more than 70% of owners of architectural firms in the Boston area are 55 or older. Those who wish to keep their firms operating after they retire need to plan now. The industry is ripe for consolidation. It's likely that there will be many mergers and acquisitions in the near future, but it is a buyer's market, given the state of the industry.

Whether you're positioning your firm to get top dollar in an acquisition or strengthening your firm so it will be one of the long-term survivors, you will need to plan ahead. As recently as 2007, A&E firms were expanding rapidly. Few planned ahead for the inevitable downturn and, as a result, were left with too much capacity, too many employees and not enough work.

Building a business without a plan is like building a building without an architect. The firms that succeed will be those that plan ahead.

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