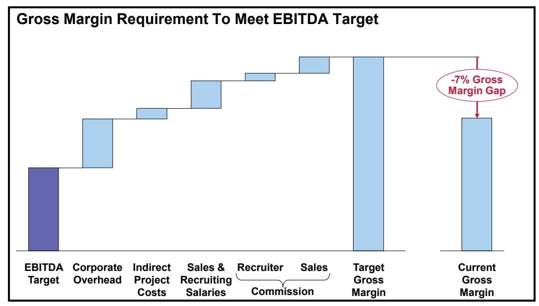
Operations Improvement At Professional Staffing Company: Dissecting Job Profitability And Redesigning Commission Structure To Improve EBITDA Margins

The Challenge: Our client, a PE-owned professional staffing company still managed by the company founder, was suffering significant margin erosion/pricing pressure due to competition from lower-cost India-based knowledge process outsourcing (KPO) firms and aggressive pricing by domestic competitors. Despite over a year of efforts by the CFO to substantially upgrade the company's systems and reporting processes, it still lacked accurate, detailed reporting to track job margins and cost structure. To meet its financial plan, the company needed to achieve its historical EBITDA margins, about 50% higher than current EBITDA margins. With no clear path on how to improve EBITDA margins, the CEO and PE firm asked Gotham to: (1) dissect the company's cost structure and job margins to gain a better understanding of profitability drivers/components; (2) redesign the sales and recruiting commission structure to incent sales personnel to sell higher-margin projects; and (3) develop robust KPI-based reports required for managing cost and profitability moving forward.

Dissecting Cost And Job Data To Identify EBITDA Margin Opportunities: To overcome our client's systems/data tracking/reporting reliability issues, Gotham undertook a detailed bottom-up approach to develop reliable cost and job performance datasets. The company used staffing software, TKO, for job and hours tracking, invoice generation, and profitability reports generation, and an ERP system, Great Plains, for cost tracking and financial reporting. These 2 systems were not connected, with the controller manually transferring summary level data between the 2 systems. Gotham worked with the company's software vendors to collect pertinent raw data and then cleaned, linked/synthesized, and reconciled the 2 datasets. Finally, we validated the data against such anchor data as sales/recruiter commissions, accounts payable, and payroll to ensure the accuracy of the cleaned datasets.

20-30% EBITDA Improvement Opportunity From Growing Select High-Margin Niches And Improving Profitability Of Lower-Margin Clients



While job profitability varied by labor markup, project expenses, sales and recruiting costs, and branch office, the company's current job margin tracking was limited, only accounting for direct expenses (labor markup and some project expenses). To gain a full understanding of the company's cost structure, Gotham analyzed detailed general ledger data and mapped each cost line to job, branch office, and corporate depending on the cost type and information available in the general ledger. We then allocated mapped costs to jobs – job-specific costs directly to jobs (e.g., labor markup, project expenses, sales and recruiting commissions); branch office-related costs (e.g., lease, utilities, office supplies) based on hours of job run at the office; and corporate costs based on hours. Armed with a clear view of job profitability from constructing the full cost structure, we then profiled job profitability by state, EBITDA range, gross margin range, labor markup, job size, industry, salesperson, etc., to identify opportunities from both improving lower-margin (e.g., select clients, branch offices) and growing high margin niches (e.g., mid-size jobs requiring 10-25 people). Capturing these opportunities would result in a 20-30% improvement in EBITDA.

15% Immediate EBITDA Gain With Additional 10% Improvement Opportunity From Revamping Commission Structure

Our client's EBITDA margins were being compressed due to steadily decreasing project markups over the last 3 years caused by increasing pricing pressure. Gotham's analysis revealed that the full commission rate was allowed at gross margins too low to enable targeted EBITDA margins (7 percentage points gap), encouraging salespeople to pursue lower-margin/high-volume projects at the expense of higher-margin, typically lower volume projects. To incent the salesforce to pursue desirable business, Gotham redesigned the commission structure with commission rates based on gross margins to encourage higher-margin (even if low volume) projects and a commission multiplier based on total gross profit dollars to encourage higher volume (even if lower-margin) projects. To set proper commission rates, Gotham built a sophisticated tool that simulated the impact of the new structure on salesperson and recruiter commissions – by inputting commission rates at incremental gross margin points and commission multipliers at various cumulative gross profit dollars, the CEO was able to understand the impact of new commission structure by salesperson, recruiter, and client. As the CEO wanted to keep the legacy commission structure for a particular set of clients, the tool also allowed the CEO to override the new commission structure. The client implemented the new commission structure for most clients, immediately capturing a 15% EBITDA gain. A further 10% increase in EBITDA will be captured after 18-month legacy commission structure transition period expires.

KPI-Based Reporting Now Provides Ongoing Visibility To Profitability

To address unreliable reporting, Gotham designed and helped implement KPI-based profitability reports to monitor business performance. First, we worked with the CEO to properly design the reports to provide information needed to understand profitability and enable decision-making. After building the reports in Excel using our clean datasets to reach agreement on design, Gotham worked with controller and the Great Plains vendor to transfer the report logic into the ERP system. We then validated the accuracy of the reports based on our profitability analysis.

The Outcome: Our client immediately implemented the recommended commission structure to capture quick-wins and started leveraging job margin profiles and KPI-based reports to address cost/profitability issues while continuing to identify potential profitable niches.

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