
FUNDAMENTAL PRINCIPLES OF FINANCIAL MANAGEMENT

Income or “Payment for Services”

To have a clear understanding of the fundamentals of financial management, we need to define the following terms.

- **Gross income:** *total compensation for all services and products.*
- **Sale:** *award of a commission upon which income can be earned.*
- **Net income:** *total compensation less*
 - *Vendors’ costs—products and services*
 - *Consultants*
 - *Out-of-pocket nonreimbursed expenses*
- **Earned income:** *net income recognized as a result of delivering a portion or all of the product or service.*
- **Profit:** *earned income less all cost of service and expenses.*

The fundamentals for management and profitability are the same for contract or residential design practices. Both need to be based on the value of services and the time it takes to deliver and manage these services. Remember, all you have to “sell” is your talent and time.

Practice Expenses or “Cost of Services”

One of the biggest issues in many design firms is the disconnect between income and expenses. Since time is money, many design firms *give away* the only asset they have—their time. This is an area in which many residential designers underestimate their value. If you are compensated solely through the sale of product (i.e., furniture, accessories, materials), the time you invest in research, selection, acquisition, installation, and handholding is easily lost. If you do not track this time, you will most likely give away more than you receive.

In a contract practice, the tracking of time to deliver a project is easier since it is accomplished mechanically. Getting staff to fill out their time cards accurately and timely is the key to earning revenue, issuing invoices, and speeding payment for services.

Once you understand the various areas of expenses, setting up a tracking system is relatively easy. Your accountant will be able to assist you in establishing these systems. The cost of services can be generally grouped into three categories.

1. Cost of labor—*generally variable*

- Direct salaries or hourly wages
- Customary and statutory benefits such as Social Security, vacation, health benefits, etc.

2. Cost of operations—*generally fixed*

- Rent
- Phone
- Technology
- Lights
- Heating
- Taxes

3. Cost of sales and marketing—*generally variable and nonbillable*

- Staff support
- Brochures
- Advertising

Financial management is therefore the balance between income and expenses.

Fixed versus Variable Expenses

The following two areas of expense are the foundation for financial planning. Certain items are nondiscretionary, such as rent, phone, lights, heating, and taxes. You must pay these items to stay in business. Others are discretionary, such as advertising and photography. While advertising may help you position your firm within your target market, it is not required for you to operate your firm.

- ***Fixed expenses*** are long term, slower to change, and less controllable on a day-to-day basis. They include such items as a lease for office space or equipment. Generally, these fixed expenses require a commitment of five to ten