A Bright 2021

Digital shop owners had a surprisingly solid 2020

and have high expectations for 2021.

About This Report

This report is a joint project between the Bureau of Digital and Promethean Research.

The objective for this report is to provide a high-level understanding of the digital services market in 2020 and gauge owner expectations for 2021.

This report is a compilation of responses from owners across North America. An online survey was conducted of digital service company owners during February 2021 to collect insights across many key performance indicators.

102 executives completed the questionnaire.

This report was published March 2021.

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About The Author

Nicholas Petroski is a Managing Partner at Promethean Research. Since 2015 Nick has helped digital firm owners better understand their industry and chart more effective paths to success. Prior to cofounding Promethean, Nicholas worked as an equity analyst at a Wall St. firm where he covered the enterprise software and semiconductor industries.

Promethean Research provides data-backed strategies for digital shops around the world. They partner with ambitious management teams to drive radical growth. Since 2015 their research has covered over 30,000 digital shops across 24 countries.

More about how Promethean works with digital shops.

Respondent Demographics

- 102 Responses

- Average size: 30 employees

- Median size: 16 employees

- Average age: 14 yrs old

This survey was open to the Bureau of Digital and Promethean Research communities during February 2021. It focused specifically on the outlook of digital shop owners and managers. Both the size distribution and age distribution of respondents fit with our view of how the overall digital services market is distributed.

52% of the shops identified as specialists which is up from 47% last year and 30% in 2018.

The average number of services offered remained unchanged from 2019 at 5. The most common services offered by shops in this survey were: Web design / development, UX design / strategy, Digital strategy, Mobile design / development, and App design / development.

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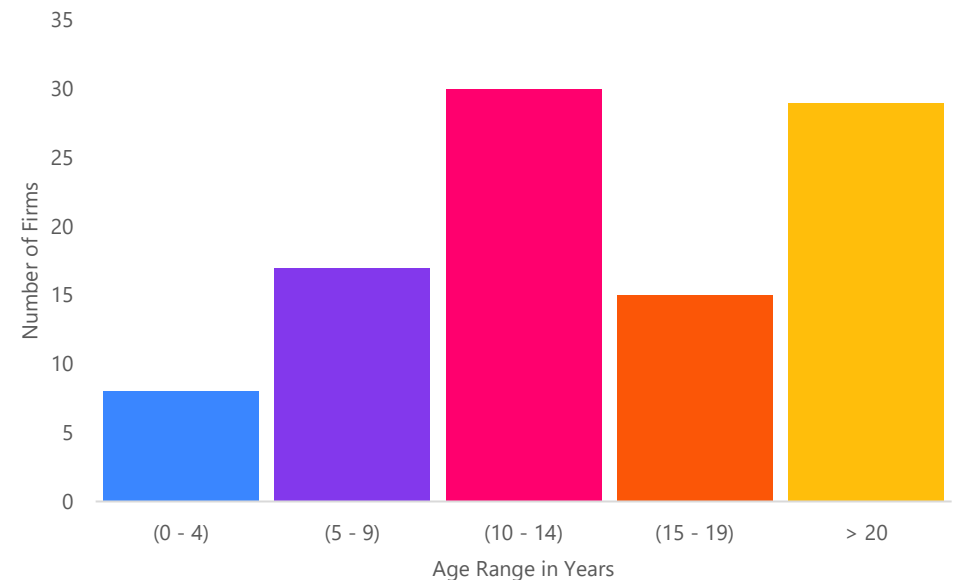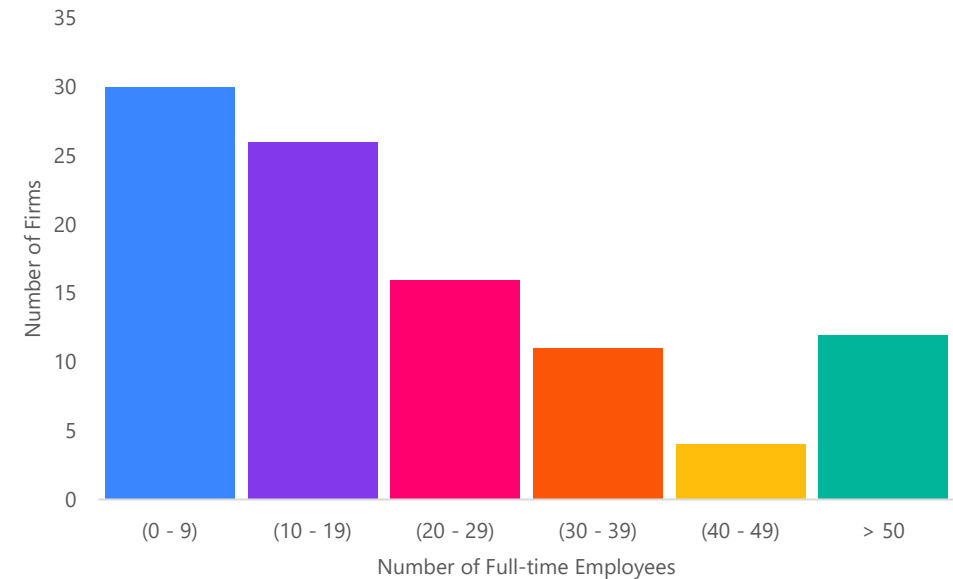
Report Summary

Digital shops wrapped up a tumultuous 2020 with solid revenue growth and margins. Average revenue growth of 10% Y/Y was led by Small and, surprisingly, Large shops where expanding project sizes provided strong tailwinds. Revenue per employee was up in 2020 vs. 2019 which indicates shops were financially healthier than many expected. We saw specialist shops (primarily specializing along verticals / industries rather than technologies / services) grow significantly faster than generalists providing another argument for specialization. This year's survey also gave us new insight into the average composition of firms at different sizes which showed the growth of the importance of sales people as firm size increased. Pricing methods remained essentially unchanged from last year with the big three (Time and Materials, Fixed Bid, and Retainer) making up the majority of responses. New data from Summit CPA shed some light into the makeup of average overhead components and utilization rates. Average utilization rates of 55% for the year are a reflection of just how challenging 2020 was.

The big story here is how optimistic owners are for a strong 2021. From their average overall outlook through their revenue growth, client budget, and hiring expectations, digital shop owners are expecting a bright 2021.


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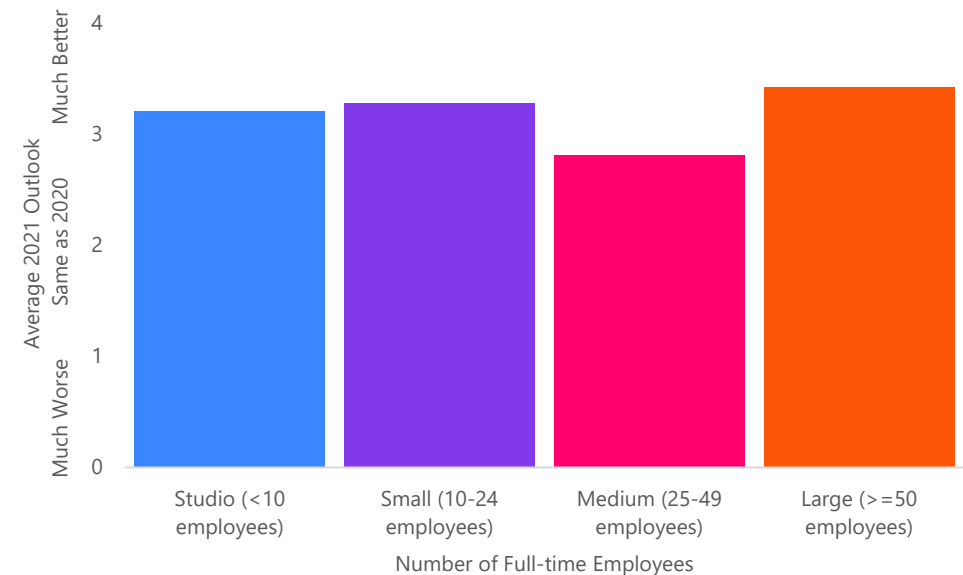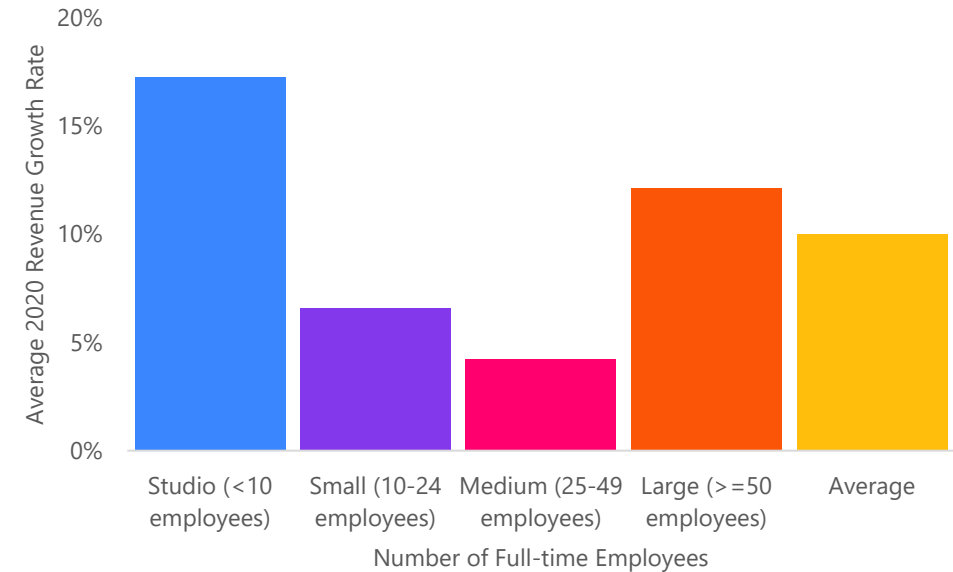
2020 In Review

2020 In Review: Revenue

Despite everything, digital shop owners reported solid results in 2020 from a revenue perspective. The average shop reported revenue growth of 10% Y/Y, which while strong in the context of everything that happened in 2020, is down significantly from the 15% Y/Y growth reported in 2019.

Studio shops grew significantly faster than average at a rate of 17% Y/Y, while Small and Medium-sized firms experienced below-average growth rates of 7% and 4% respectively. Surprisingly, Large shops saw above average growth of 12% Y/Y.

While pitching new work wasn't strongly correlated with revenue growth overall, Large shops that saw above-average revenue gains in 2020 dedicated above average effort to pitching new work. Large shops also saw project sizes increase during the year, something that was highly correlated with faster than average growth overall.

Revenue per employee, a common metric to measure the financial efficiency of a firm, averaged $156k/employee, up from $142k in 2019.


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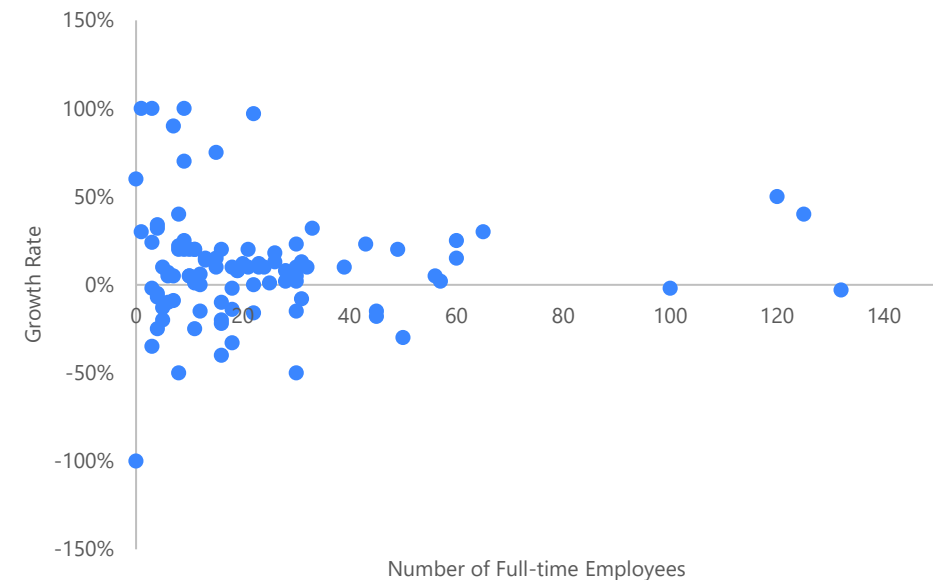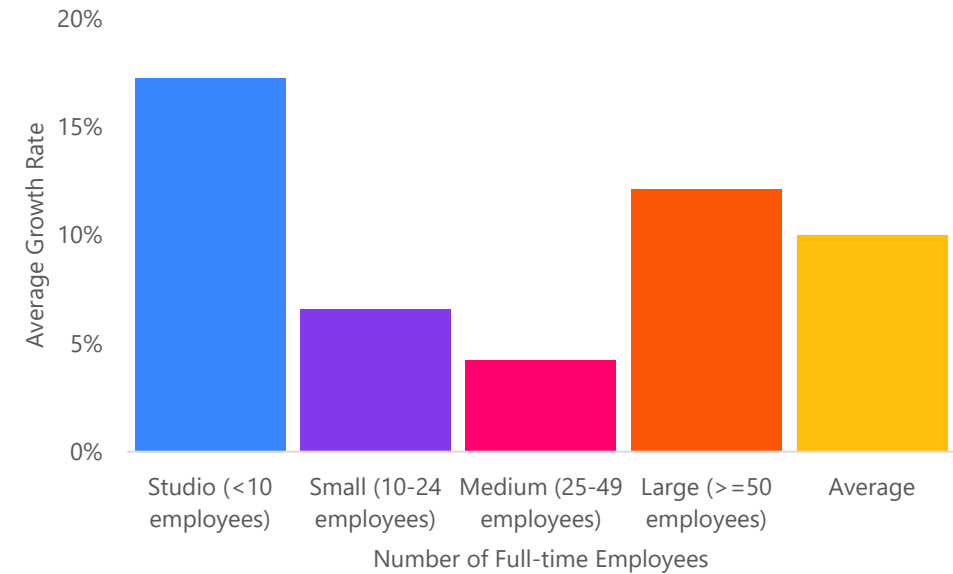
2020 In Review: Project Sizing

Half of the shops surveyed reported increasing project sizes in 2020, either slightly or significantly larger than the year before. 17% saw project sizes shrink.

Large firms enjoyed the most significant gains in project sizes while Medium-sized shops fared the worst.

Respondents that saw expansions in project sizes grew faster than those whose project sizes didn't change. Those who saw declines in project size grew slower than those whose project sizes didn't change but they weren't less profitable.

As we learned last year, (see How Digital Agencies Grow) the average digital shop grows by gaining more similarly sized clients / projects. This outlook survey points to significant growth advantages to focusing on increasing project size, rather than simply increasing the number of clients served.

All Digital Shops

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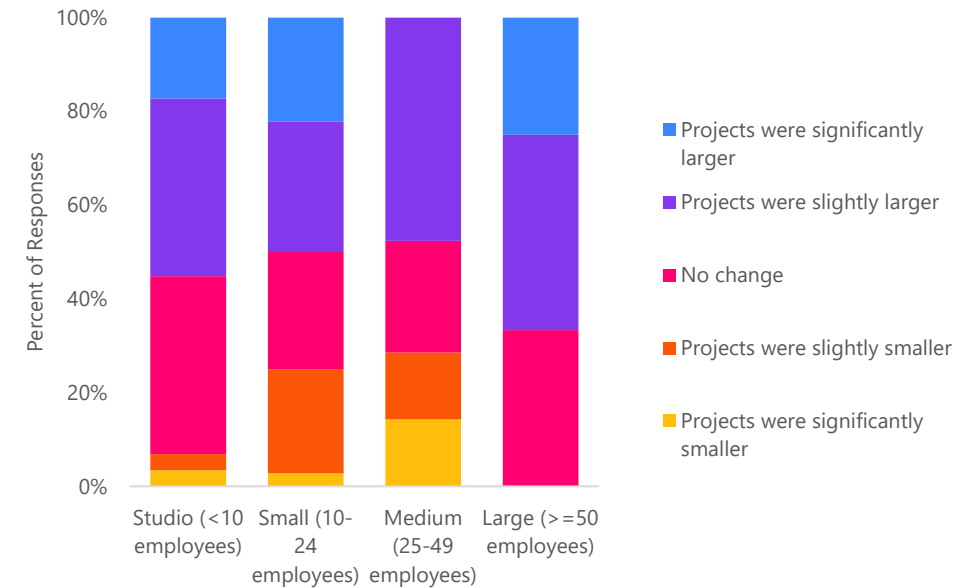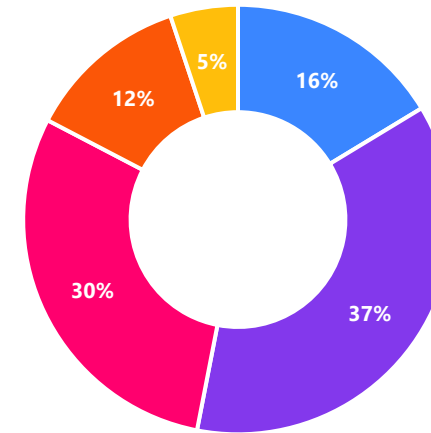
2020 In Review: RFPs

As shop size increases more revenue tends to be derived from requests for proposals. Similar to 2019, RFP reliance and revenue growth weren't correlated.

We believe the increase in RFP usage by larger firms is due to two key factors:

- It is easier to allocate staff to an RFP the more employees a firm has since larger RFPs don't involve significantly more people than smaller RFPs.

- As project size and complexity increase, it is more likely that the purchasing firm will have a standardized procurement process and larger firms tend to take on larger and more complex projects.

While RFP reliance doesn't appear to drive growth, it can be viewed as a cost of business to move up in size cohorts.

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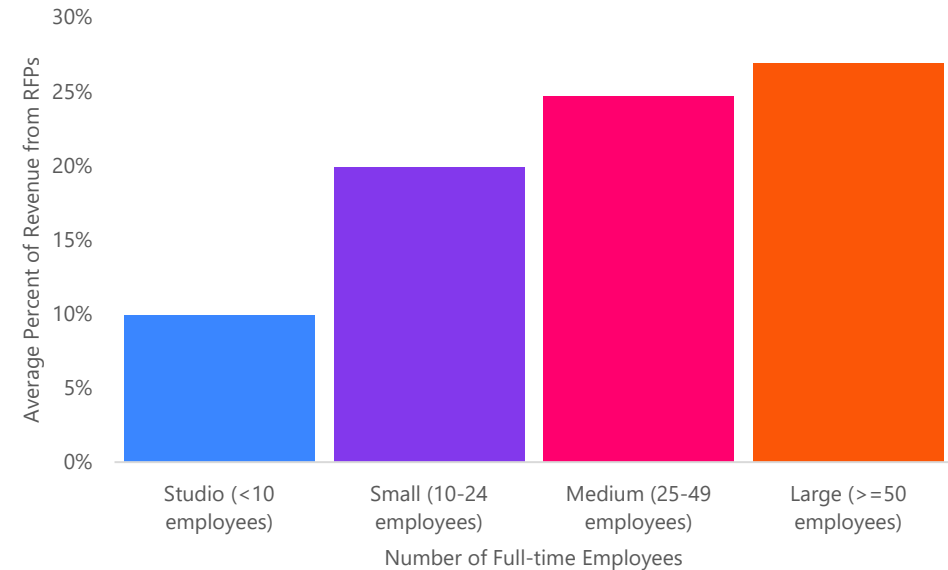
2020 In Review: Specialists

Self-identified specialists (either by service, industry, or geography) in our survey grew 34% faster than generalists last year. Conversely, profit margins were ever so slightly higher at generalist shops.

The majority of the specialists identified as specializing in a specific industry rather than a specific technology or service. This is further enforced by the count of the services offered by each. The average specialist offered an average of 5.2 services while the average generalist offered an average of 5.5 services. This indicates that the majority of the differentiation in the marketplace lies along verticals rather than services.
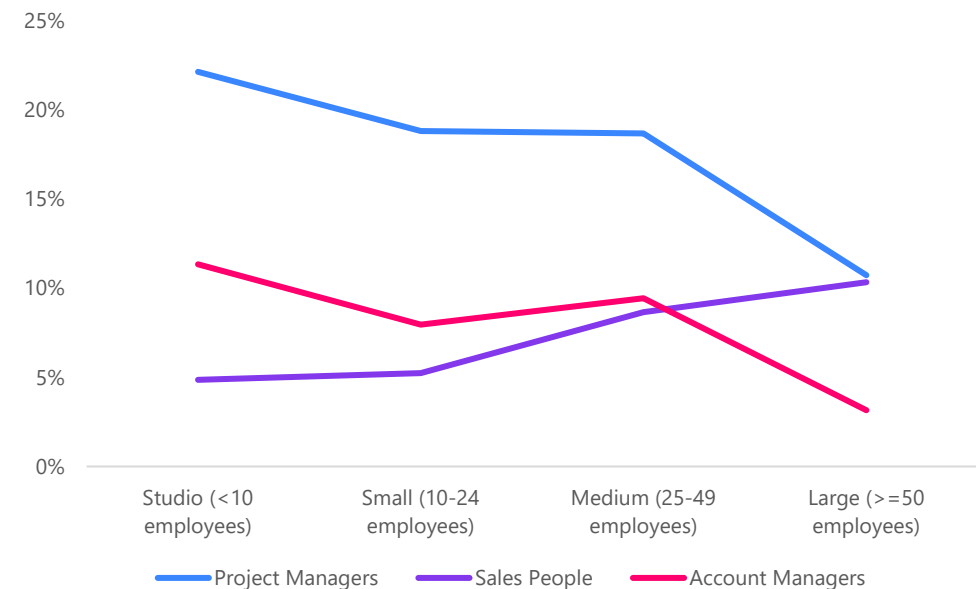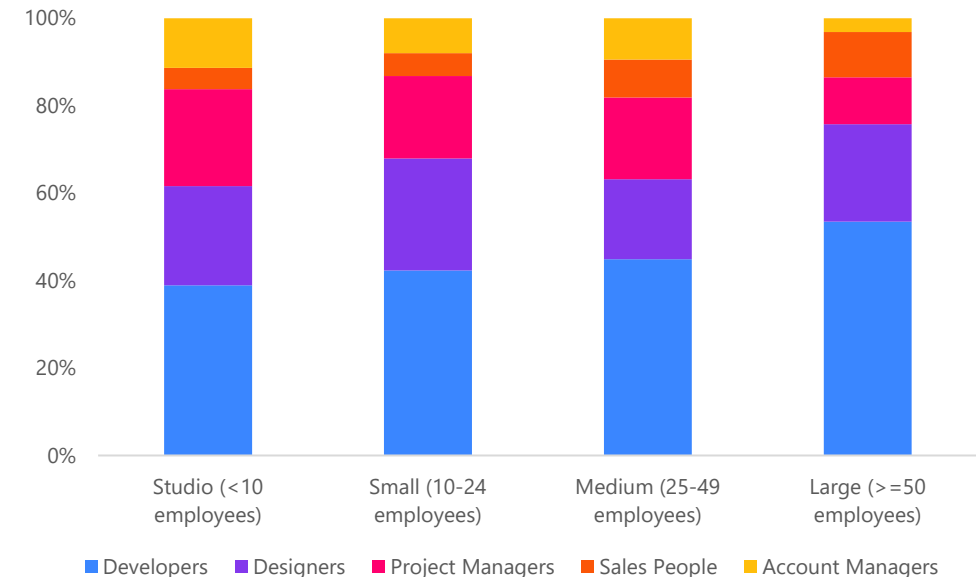

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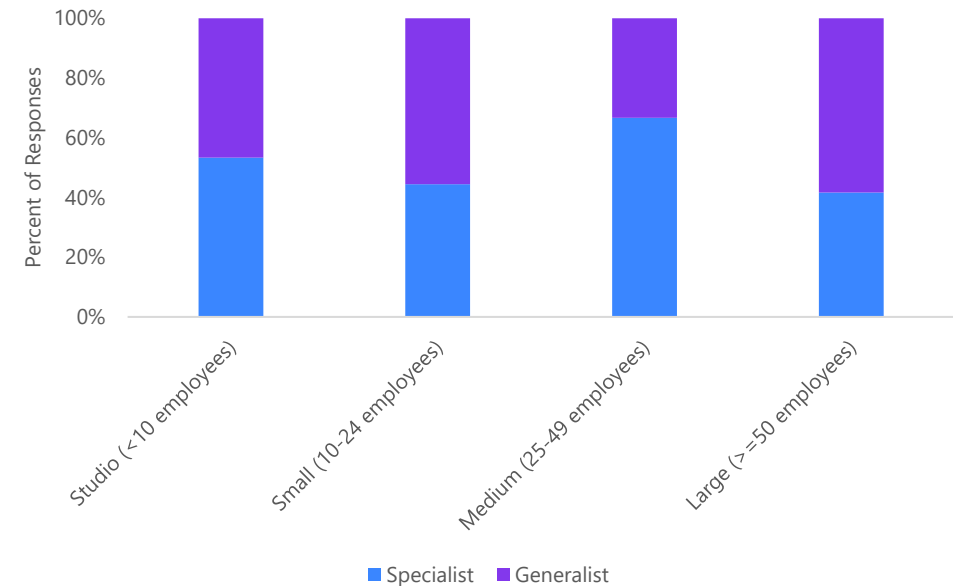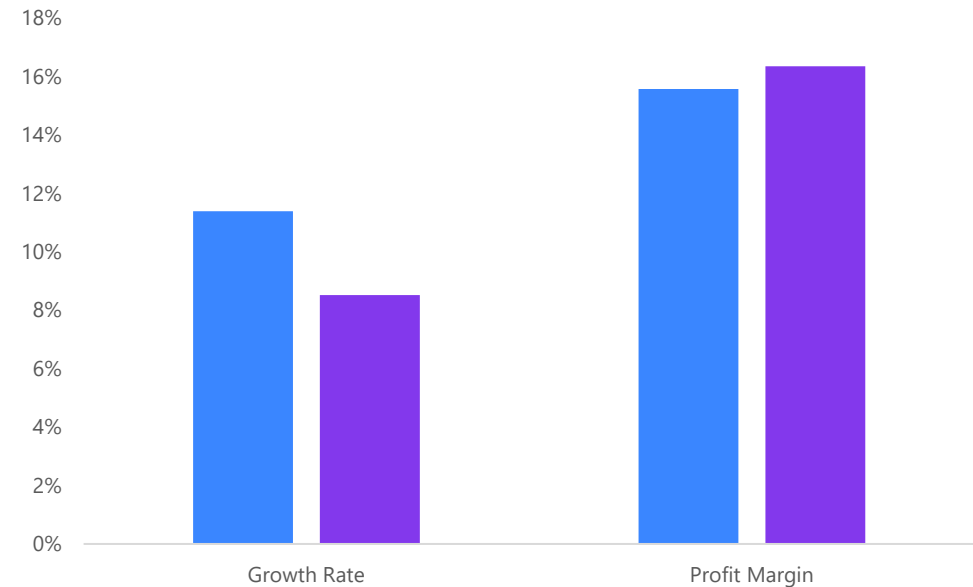
2020 In Review: Composition

This year we asked a new question designed to capture how shop composition changes as companies grow. This ended up revealing some interesting results. The percentage of developers at Studio shops was an average of 39%, this grew steadily as shop size increased up to an average of 53% at Large shops.

The percent of designers remained fairly constant across shop sizes at ~22% of employees, dipping slightly at medium firms.

The percent of project managers and account managers tends to shrink as company size increases. (See lower chart.) After some additional follow up questions, we believe this is partially due to larger account and project sizes at larger firms that don't require a linear increase in personnel coupled with alternative ways of managing accounts and projects. Some companies responded that they don't use AM or PM roles in their organizations. They use other methods of account and project management and thus employ non-standard organization structures to support these methods. Of those that do use AMs and PMs, their Account Managers managed an average of seven accounts, while Project Managers managed an average of five accounts in 2020.

The percent of employees in sales roles increases as firm size grows from a low of 5% at Studio shops up to 10% at Large shops.

Legend (upper chart): Developers, Designers, Project Managers, Sales People, Account Managers

Legend (lower chart): Project Managers, Sales People, Account Managers

2020 In Review: Pricing Methods

Respondents were asked to select all the pricing methods their firm employs. The average shop employed three methods of pricing their services. When examining which services they employed, we found a surprisingly even distribution of firms choosing Fixed bid, Time and materials, and Retainer pricing methods. The top chart shows how prevalent each pricing method was.

The bottom data table shows how common various combinations of pricing methods were. The most common combination of pricing was Retainer + Fixed bid, with 54 responses choosing both of those methods. Time and materials + Fixed bid and Time and materials + Retainer were tied for the second most common combinations. Combinations with Value-based pricing came in next, and Points-based pricing combinations were the least common.

While profitability didn't vary significantly among firms that used different pricing methods (excluding the small number of Points-based shops), firms that employed Time and materials pricing grew slightly faster than others.

Percent of Shops Employing Various Pricing Methods
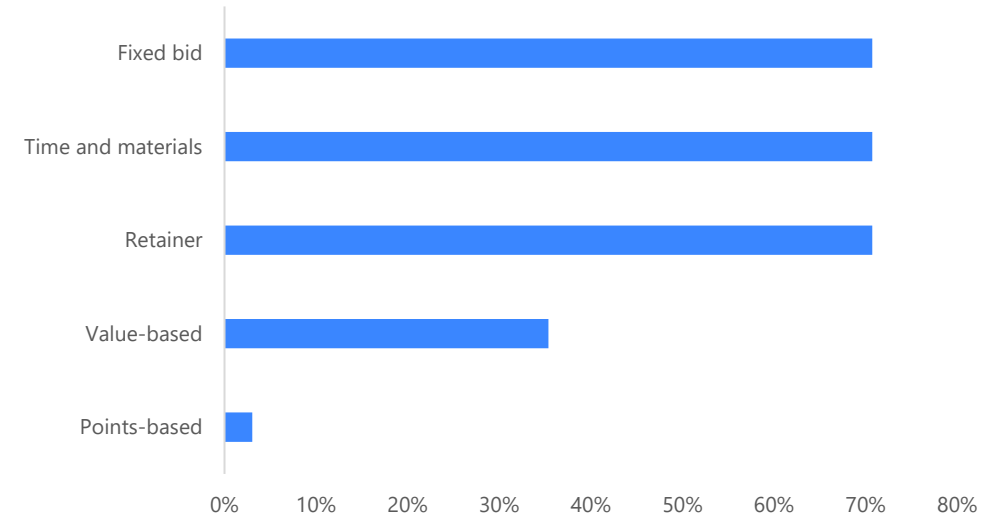
|	Fixed bid	Retainer	Value-based	Points-based
Time and materials	50	50	23	0
Fixed bid		54	26	2
Retainer			25	2
Value-based				3

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2020 In Review: Overhead

This year's survey data was augmented with data from Summit CPA, an accounting firm that works with digital service shops. They provided anonymized data on 55 digital shop's income statement breakdowns. From this we were able to parse the average percent shops spend on three key overhead expenses: Administration expenses, Sales & Marketing, and Facility expenses.

Shops spend about 1/3 of revenue on overhead expenses except for Studio shops that spend an average of 42% of their revenue on overhead.

Shops spend a fairly constant ~7% of revenue on Sales & Marketing expenses each year.

A big question we've seen come up in multiple circles is whether shops should keep their office space in light of the forced remote work experiment of 2020. These average overhead values show a ~3% average spend on Facility expenses that could be partially saved by transitioning to a fully remote firm.


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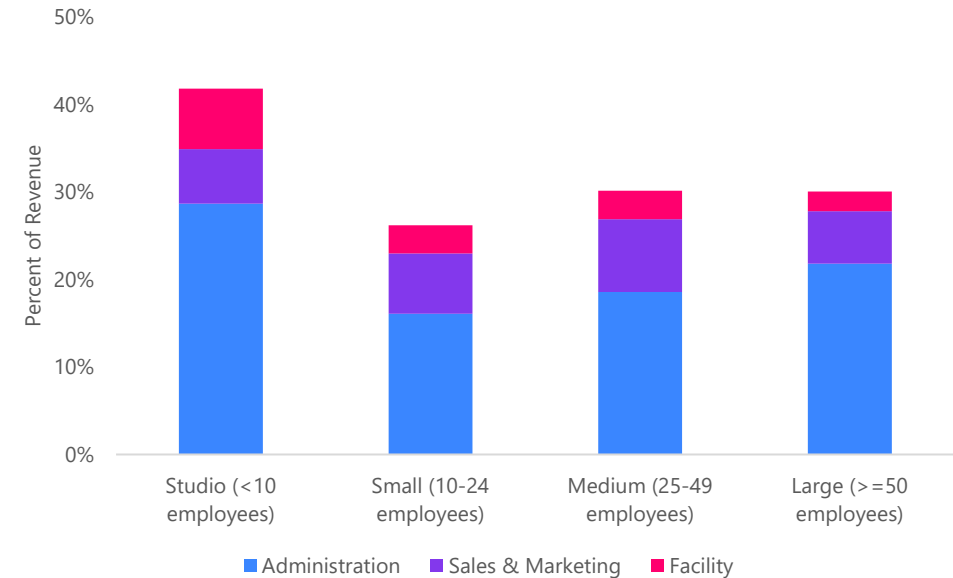
2020 In Review: Profitability

The average shop generated net profit margins of 16% in 2020. This was essentially flat from the average 16.5% in 2019 and down from 18% in 2018.

Shops that saw their project sizes expand in 2020 were significantly more profitable than those that maintained or shrunk project sizes.

Although specialist shops grew slightly faster than generalists, they reported similar profit margins.

Shops offering eCommerce and Staff augmentation generated the highest profit margins while those offering Content marketing and Digital strategy generated the lowest (excluding Public relations and Affiliate marketing).

As expected, there was a direct correlation between higher utilization rates (a post-survey follow-up question we asked) and higher profit margins.


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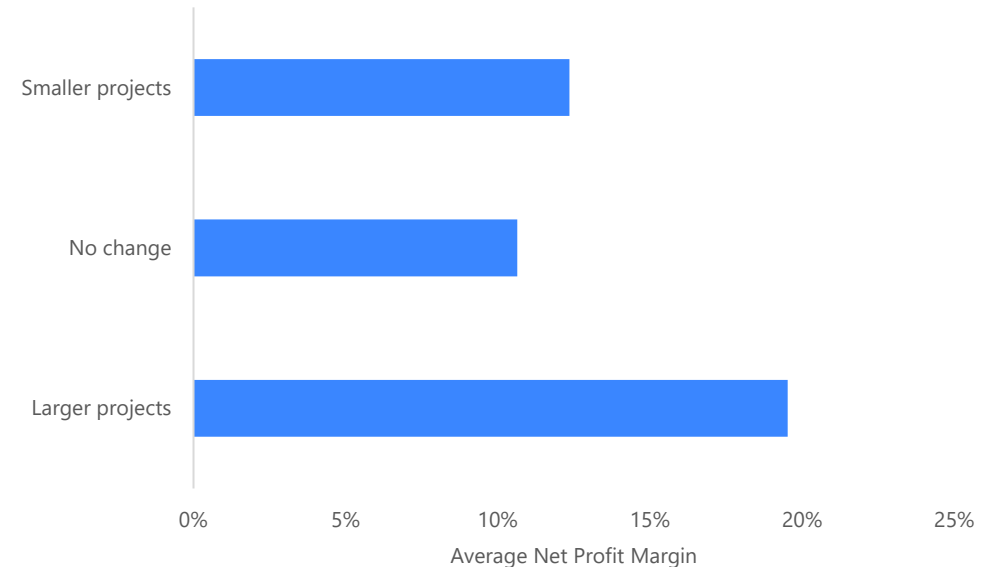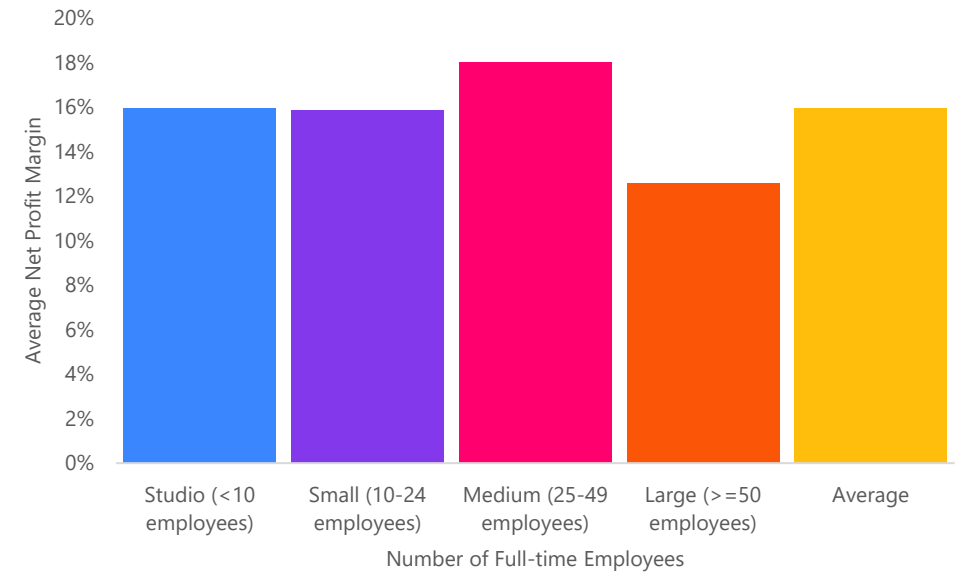
2020 In Review: Utilization

In order to provide more clarity on profit drivers, we asked follow up questions this year related to production employee utilization. We also augmented this with additional data from Summit CPA on utilization rates from 36 digital shops.

The average utilization rate from Summit's data was 55% for 2020. As expected, average utilization rose as company size increased. Larger shops tend to have more stable project streams and are able to more efficiently allocate talent and right-size if necessary. Employee allocation missteps are amplified for smaller firms.

2020 Average Utilization Rate

55%

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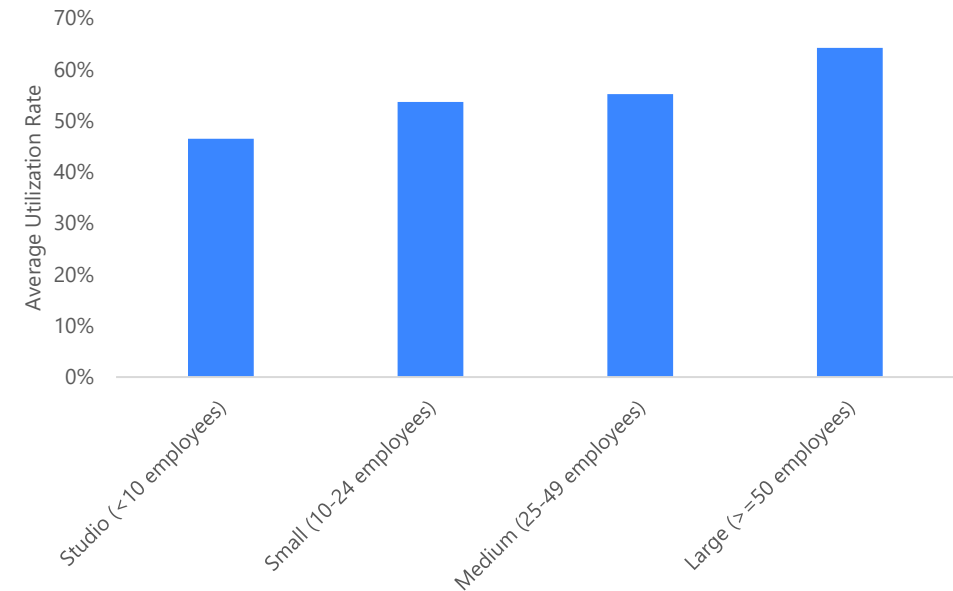
2020 In Review: Services

The average firm offered 5 distinct services in 2020, unchanged from 2019. Smaller shops tended to offer fewer services with Studio shops offering an average of 4 services. Small and Medium shops offered an average of 6 services each while Large shops narrowed their focus and offered 5 services on average.

The most commonly offered services were Web design / development, UX design / strategy, and Digital strategy. While Identity / brand design was the fourth most commonly offered service in 2019, it fell to the 6th most common service in 2020. Somewhat surprisingly, eCommerce only gained two ranks and was the 7th most common service in 2020.

Although Social media marketing and Staff augmentation were only offered by ~20% of shops, those that offered those services grew the fastest in 2020. Those offering Email marketing and Content marketing grew the slowest (excluding Public relations and Affiliate marketing).


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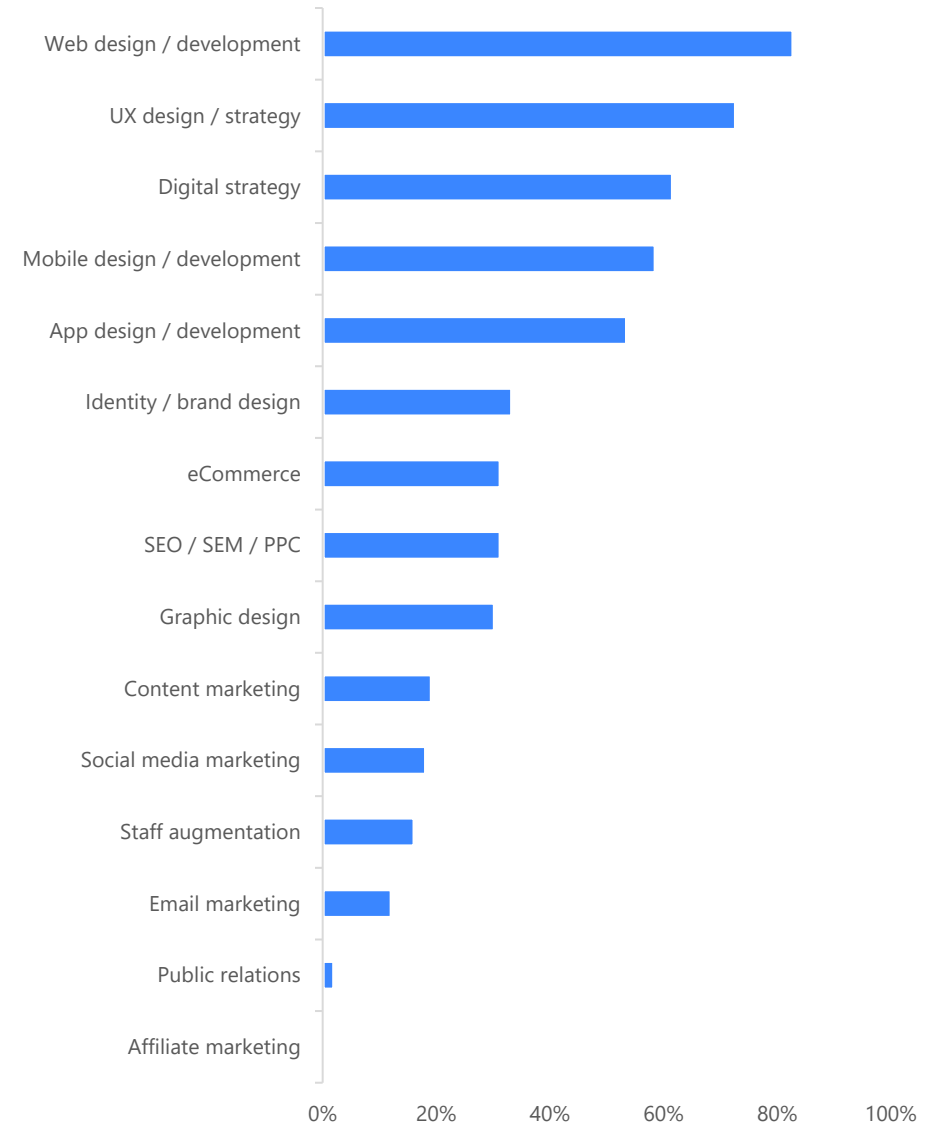
2021 Outlook

2021 Outlook: Overall

Overall, owners are slightly more optimistic about 2021 than they were going into 2020. This is compared to our survey which took place in January-February of 2020 so we don't believe there were any significant pandemic-related effects in last year's optimism results.

Studio shops are expecting a banner year in 2021 with revenue growth expectations north of 40%. Interestingly, Studio respondents only expect client budgets to grow 16% in 2021 and they only expect to increase their headcounts by 23%. This could indicate a large amount of excess capacity sitting at Studios.

Small and Medium shops expectations were all relatively in-line. Large shops are expecting some explosive growth this year with all three indicators above 20%.

The bulk of this optimism seems to stem from stronger pipelines driven by the overall push for faster digital transformation.


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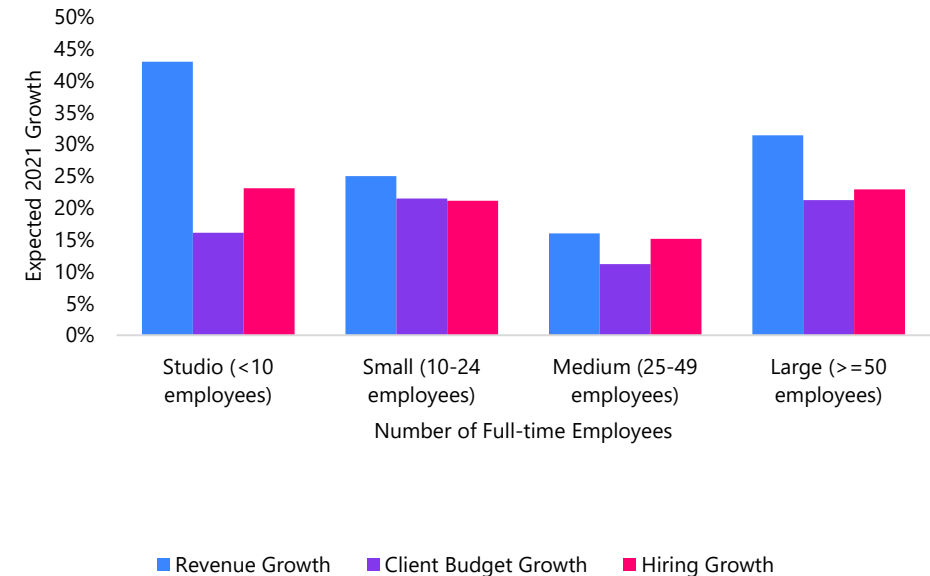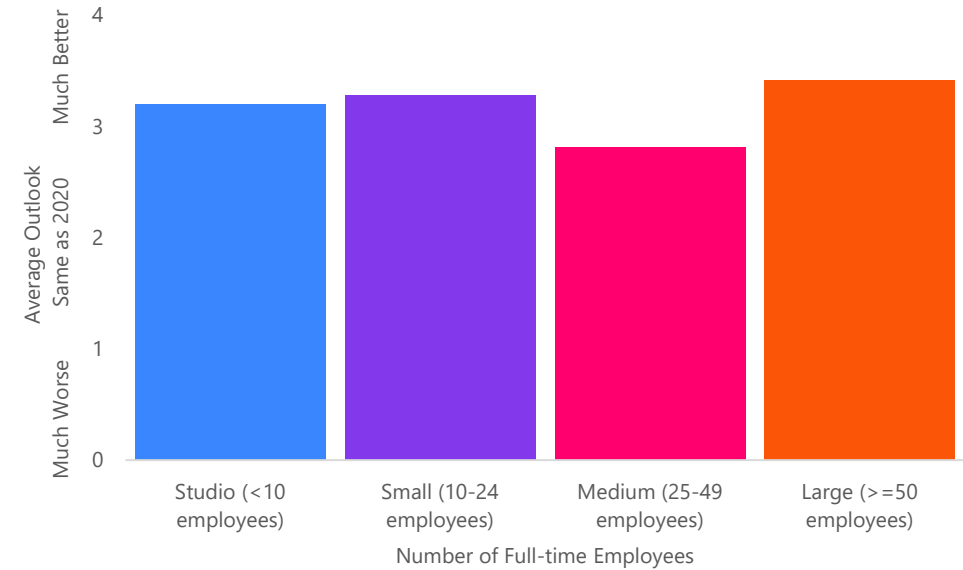
2021 Outlook: Services

For the third year in a row, we're seeing over half the firms in our survey planning to expand services with the larger firms planning greater expansions.

Shops expect to focus on Web design / development, UX design / strategy, and Digital strategy this year. eCommerce is surprisingly absent from the top five with only 20% of shops saying it will be a focus for 2021. Shops appear to be relying on their other services to satisfy the digital transformation acceleration we've seen throughout 2020.

Graphic design as a service focus is expected to lose some ground this year with only 12% of shops saying they'll focus on it vs. the 30% of shops that offered it last year. This is down from last year when about 20% of shops expected to focus on Graphic design in 2020. This decline could indicate a commoditization of the service and it appears that owners have seen this coming as they've expected to see declines here for the past two years.

We asked which services owners expected to decline in the next 2-3 years and for the third year in a row Web design / development topped the charts. So even though most shops are focusing heavily on that service, owners view it as a precarious investment.


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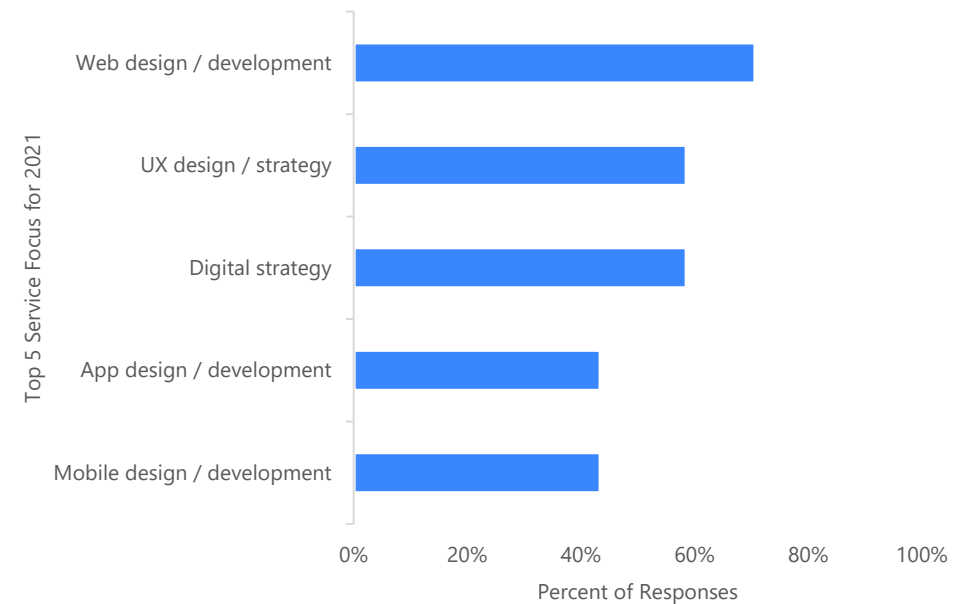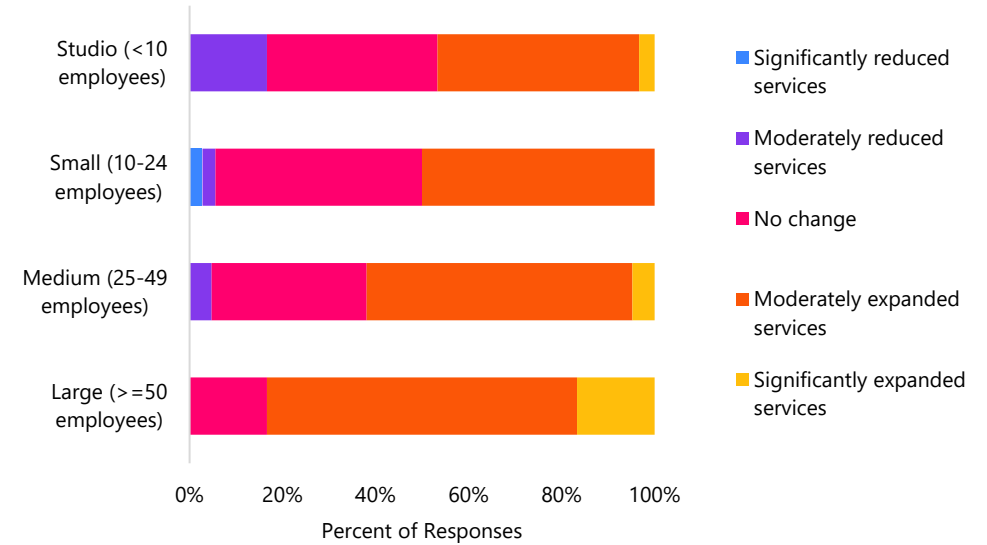
2021 Outlook: Hiring

Digital shops plan on increasing their headcounts by an average of 21% in 2021. We view this metric (vs. expected revenue growth) with more weight as it encompasses owner's plans to invest in their businesses during the year. Should this growth in hiring translate to revenue growth for the year, this survey is indicating an incredibly healthy 2021 for digital shops.

Developers are expected in the highest demand followed by designers. Studio to Medium shops plan to add more account managers than sales people but this shifts at Large shops.

Overall, owners are expecting it to be slightly more difficult to find qualified in employees in 2021. Studio through Medium shops are all expecting hiring to be about as challenging in 2021 as it was is 2020 but Large shops are expecting it to be significantly more difficult.

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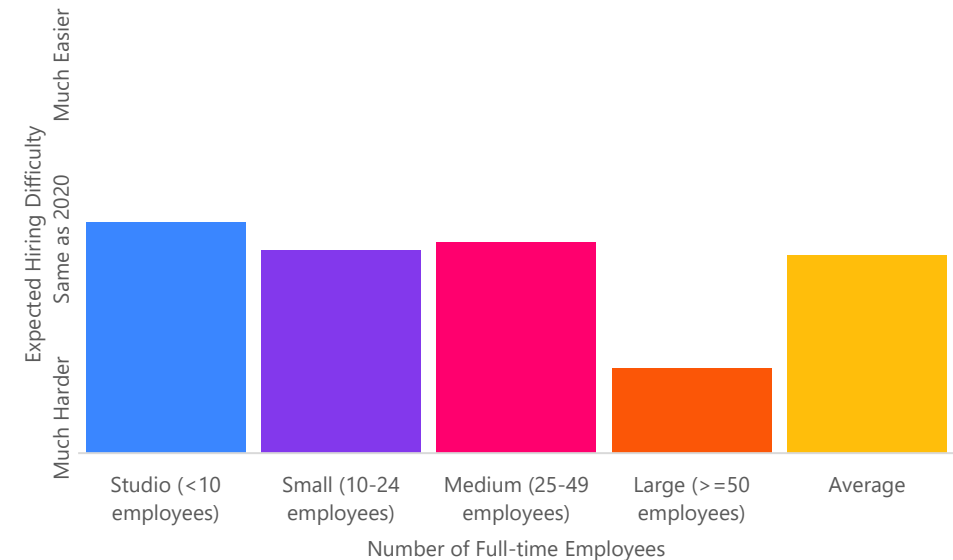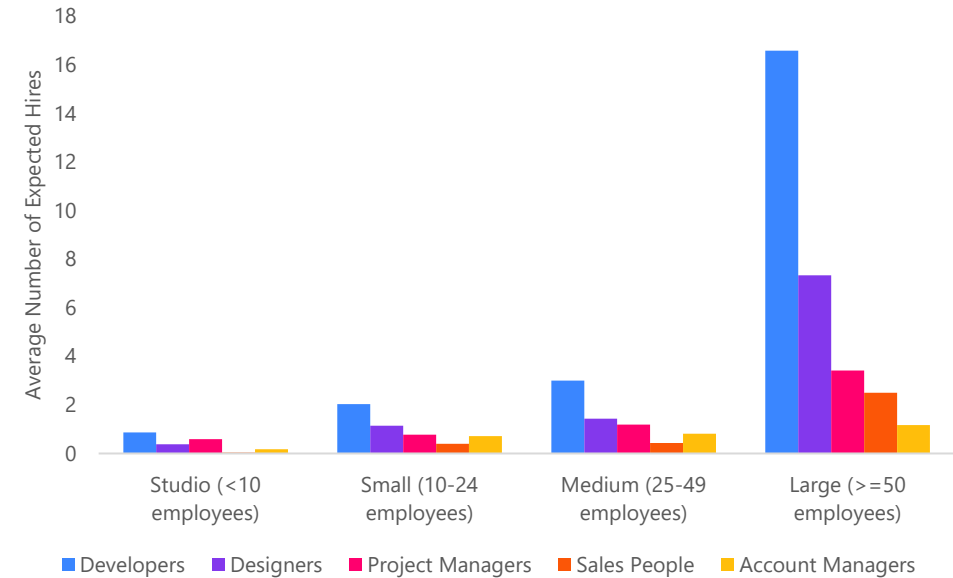
Thank You

Thank you to everyone who participated in this year's survey! For more information, including research and resources for digital shops, visit <u>Promethean Research</u> and the <u>Bureau of Digital</u>.