

COMMENTS FROM



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People who are considering buying or selling an information technology company frequently look for a few key measurements to gauge the performance of the business.

While a complete analysis of any business is an involved process, one key calculation that is frequently performed involves determining the firm's sales per employee. Sales, or more appropriately net revenue, should include all revenues received from the sale of software, maintenance contracts, services and the gross margin from hardware. Since the price of hardware can fluctuate, the inclusion of just the gross margin on hardware eliminates distortions in measurements

The ratio is as follows:

$$\frac{\text{Net Revenues}}{\text{Equivalent Full time Employees}}$$

While each new employee should generate additional net revenues for an information technology firm, a very crude rule of thumb reveals that for a firm to be profitable the sales per employee should exceed \$100,000 to \$150,000. Variations and exceptions exist. Depending on the firm's underlying cost structure, most notably its personnel and other operating expenses, this figure can vary. If the firm consistently has high operating expenses, its sales per employee will need to be higher than normal to generate a profit. The converse is also true.

This ratio should be calculated based on the number of equivalent full time employees. Adjustments should be made if employees are not with the firm for the entire year or work on a part time basis. For example, if a position is filled for only three months during the year, that would count as one quarter or 25% of an equivalent full-time employee (3 months ÷ 12 months = 25%). If one person works part-time, 20 hours per week for the entire year, this would count as one half of an equivalent full time employee (20 hours ÷ 40 hours = 50%). Independent contractors should also be included in this calculation.

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The next issue of Comments From The Chalfin Group will discuss the personnel productivity ratio.

The Chalfin Group provides strategic planning and valuation services to information technology firms.

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