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.

The largest expense of most information technology firms is its personnel costs. These costs include salaries, bonuses, health insurance, payroll taxes, and other direct employee costs. The Chalfin Group believes all information technology firms should carefully monitor the relationship between net revenues and personnel costs.

Adjusted net revenues is defined as 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 only the gross margin on hardware eliminates distortions.

One ratio The Chalfin Group utilizes to measure the relationship between the adjusted net revenues and personnel costs is the Personnel Productivity Ratio. This ratio is:

$$\frac{\textbf{Adjusted Net Revenues}}{\textbf{Personnel Costs}}$$

The above ratio shows how much of a firm's net revenues are being generated from each dollar of personnel costs. The reciprocal, or converse, of the Personnel Productivity Ratio is the Personnel Cost Ratio which is:

$$\frac{\textbf{Personnel Costs}}{\textbf{Adjusted Net Revenues}}$$

The Personnel Cost Ratio provides a similar measurement as the Personnel Productivity Ratio except it measures how much a business is paying in personnel costs for each dollar of adjusted net revenues.

The guidelines that each firm should strive for vary depending on a variety of factors which are unique to every business. However, as a general rule of thumb, for a firm to be profitable, its Personnel Cost Ratio should be below 66% and its Personnel Productivity Ratio should be above 1.6.

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The next issue of Comments From The Chalfin Group will discuss business plans.

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

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