



METRICS THAT MATTER: MEASURING PROFESSIONAL SERVICES BUSINESS





METRICS THAT MATTER: MEASURING PROFESSIONAL SERVICES BUSINESS

Metrics Masters

When it comes to managing a services business, few topics generate as much interest—and controversy—as the topic of Metrics. Whether the question is what to measure or how to measure it, it can be challenging to reach consensus within a single team environment, much less at departmental and organizational levels.

There are easily over fifty meaningful metrics a management team could use to assess their professional services business. The issue is determining what specific metrics provide the greatest insight. Unfortunately, revenue and profitability are not the beginning and ending of your measurement process. These two metrics provide very limited insight into the strengths and weaknesses of your PS business. In this article, we will introduce a practical framework managers can use when selecting the appropriate metrics for their PS organization. Future articles will discuss types of metrics in more detail and discuss the process of defining and deploying a metric strategy.

What Metrics?

When it comes to the professional services business, managers will quickly agree on a short list of metrics that are “must haves”. Yes, you need to understand the utilization rate of your consultants.

Revenue and bookings are obviously critical to track. Then what? Load costs? Project Margins? Employee turnover rate? The debate begins. **Table 1: Ten Professional Services Metrics** provides ten metrics for a professional service organization that I have pulled from the appendix of my book, *Building Professional Services: The Sirens’ Song*. I can articulate the specific value of each one of these metrics. I can explain how each metric provides specific business insight. Despite this, I have yet to meet with a professional services organization that has all ten of these metrics at their finger tips. I am learning that metrics are a “premium” activity for most service organizations. “Yes, it would be nice to have all this data and insight, but we don’t have the staff, time or systems to generate lots of metrics.” Resources are

TABLE OF CONTENTS

Metrics Masters

Page 2

Metric Perspectives

Page 4

Zone 0 Metrics

Page 11

Zone 1 Metrics

Page 15

Zone 2 Metrics

Page 19

Zone 3 Metrics

Page 23

tight. You do not want to add metrics for the sake of having one more number to review. You want to carefully add metrics that bring true strategic insight and help you improve the state of your business. You want to add metrics that matter. How do you do this?

In the well-received book *“The Balanced Scorecard”*, David P. Norton and Robert S. Kaplan introduce the concept that “existing performance measurement approaches, primarily relying on financial accounting measures, are becoming obsolete”. Norton and Kaplan are convinced that metrics that focus simply on financial performance “hinder an organization’s ability to create future economic value”. Furthermore, they state “the success of organizations cannot be motivated or measured by financial metrics alone”. I believe their warning is particularly relevant for human capital intensive businesses. In a professional services business, future quarterly revenues and profits are a direct reflection of how your employees and consultants will execute their jobs over the next three months. Do they have the right skills? Are they motivated? Are they building deep relationships with your customers? Last quarters revenue and profit numbers will provide little insight into answering these telling questions.

To help companies accept the reality that there is more to a healthy business than profit and loss numbers, Kaplan and Norton engineered a balanced scorecard that has four distinct categories where companies should track data:

- **Financial:** ROI, revenue growth, revenue, mix
- **Customer:** Customer satisfaction, account share
- **Internal:** Quality control, time-to-market, operational efficiency
- **Learning and Growth:** Employee satisfaction, training, skills development

Broadening the areas companies should track with discipline is a significant step in the right direction. However, creating additional categories does not help a management team determine what specific metrics they should focus on. There is still this issue of priority. “Remember, I don’t have a lot of extra staff cycles. Which metrics will tell me the most?” To begin addressing this challenge, I want to define the concept of metric perspectives.

Metric Perspectives

Every metric provides a certain perspective on your business. In other words, different metrics tell you different things about your business. Some metrics tell you there is a problem today. Some metrics give you a heads up that there will be a problem down the road. Also, metrics naturally have different scopes. Total services revenue indicates how the overall business is doing, but provides little insight on how individual consultants are doing.

Individual utilization metrics provides insight on individual performance and the overall health of the business. Continuing this logic, there are at least five unique metric perspectives you can consider:

- **Functional Perspective:** What business function does this metric help evaluate? Your sales organization? Your delivery teams? Service marketing?
- **Economic Perspective:** Almost every internal company initiative has one of two objectives: improve operational efficiency or create future revenue (economic value). Does the metric track improvements in operational efficiency or assess the economic value of the business?
- **Timeframe Perspective:** Just like economic data, is the metric a leading or lagging indicator of how the business is performing? Does the metric indicate you currently have a real problem, or does the metric warn that soon you will have a problem if the current trend continues?
- **Scope Perspective:** Does the metric measure the performance of specific individuals, specific projects or the entire business unit?
- **Stakeholder Perspective:** Does this metric provide insight on how your external stakeholders view you? External stakeholders would include customers and partners.

| Metric | Definition |
|------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Backlog | The total value of contract commitments yet to be executed. (Total Backlog = Previous Fiscal Years Commitments + Latest Fiscal Years Sales – Latest Fiscal Years Revenue) |
| Bill Rate | Average billable rate achieved by class of consultant. |
| Gross Margin (%) | The gross profit generated per dollar of service delivered. (Gross Margin = Total Services Revenue – Cost of Services Delivered (COS)), traditionally called “cost of goods sold” (COGS) |
| Hit Ratio | The competitive success rate of the company in the markets it chooses to compete in. Does not include single-sourced bids. |
| Load Costs | Total business costs that are not directly related to the cost of delivering services. |
| Profit per Project | The profit generated by a specific project. (Project Profits = Total Project Revenue – COS – Sales Costs) |
| Rate Realization | The amount of revenue actually earned as a percentage of potential revenue represented by the list prices. |
| Sales Costs | The total costs for the selling efforts of each line of business. Total Sales Costs includes salaries, expense accounts and commissions for sales management, sales people and sales support. |
| Total Services Revenue | Measurement of the different types of revenue; should be listed separately by consulting, solutions and third party pass-through. |
| Utilization Rate | Measures the organization's ability to maximize its billable resources. |

Table 1: Ten Professional Services Metrics

In **Table 2: Metric Perspectives**, these five distinct perspectives are applied to the ten metrics defined in Table 1. The table shows what perspectives are satisfied by each metric. For example, backlog is a leading indicator. If backlog drops below a certain threshold, the business could be moving in the wrong direction. Yes, revenue targets may be met for this quarter. However, two

or three quarters out may be a problem if backlog is not improved. Backlog can be used to evaluate the service delivery and operations functions. Backlog is not an appropriate metric to effectively evaluate the Services Engineering (Development) function.

Now that these five distinct perspectives have been defined, they can be applied to help create an effective metrics portfolio.

| | Functional Perspective | | | | | Timeframe Perspective | | Economic Perspective | | Scope Perspective | | | Stakeholder Perspective | |
|------------------------|------------------------|----------|--------------|----------------|-------------|-----------------------|---------|----------------------|--------|-------------------|---------|----------|-------------------------|----------|
| | Service Sales | Delivery | Service Mktg | Service Engrng | Service Ops | Leading | Lagging | Efficiency | Values | Staff | Project | Business | Internal | External |
| Backlog | | ✓ | | | ✓ | ✓ | | | ✓ | | | ✓ | ✓ | |
| Bill Rate | ✓ | ✓ | | | | | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ | |
| Gross Margin (%) | ✓ | ✓ | ✓ | ✓ | ✓ | | ✓ | | ✓ | | | ✓ | ✓ | |
| Hit Ratio | ✓ | | ✓ | | | ✓ | | | ✓ | ✓ | ✓ | ✓ | ✓ | |
| Load Costs | | | | | ✓ | | ✓ | ✓ | | | | ✓ | ✓ | |
| Profit per Project | | ✓ | | ✓ | | | ✓ | ✓ | | | ✓ | ✓ | ✓ | |
| Rate Realization | ✓ | ✓ | | | | | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ | |
| Sales Costs | ✓ | | | | | ✓ | | ✓ | | | | ✓ | ✓ | |
| Total Services Revenue | ✓ | ✓ | ✓ | ✓ | | | ✓ | | ✓ | | | ✓ | ✓ | |
| Utilization Rate | ✓ | ✓ | ✓ | | ✓ | | ✓ | ✓ | | ✓ | ✓ | ✓ | ✓ | |

Table 2: Metric Perspectives

Metric Perspectives Graph

We are still working to answer the question: What tight set of metrics should I be using to evaluate my professional services business? Remember, the smaller the list the better. By using the concept of metric perspectives, we can create a truly balanced metrics portfolio. The objective is to identify a set of metrics that minimizes any perspective blind spots. For example, you would not want to pick ten metrics to manage your service business—only to realize that not one of them is a leading indicator of how your business is doing.

Figure 1: Metrics Perspective Graph

Introduction shows the metrics perspective graph. This graph allows you to map metrics to determine if there are any obvious perspective blind spots. Figure 1 shows there are four distinct zones that metrics can be mapped into:

ZONE 0: *Lagging, Economic Value.* Metrics in Zone 0 represent how the business has actually performed. Metrics in this zone are the ones ultimately used to evaluate

a management team and include total service revenues and profitability.

ZONE 1: *Lagging, Efficiency.* Metrics in Zone 1 indicate you have a serious and immediate problem in the way you are running the PS business. If operational efficiencies are not improved, revenues and profits will suffer.

ZONE 2: *Leading, Efficiency.* Metrics in Zone 2 provide early warning that you may have efficiency issues. Poor performance on these metrics does not mean revenue and profits (Zone 0) will be immediately impacted. However, these metrics are a pointer to areas that, if not addressed, could impact future financial performance.

ZONE 3: *Leading, Economic Value.* Metrics in Zone 3 provide insight on how the business will be doing in the future. Are you creating economic value that will generate future revenues and profits? Or, are you whittling down your intellectual and human capital in order to pay today's bills?

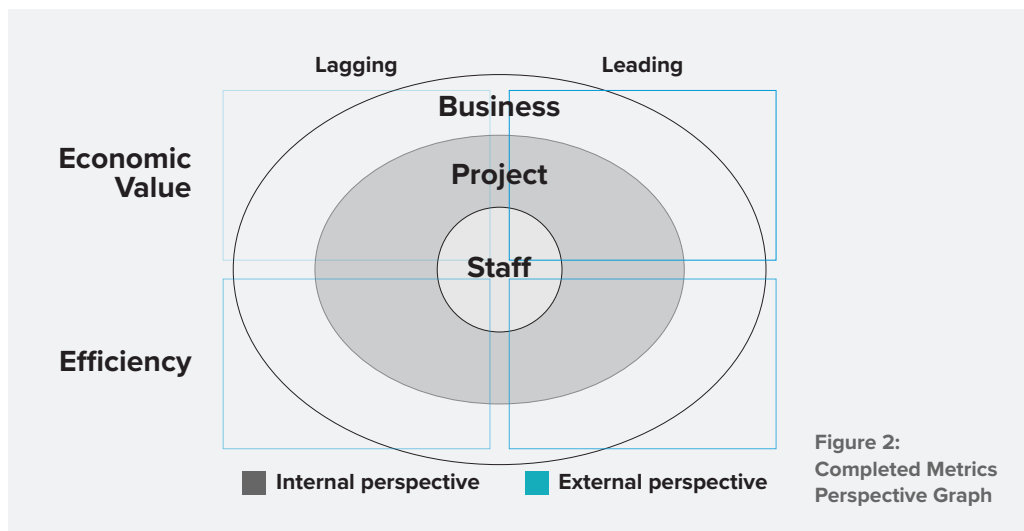


Finally, we need to map scope and stakeholder perspective onto the picture.

Figure 2: Completed Metrics Perspective Graph adds these two perspectives. We have added three rings that represent the scope of the metric. Metrics that only measure the overall business are placed in the outer ring. Metrics that assess the health of projects are placed in the middle ring. Metrics that can evaluate down to the staff level are placed close to the center of the graph.

Stakeholder perspective will be shown by the color used when placing the metric on the graph. Metrics colored in GRAY have an internal perspective—the metric is important to you and your superiors. Metrics colored in BLUE have an external perspective—your customers or partners care about your performance in this area.

Great, we now have this pretty graph. We need to put it into action.



Using the Metrics Perspective Graph

Let us start using the graph by mapping an industry standard metric that almost every service business uses: utilization. As a metric, consultant utilization provides the following perspectives into your service business:

- **Functional Perspective:** Utilization is used to evaluate the service delivery function.
- **Economic Perspective:** Utilization evaluates the efficiency of your service organization.
- **Time Frame Perspective:** Utilization is a lagging metric. When utilization goes down, you have a problem now. After the low utilization report comes in, you can't recapture those lost billable hours. Like airplane seats and hotel rooms, you cannot inventory consulting capacity.
- **Scope Perspective:** Utilization is used to evaluate the performance of individual employees. This data can then be used to evaluate the health of projects and

eventually the overall business. In other words, utilization is a metric that can provide insight on all levels of your PS business.

- **Stakeholder Perspective:** Utilization is an internal viewpoint. Your customers and partners are not concerned about your utilization rates.

With this perspective information, **Figure 3: Mapping Utilization** maps utilization onto the metrics perspective graph.

The good news about utilization is that it covers the lower quadrant of the graph nicely. It is a metric that hits the center bull’s-eye of “staff”. This means the metric can provide insight on individual employees, specific projects or the overall business. However, if you only used

utilization to measure your services business, you would have several blind spots:

- **Functional Blind Spots:** Not specifically evaluating sales, marketing or services engineering.
- **Economic Blind Spots:** Not evaluating the return on investments you are making into the business. Not understanding the economic potential of your service portfolio. Yes, you may be utilized today, but what about six months from now?
- **Time Frame Blind Spots:** You have no leading indicators that will warn the business may be heading south.
- **Stakeholder Blind Spots:** You have no indication how customers and partners feel about the services you are delivering.

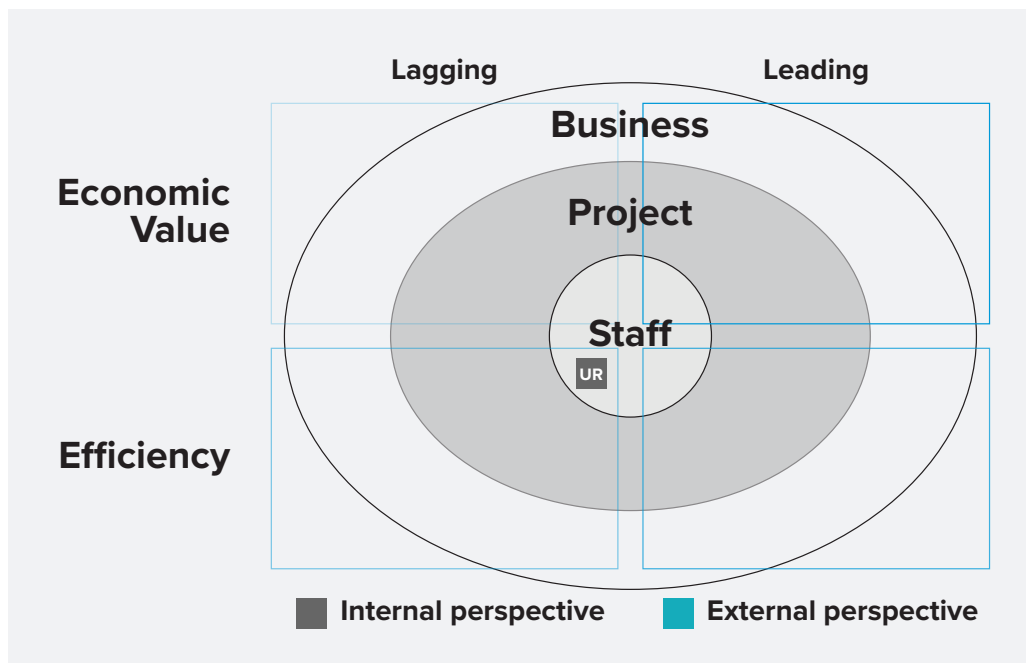


Figure 3: Mapping Utilization

Only using one metric is a simplified example to demonstrate how blind spots can exist. Now, let's map the top ten metrics we called out in Table 1. **Table 3: Metrics Reference Codes** provides a two letter code for each metric.

| Metric | Code |
|------------------------|------|
| Backlog | BL |
| Bill Rate | BR |
| Gross Margin (%) | GM |
| Hit Ratio | HR |
| Load Costs | LC |
| Profit per Project | PP |
| Rate Realization | RR |
| Sales Costs | SC |
| Total Services Revenue | TR |
| Utilization Rate | UR |

Table 3: Metric Reference Codes

Figure 4: Ten Service Metrics maps these metrics onto the perspective graph. Remember, the closer to the center the metric lands, the greater potential scope it has. Being close to the bullseye is a good thing.

A majority of the PS organizations I have worked with do not have all ten of these metrics at their finger tips. Even if they did have these ten traditional metrics in place, there are still weak spots:

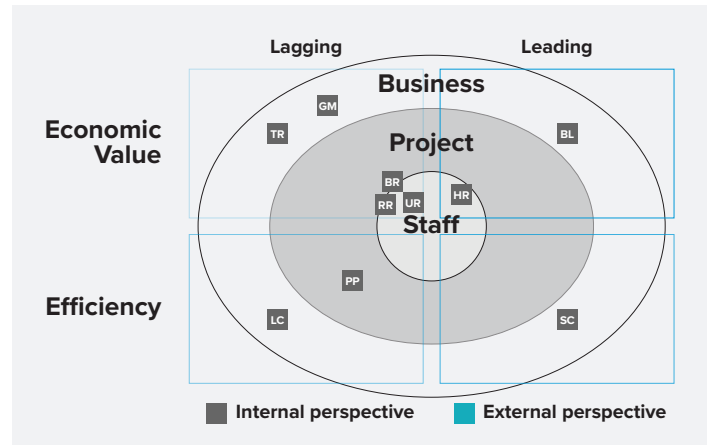


Figure 4: Ten Service Metrics

1. **There is not one metric that provides an external perspective.** How do customers view the business? How do critical partners feel about your skills and ability to deliver? None of these metrics provide insight on how the external world views your business.
2. **70% of these metrics are lagging.** They provide little insight on what direction the service business is moving: positive or negative. Yes, you may have made money this quarter, but are you headed in the right direction? Hit rates, sales costs and backlog do provide leading information—so you are not totally blind. However, you have no leading indicators on the health of the service portfolio or the skills of your staff.
3. **No leading metrics to evaluate the health of projects.** Project profitability tells you after the fact how it went. Are your projects on track now? Are you getting better at managing your projects?

Hopefully the power of this graph is becoming apparent. By considering the concept of metric perspectives, you have much greater

insight into what metrics provide what insight. Mapping these perspectives onto a picture makes the assessment more visual and intuitive. If you mapped the metrics you currently use to manage your PS business onto this graph, what would the picture look like? I am guessing you see the following reality:

- Very few (if any) leading metrics.
- Limited insight on the cost and effectiveness of your service sales activities. You may track revenues and bookings, but not hit rates, sales costs per rep or sales cost per project type.
- Very little insight into overall operational efficiency. Are you getting faster, better, cheaper in the way you deliver your service portfolio?
- No hard metrics to evaluate the specific activities of service development and service marketing.

These blind spot should be addressed. Once again, I am not advocating you track thirty PS metrics. I am advocating you track at least ten to twelve metrics that minimize the types of blind spots I have listed above.

Zone 0 Metrics

Now that we have reviewed the framework, let's take a deeper dive into Zone 0. As previously defined, Zone 0 metrics provide lagging information about the economic health of the professional service business. In other words, metrics in this zone tell you how you how much money you just made—not how much you will make. Also, this

Key Messages

- You can't manage what you don't measure—every senior manager will agree to this truism. Even though we all agree to it, we have a tough time living it.
- Metrics are a premium activity. It takes money and staff to generate data. PS organizations want to apply finite resources to the right activities.
- Management teams must make a conscious decision to focus on a tight set of metrics that will provide the most strategic insight into the business.
- To accomplish this objective, managers can use the concept of metric perspectives to assess and prioritize what metrics they will use.
- At a bare minimum, a balanced metrics portfolio contains leading indicators on the health of the business.

zone does not provide specific insight into the operational efficiency of your organization. Are we doing things faster, better, cheaper? Zone 0 is not very helpful answering these questions. Having said all this, the metrics that live in Zone 0 are critical to the continued employment of the management team.

If targets in this Zone 0 are consistently missed, the management team will eventually be replaced. That why this Zone is always a focal point.

Example Metrics

Specifically, which metrics in this critical zone impact employment longevity? There are

ten metrics that live in Zone 0. **Table 4: Zone 0 Metrics**, lists these ten metrics and defines them.

Priorities

In the first column of **Table 4**, I have documented the three natural priority levels that exist within these ten metrics.

Priority 1: Total Service Revenues, Operating Profit, Gross Margin. These are the metrics that EVERY service organization tracks. When these three go soft, executives need answers.

Priority 2: Bill Rate, Rate Realization, Labor Multiplier. These metrics are the next

wave most likely to be tracked by management. They provide immediate insight into how profitable you will be for the quarter.

Priority 3: Revenue per Practice, Profit per Practice, Solution Revenue, Solution Margin. These are Zone 0 metrics that many service organizations do not take the time to calculate. Nevertheless, they provide immediate insight into the profitability of specific service lines and provide greater insight into where profitability problems may exist.

| | Metric | Definition | Code |
|---|------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| 1 | Total Services Revenue | Measurement of the different types of revenue; should be listed separately by consulting, solutions and third party pass-through. | TR |
| 1 | Operating Profit | The profit generated by operations, also known as Operating Margin. (Operating Profits = total services revenue – cost of services (COS) delivered – total operating expenses) | OP |
| 1 | Gross Margin (%) | The gross profit generated per dollar of service delivered. (Gross Margin = total services revenue – COS) , traditionally called cost of goods sold (COGS) | GM |
| 2 | Bill Rate | Average billable rate achieved by class of consultant. | BR |
| 2 | Rate Realization | The amount of revenue actually earned as a percentage of potential revenue represented by list prices. | RR |
| 2 | Labor Multiplier | The average factor by which billable personnel can be charged over and above their fully loaded costs. A Labor Multiplier of 1.0 indicates a breakeven point. (Fully Loaded Costs = direct salary + direct fringe benefits + overhead + G&A + margin) | LM |
| 3 | Revenue per Practice | Total services revenues incurred by specific consulting practice. | RPP |
| 3 | Profit per Practice | The profit generated by practice operation, also known as Operating Margin. (Operating Profits = total services revenue – COS – total operating expenses) | PPP |
| 3 | Solution Revenue | Total services revenues incurred from a specific solution. | SR |
| 3 | Solution Margin | Average margin experienced when delivering a specific solution. | SM |

Table 4: Zone 0 Metrics

Table 5: Zone 0 Metrics Perspectives provides additional data on what these ten metrics can be used to manage. **Figure 5: Zone 0 Metrics Graph** maps these ten metrics onto the metrics perspective graph.

| | Metric | Sales | Delivery | Mktg | Dev | Ops | Staff | Project | Business | Internal | External |
|---|------------------------|-------|----------|------|-----|-----|-------|---------|----------|----------|----------|
| 1 | Total Services Revenue | ✓ | ✓ | ✓ | ✓ | | | | ✓ | ✓ | |
| 1 | Operating Profit | | | | | | | | | | |
| 1 | Gross Margin (%) | ✓ | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | |
| 2 | Bill Rate | ✓ | ✓ | | | | ✓ | ✓ | ✓ | ✓ | |
| 2 | Rate Realization | ✓ | ✓ | | | | ✓ | ✓ | ✓ | ✓ | |
| 2 | Labor Multiplier | | | | | | | | ✓ | ✓ | |
| 3 | Revenue per Practice | ✓ | ✓ | ✓ | ✓ | | | | ✓ | ✓ | |
| 3 | Profit per Practice | ✓ | ✓ | ✓ | ✓ | | | | ✓ | ✓ | |
| 3 | Solution Revenue | ✓ | | ✓ | | | | ✓ | ✓ | ✓ | |
| 3 | Solution Margin | ✓ | ✓ | | ✓ | | | ✓ | ✓ | ✓ | |

Table 5: Zone 0 Metrics Perspectives

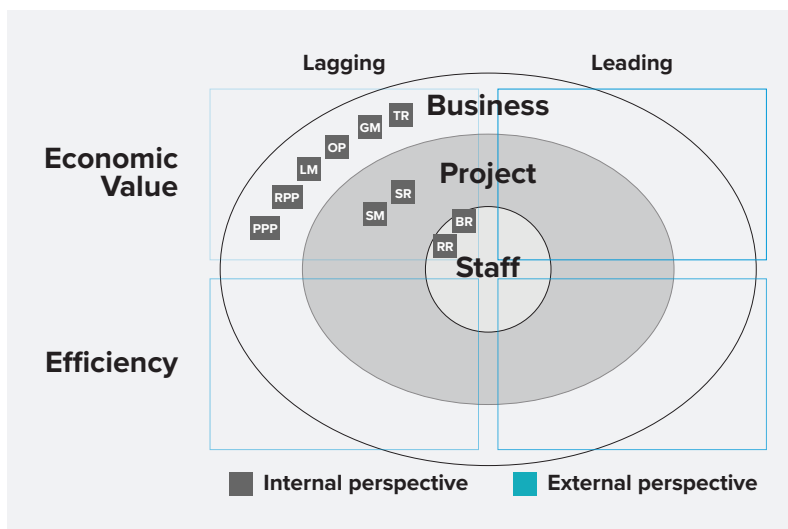


Figure 5: Zone 0 Metrics Perspective Graph

Deficiencies

Hopefully, by looking at **Figure 3**, the deficiencies of Zone 0 metrics becomes apparent. There is a natural tendency for the PS management team to fixate itself on Zone 0 metrics. This is understandable. If revenues and profits are falling, jobs are at stake. But if a management team only tracks metrics in Zone 0, they have a seriously flawed metric strategy. These ten metrics will not provide insights in the following areas:

Future Economic Value: Yes, we just had a good quarter! But what will future profits look like? Zone 0 metrics don't help me here.

Operational Efficiencies: Revenues and profits do indicate if we are managing the business well or not. However, they do not provide much insight where operational challenges may exist. Margins were off. Why? Were sales costs too high? Did we simply scope the projects poorly? Zone 0 comes up empty when asking these questions.

External Perspective: Last but not least, the ten metrics in Zone 0 are all important to managers. They are not important to customers. Does a customer really care if margins and profits were down? No. If you are trying to determine how customers feel about you, Zone 0 does not help.

Targets

The most frequent request I receive from management teams is to provide guidance for the following Zone 0 metrics:

Gross Margin: How much margin should are professional service business be throwing off?

Operating Profit: What operating profit is reasonable and sustainable for a PS business?

Bill Rate: Hey, are our bill rates too high (like our sales people keep telling us)?

Rate Realization: What rate should we be expecting from our consultants? 65%, 75%, 100%?

Over the past three years, I have found the specific targets for these four metrics vary widely from organization to organization, practice to practice and industry to industry. Gross margins in PS are ranging from 10% to 45%. Operating profits are ranging from -20% to 20%. Realization rates are typically ranging from 50% to 90%. The spectrums are WIDE. Having said this, I do see some pattern recognition.

First of all, actual gross margins are consistently lower than target gross margins. The most common target I see for gross margin is 40%. The actual gross margins in PS are much closer to 25%. Operating profit targets are typically set between 12%-15%. Actuals are hovering around 10%. I base these observations on the few companies that will publicly report the gross margins and profits of their professional service business and the various companies I have had the privilege to work with directly.

My experiences lead me to the following conclusion: there are no universal targets that make sense for Zone 0 metrics. Target margins and profits should be driven by the specific business model for your professional service organization, NOT some mythical standard that in reality does not exist. For more information on target business models for professional service organizations, please refer to the previously published article *The Professional Services Business Model—Fighting the 40/20 Myth*.

Zone 1 Metrics

Per the earlier definition, Zone 1 metrics provide important insights on the operational efficiencies of your PS business. However, these insights are lagging in nature—not predictive.

If targets in Zone 1 are consistently below industry expectations, PS revenues and profits will continue to disappoint.

Example Metrics

There are at least eight metrics that can logically be placed in Zone 1. **Table 6: Zone 1 Metrics** lists these eight metrics and defines them.

Priorities

In the first column of **Table 6**, I have documented the three priority levels for these eight metrics. These assigned priorities are most likely the opposite priorities most PS managers would assign to these metrics. Let me defend my prioritization:

Priority 1: Profit per Project, Project Overrun Costs, Cost of Services Delivered, Delivery Labor Costs. All of these metrics inform the management team how much

Key Messages

- When creating a metrics portfolio, it is important to consider what the metrics are telling you. The objective is to identify a set of metrics that minimizes any perspective blind spots.
- Zone 0 metrics provide lagging information about the economic health of the professional service business.
- If targets in Zone 0 are consistently missed, the management team will eventually be replaced.
- Zone 0 metrics do not provide insights into critical areas such as future economic performance, operational inefficiencies or customer satisfaction.
- In the industry, Zone 0 metrics are all over the map. There is a wide spectrum of results for these metrics. Industry dynamics, organizational maturity and service type all impact what a professional service organization can achieve in Zone 0. Universal targets for these metrics does not make sense.

cost is actually involved in delivering their services. When project profitability decreases and project overruns increase, overall PS profitability (Zone 0 metric) will soon be impacted. If delivery labor costs are increasing, profitability will be impacted. In other words, the management team must understand the true and total costs required to deliver the service portfolio. These costs need to be monitored and aggressively managed. If not, the natural tendency is

for project costs to become bloated and margins to erode.

Priority 2: Load Costs, Delivery Overhead Costs. These metrics are the next area management can track to identify potential efficiency improvements. These metrics provide insight into how much overhead the PS organization is carrying to support project delivery. The healthiest project margins will have difficulty covering unnecessary and inflated overhead costs.

Priority 3: Utilization and Cash Flow. The fact utilization is placed as a third priority is no doubt controversial. Every PS leader demands that consultant utilization be tracked and accounted for. I agree, utilization is a very insightful metric. If consultants are

only being utilized 50%-60% of the time, the business is inefficient and over resourced. However, utilization is one of the most abused metrics available to the management staff. If you tell PS staff you will be tracking utilization, they will be utilized—trust me. The question remains, how beneficial the utilization was. Tracking real project costs and overruns will provide more immediate and potentially more accurate insights into the efficiencies of your business.

Even if deals are being won and top line revenue is growing, you may not be delivering your services portfolio at an optimized level. Zone 1 metrics help answer a very pertinent business question: “How efficient are we as a professional services organization?”

| | Metric | Definition | Calculation | Code |
|---|----------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------|------|
| 1 | Profit per Project | The profit generated by a specific project. Project Profits = Total Project Revenue – COS – Sales Costs | | PP |
| 1 | Cost of Services Delivered | The fully loaded direct and indirect costs of billable services. Includes the expenses of any managers that are more than 50% billable. Costs of Services Delivered = Delivery Labor Costs + Deliver Overhead Costs | Cost of Services Delivered/Total Services Revenue | COS |
| 1 | Delivery Labor Costs | The direct costs of billable services. Includes the labor costs of any managers that are more than 50% billable. | Delivery Labor Costs / Total Services Revenue | DLC |
| 1 | Project Overruns | The accuracy with which project costs are forecasted. | Total Project Costs Incurred / Total Estimated Project Costs | POR |

Table 6: Zone 1 Metrics

| | Metric | Definition | Calculation | Code |
|---|-------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|------|
| 2 | Delivery Overhead Costs | The fully loaded indirect costs of billable services. Includes the related expenses of any managers that are more than 50% billable. Delivery Overhead Costs = Fringe Benefits + Travel + Delivery – Unit Management Costs – All other related costs with full-time consultants, hourly employees or independents | Delivery Overhead Costs / Total Services Revenue | DOC |
| 2 | Load Costs | Total business costs that are not directly related to the cost of delivering services. | | LC |
| 3 | Utilization Rate | Measures the organization's ability to maximize its billable resources. | Total # of hours billed/# of working hours in a year (varies by geography) x # of billable hours | UR |
| 3 | Cash Flow | The amount of cash generated (or absorbed, if negative) by the organization. | Cash Flow from Operations / Total Services Revenue | CF |

Table 6: Zone 1 Metrics

Table 7: Zone 1 Metrics Perspectives provides additional data on what these eight metrics can be used to manage. **Figure 6: Zone 1 Metrics Graph** maps these eight metrics onto the metrics perspective graph.

| Metric | Sales | Delivery | Mktg | Dev | Investment | Staff | Project | Business | Internal | External |
|----------------------------|-------|----------|------|-----|------------|-------|---------|----------|----------|----------|
| Profit per Project | | ✓ | | ✓ | | | ✓ | ✓ | ✓ | |
| Cost of Services Delivered | | ✓ | | ✓ | | | ✓ | ✓ | ✓ | |
| Delivery Labor Costs | | | ✓ | | ✓ | | | ✓ | ✓ | ✓ |
| Project Overrun | | | ✓ | | ✓ | | ✓ | ✓ | ✓ | ✓ |
| Delivery Overhead Costs | | ✓ | | | | | | ✓ | ✓ | |
| Load Costs | | | | | | | | ✓ | ✓ | |
| Utilization Rate | ✓ | ✓ | ✓ | | | ✓ | | ✓ | ✓ | |
| Cash Flow | | | | | | | | ✓ | ✓ | |

Table 7: Zone 1 Metrics Perspectives

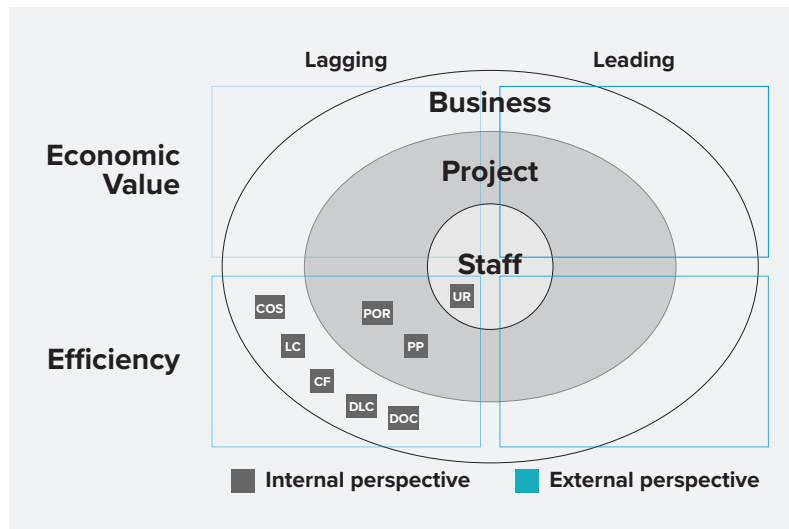


Figure 6: Zone 1 Metrics Perspective Graph

Deficiencies

Zone 1 metrics have two significant deficiencies. First of all, the metrics are indeed lagging in nature. Soaring delivery costs or project overruns tell you there is a problem after it has occurred. Secondly, these metrics are very internally focused. As a PS manager, YOU care about utilization rates and delivery load costs. Your clients do not.

Targets

In the previous article on Zone 0 metrics, I discussed the fact that best practice targets for many of these metrics are a slippery slope to stand on. However, there are some reasonable guidelines for two of the Zone 1 metrics:

Utilization: PS organizations have a tendency to target very high utilization rates. I believe this bias comes from the heritage of traditional professional service organizations such as law firms and accounting firms. In these environments, employees are often expected to bill

over forty hours a week to client accounts. I believe PS activity within a product company is a very different environment. I have yet to review a PS organization that was sustaining 100% billable utilization. I do see PS organizations that report 100%+ utilization rates. However, these rates track non-billable activity such as pre-sales calls. For billable utilization activity, I believe there is a natural strike zone that sits between 60% and 85% billable utilization. Less than 60% and the PS organization cannot financially support itself. Greater than 85% and no time is left for ongoing staff development.

Project Overruns: Project overruns occur. It is a fact of life when you are delivering complex technology centered solutions. The question is the order of magnitude. On an ongoing basis, project overruns should average 10%-25%. If your project costs consistently exceed 25% of the initial estimation, your ability to estimate effort is seriously in question. If you are bidding

projects at a fixed price, your ability to be profitable is clearly in jeopardy!

Zone 2 Metrics

Let's begin the transition to leading metrics by visiting Zone 2. Per the earlier definition, Zone 2 metrics provide leading insights into the operational efficiency of your PS business.

If Zone 2 metrics begin declining, operational efficiency will begin suffering. If operational efficiency drops, reduced margins and profits are sure to follow.

Example Metrics

There are at least ten metrics that can logically be placed in Zone 2. **Table 8: Zone 2 Metrics** lists these ten metrics and defines them.

Priorities

In the first column of **Table 8**, each Zone 2 metric is rated by priority level.

Priority 1

Bid and Proposal Costs – This metric is a little tricky. Even though it is a cost metric and fundamentally speaks to efficiency, it can speak to so much more. We are winning more business! However, if bid costs are going up, something is changing. Are we simply getting sloppy in our bid approach? Are new competitors entering our space? Or, are we chasing business we simply should not be chasing? **Review those bid costs now, before your revenues reflect the fact the sales folks were chasing the wrong business.**

Channel Mix – How efficiently are we using all of our sales channel options?

Key Messages

- When creating a metrics portfolio, it is important to consider what the metrics are telling you. The objective is to identify a set of metrics that minimizes any perspective blind spots.
- Zone 1 metrics provide lagging information concerning the operational efficiency of the professional service business.
- If targets in Zone 1 are below industry expectations, the PS business will find it difficult to effectively compete in the marketplace. Revenues and profits will eventually be compromised.
- Zone 1 metrics such as utilization and project overruns costs can and should be benchmarked against industry standards.

Are the old partners getting any better at selling the new services? Does everything still get sold through the most expensive channel option we have—direct sales staff? **Act to improve the channel mix now, before you are forced to reduce direct sales staff later.**

G&A – Are G&A costs creeping up? This often happens in service businesses. If G&A continues to climb as a percentage of total revenues, you are probably spending money to mask other fundamental issues in the business. **Take a look at creeping G&A costs now, before the CFO hands you required budget cuts.**

Project Completion Ratio – Yes, you track project profitability after the fact. But how

about the large projects in play right now? Are the teams meeting commitments on time? Also, this is the first metric we have spoken of that has an external perspective as well. In other words, your customers care how you do here. Are you delivering on your commitments to them? **Track project milestones now, before you realize chunks of revenue will be delayed next quarter.**

Priority 2

Research and Development Costs – How much money does PS spend to manage intellectual property and improve delivery methodologies? If this number is becoming too large, profits suffer. If this number becomes too small, you struggle to increase the value you bring to customers. **Track how much money is invested in solution development and improvement now, before your solution portfolio becomes stale and unmarketable.**

Total Operating Expenses – Many PS organizations are not disciplined in their tracking of Sales Costs vs. Marketing Costs, G&A, etc. To offset this common deficiency, it is recommended that the management team tracks the total amount of money spent to support the business. If PS margins are flat and total operating expenses are growing, there is a problem. **Understand total operating expenses now, before there are not enough margin dollars to support them.**

Training Costs and Training Days – Like R&D Costs, the concern on training is centered more around under-investment. **Catch severe declines in training investments now, before consultants embarrass your brand six months from now.**

Priority 3

Alliance and Partner Costs – Partners are a critical component to the delivery of most “solutions”. How much money are you investing in identifying, qualifying and enabling these critical partners? Are you wasteful or under-investing? **Spend money certifying your delivery partners today, before they tank a critical engagement tomorrow.**

Collateral Costs – How much does PS spend on marketing materials? If it is the largest portion of your service marketing budget, you have a problem—trust me. **Reduce marketing material costs now, before you wish you did.**

These Zone 2 metrics provide wonderful perspectives into your business. Once again, no executive will be fired because R&D costs were too low, or project completion ratios have slipped by 10%. However, that same executive could be subjected to a very unpleasant business review four quarters down the road, when a poorly differentiated service portfolio and poor project execution has created significant slips in revenues and profits.

| | Metric | Definition | Calculation | Code |
|----------|-------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|----------------|
| 1 | Bid & Proposal Cost | Total dollars spent on submitting a bid, including dollars spent on bid qualification, financial analysis, alliance/partner selection, feasibility analysis, proposal submittal, and best and final offer (BAFO). | Total dollars spent for submitting bids / total contract value of bids submitted | BPC |
| 1 | Channel Mix | Percentage of sales revenues that occur through each potential sales channel. | | CM |
| 1 | General and Administrative Expenses (G&A) | The general expenses not captured in COS, Sales, Marketing or R&D. G&A Expenses = Total Expenses - Training Costs + Management Costs + other administrative costs | G&A Expenses / Total Services Revenue | G&A |
| 1 | Project Completion Ratio | Measures the degree of completion against project milestones. | Number of milestones accomplished on schedule / total milestones targeted. | PCR |
| 2 | Research & Development Costs | Degree of investment made to enhance the firm's tools, products and methodologies. Total R&D Costs = Infrastructure + Sales Tools + Delivery Tools | R&D Costs / Total Services Revenue | R&D |
| 2 | Total Operating Expenses | The sum of all non-delivery operating expenses. Total Operating Expenses = G&A Costs + Sales Costs + Marketing Costs + R&D Costs | Total Operating Expenses / Total Services Revenue | TOE |
| 2 | Training Costs | The total cost of training. Training expenses include curriculum design and development, instruction costs and facilities costs. | Training Expenses / Total Services Revenue | TC |
| 2 | Training Days | Average number of working days spent in training. | Number of employee working days spent training / total number of employee working days | TD |
| 3 | Alliances & Partnering Costs | The amount of dollars spent on alliance and partner programs by line of business. | Alliance & Partnering costs / Total Services Revenue | APC |
| 3 | Seminars & Collateral Material Costs | The amount of dollars spent on prospect and/or client seminars and marketing collateral. | Alliance & Partnering costs / Total Services Revenue | COL |

Table 8: Zone 2 Metrics

Table 9: Zone 2 Metrics Perspectives provides additional data on what these ten metrics can be used to manage. **Figure 7: Zone 2 Metrics Graph** maps these metrics onto the metrics perspective graph.

| Metric | Sales | Leading | Lagging | Efficiency | Investment | Staff | Project | Business | Internal | External |
|-------------------------------------|-------|---------|---------|------------|------------|-------|---------|----------|----------|----------|
| Bid & Proposal Cost | ✓ | ✓ | | ✓ | | | ✓ | ✓ | ✓ | |
| Channel Mix | ✓ | ✓ | | ✓ | | | | ✓ | ✓ | |
| G&A Expenses | | ✓ | | ✓ | | | | ✓ | ✓ | |
| Project Completion Ratio | | ✓ | | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ |
| R&D Costs | | ✓ | | ✓ | | | | ✓ | ✓ | |
| Total Operating Expenses | | ✓ | | ✓ | | | | ✓ | ✓ | |
| Training Costs | | ✓ | | ✓ | | | | ✓ | ✓ | |
| Training Days | | ✓ | | ✓ | | ✓ | | ✓ | ✓ | |
| Alliance/Partnering Cost | | ✓ | | ✓ | | | | ✓ | | |
| Seminar & Collateral Material Costs | | ✓ | | ✓ | | | | ✓ | ✓ | |

Table 9: Zone 2 Metric Perspectives

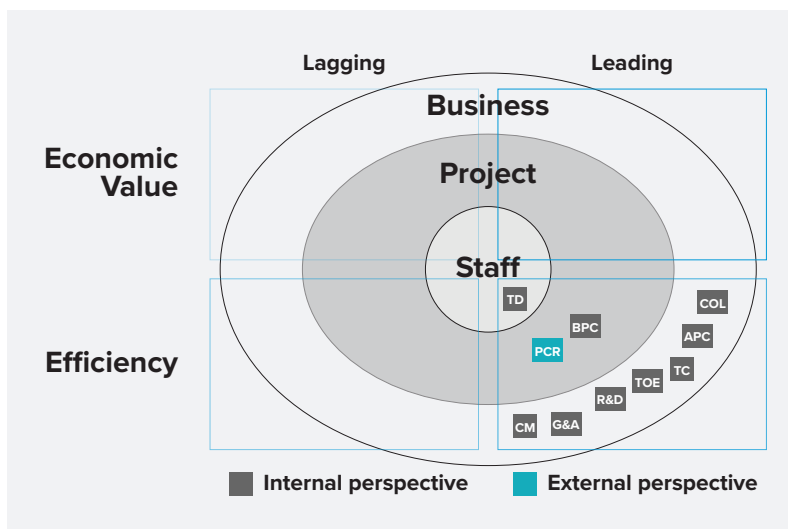


Figure 7: Zone 2 Metrics Perspective Graph

Zone 3 Metrics

Finally, our long journey through professional services business metrics comes to a close as we enter Zone 3. The metrics in this zone provide the greatest insight into the future economic health of a PS business. Revenues and profits normally determine whether managers are paid bonuses for the quarter. The metrics in Zone 3 are early indicators on how bonuses will be paid four quarters from now.

If Zone 3 metrics begin declining, your PS business is in decline. It is only a matter of time before revenues and profits will suffer.

Example Metrics

Table 10: Zone 3 Metrics lists ten metrics that provide a **leading** economic assessment of the PS business.

Priorities

In the first column of **Table 10**, each Zone 3 metric is rated by priority level.

Priority 1

Account Expansion – This metric tracks how much follow-on business a professional services team gets after the first engagement. If this dollar value is increasing per account, PS is doing a better job of delivering, establishing credibility and identifying new opportunities. If this metric is declining, customers are not impressed with your services or staff. Account expansion in existing customers is typically an easier task than securing new accounts.

Backlog – First backlog slips. A decline in recognized revenues is not far behind.

Ideally, your quarter starts with at least 75% of the service work identified and booked. For most project-based services, a backlog below 50% of the target revenue for the quarter is a difficult hole to climb out of.

Hit Ratio – This metric tells you how successful your sales proposals are. If your hit ratio is improving, your positioning and value proposition are most likely improving. Also, your employees are becoming more effective at selling the solution. A declining hit ratio is an early indicator that a solution is growing stale and competitors have created a more compelling value proposition.

New Client Ratio – How much business is coming from new customers? This metric provides the mirror insight that “account expansion” does. If ALL of your revenue is coming from the existing client base, you are not effectively selling or marketing the portfolio to new prospects.

Priority 2

Customer Value – Customer Value, Customer Loyalty, Customer Satisfaction. All related metrics. The bottom line: How do customers feel about the services you are delivering? A downward trend here provides an early warning signal that all is not well.

Delivery Tools – This metric is closely related to R&D spend. The difference is that here you want to measure how much has been invested in tangible infrastructure that facilitates the delivery of service offerings. If this percentage is flat or declining, you

may be under investing in the tools that differentiate your services. This scrimping will not show up this quarter, but can bite you later in the year.

Sales Yield – How effective is your selling process? If sales yields are increasing, your solution selling skills are improving or your solution positioning is more compelling. Either way, the economic value of your PS business is increasing.

Solution Portfolio Maturity – This is the concept of measuring your ability to deliver a particular service consistently. If service maturity is increasing, your ability to improve margins increases. Your ability to improve margins is a great indicator of the economic health of the business.

Priority 3

Skills Gaps – Do you have the skills you need to deliver your services? When you

first start a PS business, this gap may be significant. The goal is to shrink it. If the gap is not improving or widening, you will eventually pay a very real price in margins and revenues.

Turnover Rate – Last but not least. What is your overall turnover rate in the PS business? A key consultant can leave today and the quarter is not lost. Your top ten consultants leave over the next six months and revenues may be impacted. A spike in turnover rates can be an early warning sign that the business is not on track.

Zone 3 metrics provide the greatest insight into the true health of your professional service organization. Ironically, these are the metrics that are **least likely** to show up on a monthly PS dashboard.

| | Metric | Definition | Calculation | Code |
|---|-------------------|----------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|------------|
| 1 | Account Expansion | The ability of a vendor to expand its account penetration and its volume of business within existing accounts. | Add on revenue / dollar value of original proposal | AE |
| 1 | Backlog | The total value of contract commitments yet to be executed. | Total Backlog = Previous Fiscal Years Commitments + Latest Fiscal Years Sales – Latest Fiscal Years Revenue | BL |
| 1 | Hit Ratio | The competitive success rate of the company in the markets it chooses to compete in. Does not include single-sourced bids. | Revenue from proposals won / possible revenue from proposals submitted | HR |
| 1 | New Client Ratio | Measures a vendor's ability to win new accounts and develop new business. New Client Ratio = new clients / total clients | Total dollar value of new client accounts / total dollar value of all client accounts | NCR |

Table 10: Zone 3 Metrics

| | Metric | Definition | Calculation | Code |
|---|-----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
| 2 | Customer Value | Measures how satisfied the customer is with the services delivered. Identifies how customers receive value from the service offering. | Perceived Business Benefit of Service Offerings - Cost of Service Offering. Benefit ultimately represents the sum total of expected cost savings and/or increased revenues. | CV |
| 2 | Delivery Tools | The amount of R&D investment in Delivery Tools. Delivery Tools = automated methodology tools + project management + online skills inventory/resource + time scheduler + automated labor voucher + real-time conferencing + workgroup sharing + knowledge database | Delivery Tools / Total Services Revenue | DT |
| 2 | Sales Yield | The sales productivity of the company. (Target values or sales quota versus actuals are encouraged.) | Sales dollar value / number of direct or full-time equivalent sales people | SY |
| 2 | Solution Portfolio Maturity | The average maturity rating for target solutions. | Average of: number of completed sales and delivery tools for a solution / total number of sales and delivery tools to be created | SPM |
| 3 | Skills Gaps | Measures the gap between the skills required to deliver target services and the skills available within the delivery staff. | | SG |
| 3 | Turnover Rate | A measure of attrition. An example of a former employee is a person who was on the personnel roster at the start of the previous fiscal year and was no longer on the personnel roster at the start of the current year. | Number of Former Employees (annualized) / total number of employees (annualized) | TR |

Table 10: Zone 3 Metrics

Table 11: Zone 3 Metrics Perspectives provides additional data on what these ten metrics can be used to manage. **Figure 8: Zone 3 Metrics Graph** maps these metrics onto the metrics perspective graph.

| Metric | Delivery | Mktg | Dev | Ops | Leading | Lagging | Efficiency | Economic Value | Staff | Project | Business | Internal | External |
|-----------------------------|----------|------|-----|-----|---------|---------|------------|----------------|-------|---------|----------|----------|----------|
| Account Expansion | ✓ | | | | ✓ | | | ✓ | ✓ | ✓ | ✓ | | ✓ |
| Backlog | ✓ | | | ✓ | ✓ | | | ✓ | | | ✓ | ✓ | |
| Hit Ratio | | ✓ | | | ✓ | | | ✓ | ✓ | | ✓ | ✓ | |
| New Client Ratio | | ✓ | | | ✓ | | | ✓ | ✓ | | ✓ | | ✓ |
| Customer Value | ✓ | ✓ | ✓ | | ✓ | | | ✓ | ✓ | | ✓ | | ✓ |
| Delivery Tools | ✓ | | ✓ | ✓ | ✓ | | | ✓ | | | ✓ | ✓ | |
| Sales Yield | | ✓ | | | ✓ | | | ✓ | | | ✓ | ✓ | |
| Solution Portfolio Maturity | | ✓ | ✓ | | ✓ | | | ✓ | | | ✓ | ✓ | |
| Skills Gaps | ✓ | | ✓ | | ✓ | | | ✓ | ✓ | | ✓ | ✓ | |
| Turnover Rate | ✓ | ✓ | ✓ | ✓ | ✓ | | | ✓ | | | ✓ | ✓ | |

Table 11: Zone 3 Metric Perspectives

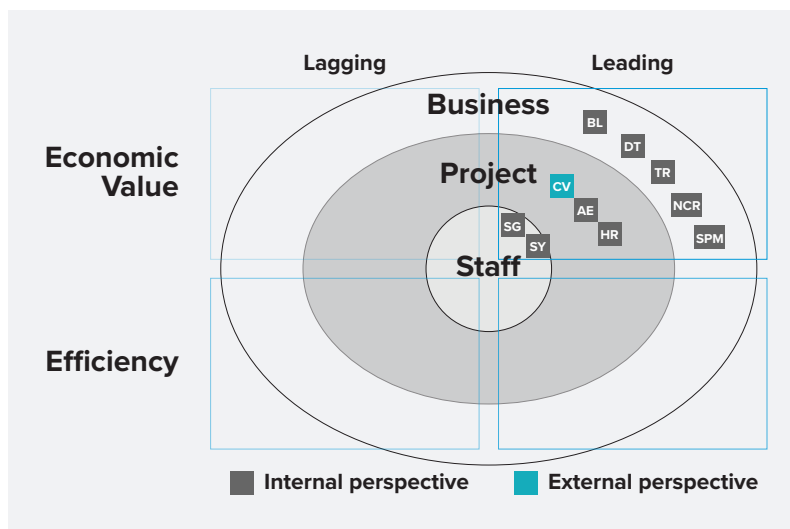


Figure 8: Zone 3 Metrics Perspective Graph

Summary

We hope you have found this article on professional services business metrics to be valuable to your business. Remember, professional services is a human capital intensive business. Scaling or contracting a human capital intensive business can be much more challenging than scaling or contracting manufacturing capacity. On-boarding people takes time. Off-boarding takes even longer. Improving skills and human efficiency takes patience and understanding. Services that are centered on complex technologies have the added challenge of scaling human resources that are competent in both hard (technical) and soft (consultative) skills. In all this complexity, I don't see how a modern professional service business improves without insightful data. I hope this metrics framework provides you an approach to acquire that insightful data.

Key Messages

- When creating a metrics portfolio, is important to consider what the metrics are telling you. The objective is to identify a set of metrics that minimizes any perspective blind spots.
- Professional Services Management teams have a tendency to focus on metrics that provide **lagging** information concerning the health of the professional services function.
- Zone 2 metrics provide **leading** information concerning the operational efficiency of the professional services business.
- Zone 3 metrics are **leading** indicators of the future economic health of the professional services business.
- If Zone 2 and 3 metrics are in decline, future financial targets are at risk.

About the Author

Thomas E. Lah is the Executive Director of The Technology Professional Services Association (TPSA), author of **Mastering Professional Services** and **Building Professional Services: A Siren's Song** and currently consults with companies to establish or improve their professional services organizations. Thomas is actively engaged with The Ohio State University, hosting an executive education program focused on frameworks and strategies to successfully build professional services at product-centric companies.

He received an undergraduate degree in Information Systems and holds an MBA from the Fisher College of Business at The Ohio State University.