BUSINESS GUIDE

Metrics That Matter

Measuring Professional Services Business
Introduction

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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 business guide, 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 fingertips. 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 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 quarter’s 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:

1. Financial: ROI, revenue growth, revenue, mix
2. Customer: Customer satisfaction, account share
3. Internal: Quality control, time-to-market, operational efficiency
4. 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:

1. Functional Perspective: What business function does this metric help evaluate? Your sales organization? Your delivery teams? Service marketing?
2. 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?
3. 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?
4. Scope Perspective: Does the metric measure the performance of specific individuals, specific projects, or the entire business unit?
5. 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?

Figure 1. Metrics Perspective Graph Introduction

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 **teal** 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.

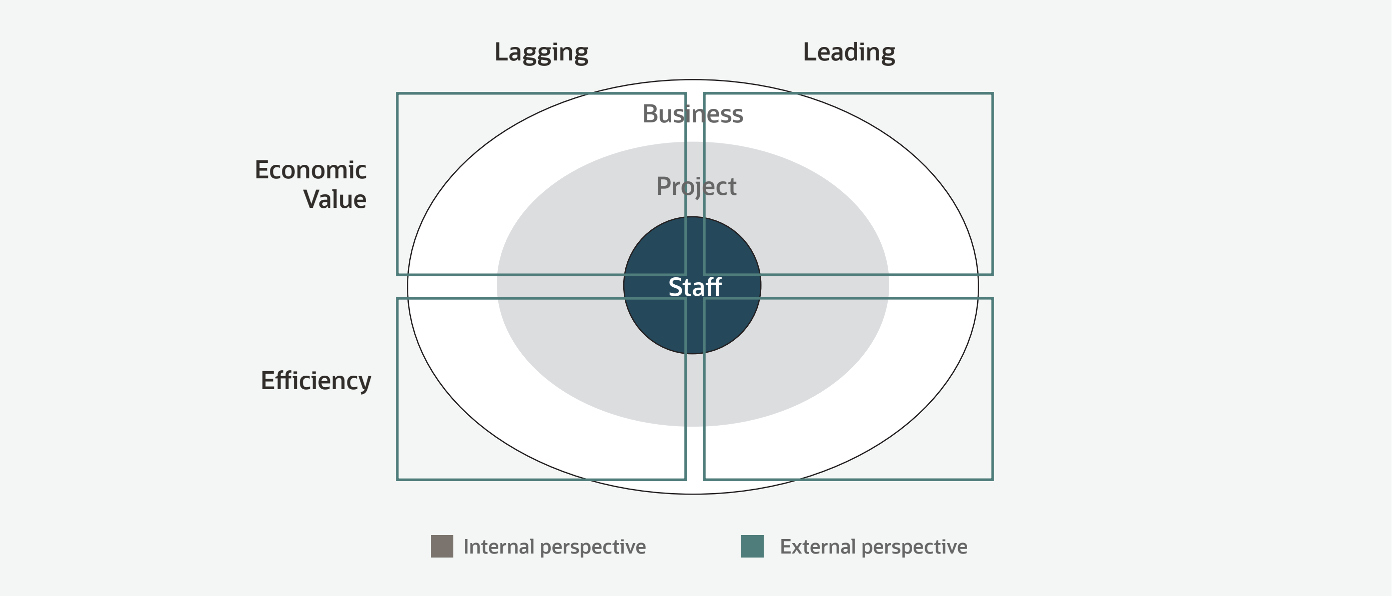


Figure 2. Completed Metrics Perspective Graph

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.
- Timeframe 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.

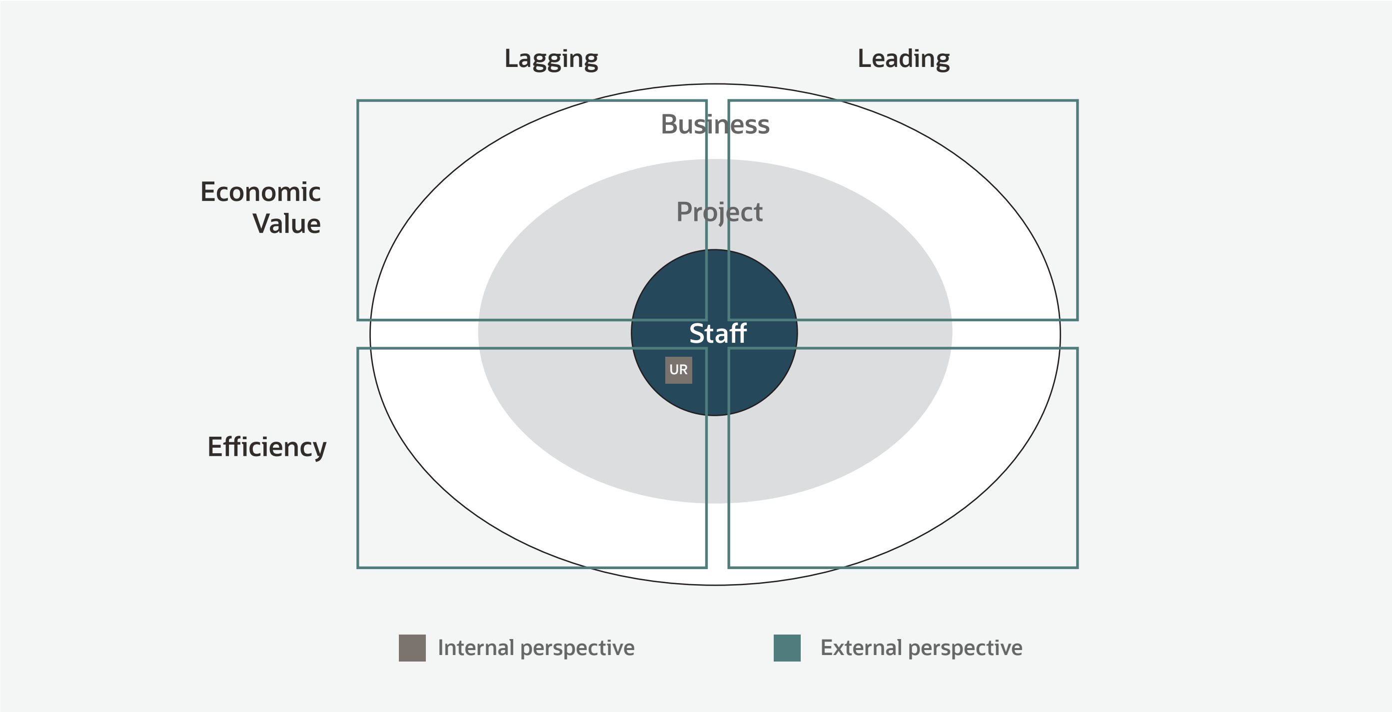


Figure 3. Mapping Utilization

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 fingertips. Even if they did have these ten traditional metrics in place, there are still weak spots:

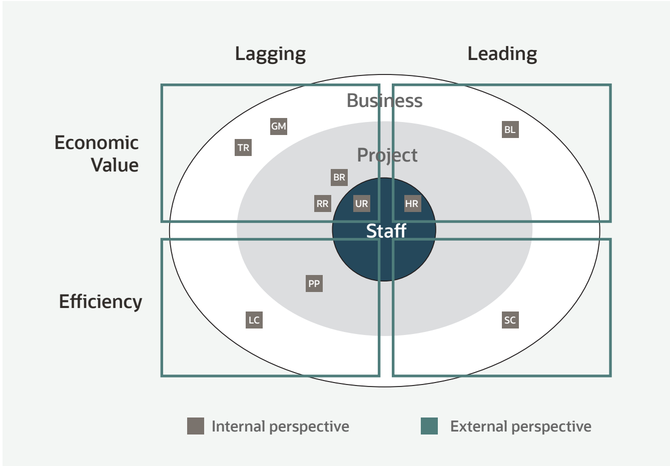


Figure 4. Ten Service Metrics

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.

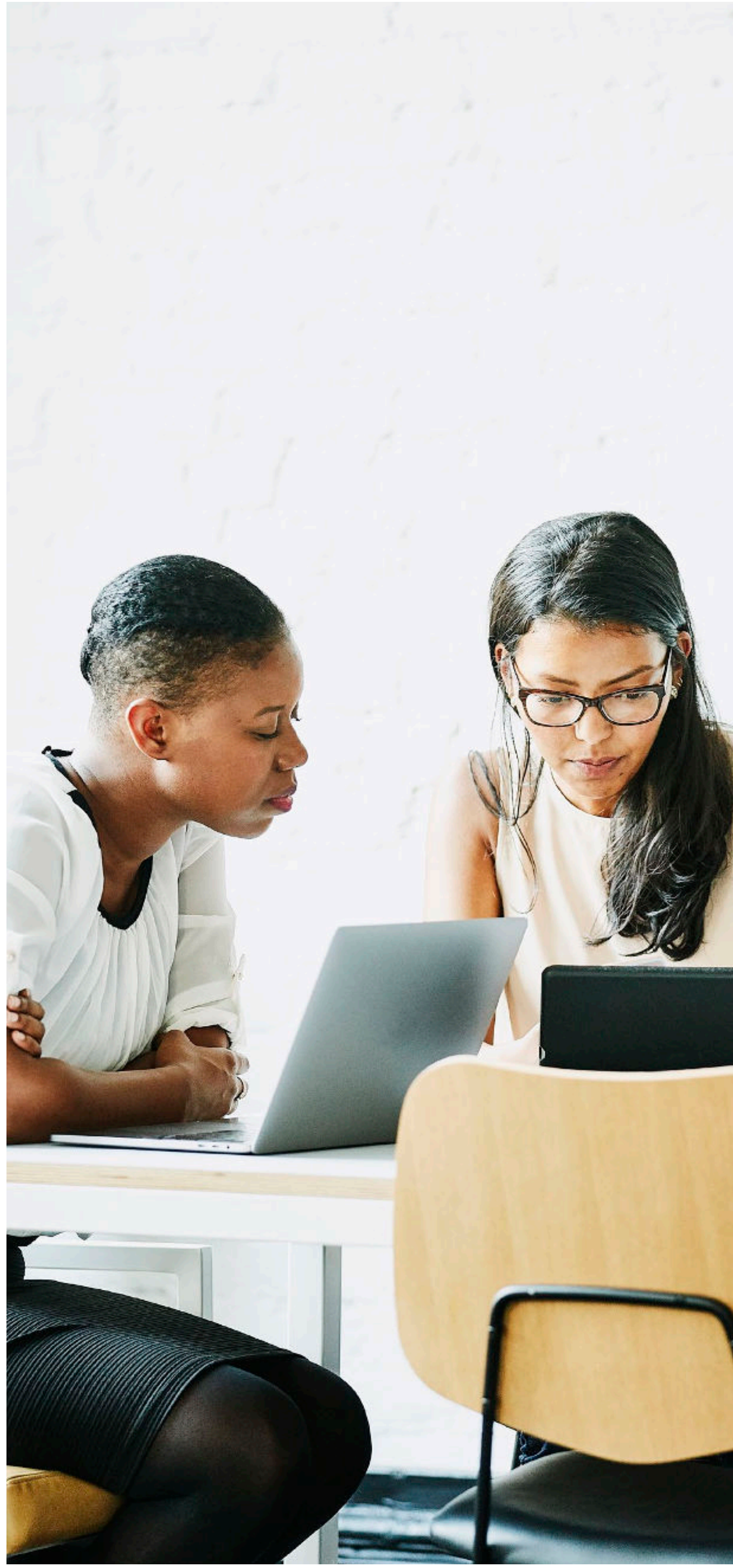
2. 70% of these metrics are lagging. They provide little insight on what direction the service business is moving: positive or negative. Yes, you may have made money this quarter, but are you headed in the right direction? Hit rates, sales costs, and backlog do provide leading information—so you are 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 spots 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.



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