Professional Services Metrics

Tracking Utilization, Profitability and Realization Metrics to Improve Performance

NETSUITE

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Introduction

Professional services organizations have seen a dramatic shift in the challenges facing the industry over the past decade. Ever-decreasing margins due to increased competition and (in some sectors) de-regulation have created cost pressures on businesses seeking to grow or simply maintain past profit levels.

Yet new opportunities have emerged as well. Cloud business management technologies have helped service providers expand into new markets, better track and manage key metrics, and drive client satisfaction. As demand for professional services grows, leaders will differentiate themselves through end-to-end visibility that enables them to capitalize on opportunities.

While the professional services industry landscape has changed, the underlying metrics to manage services businesses have remained consistent. This white paper examines three core metrics critical to professional services performance and offers practical examples of how you can apply them to measure and optimize your own business:

- **Utilization**: Maximize the billable hours of your consultants to increase revenue.
- **Profitability**: Sharpen analytic visibility into the factors behind profitability by client and project.
- **Realization**: Measure your actual revenue vs. optimal revenue to assess your performance.

Gathering and effectively using these metrics is not easy if you are still using Microsoft Excel or disparate systems to manage critical tasks like timesheets, expenses, resource management, project management and invoicing.

Professional Services Metrics

NetSuite's experience of working with many of the world's leading professional services businesses has highlighted the importance of monitoring and measuring utilization, client and project profitability, and realization.

Although many additional metrics exist and apply to different segments of the professional services sector, the three highlighted metrics span the entire professional services industry.

Utilization

The most important asset within any professional services organization is its people, and managing those billable resources in the most effective manner can literally make or break a services business (especially during a period of decreasing margins). Optimizing utilization has a direct correlation with profitability; therefore, the ability to accurately bill all hours worked on a project is extremely important. The following example demonstrates the minimum benefit a 25-person business would attain from improving utilization rates:

Utilization Example	
Company: 25 consultants	**Avg. Billing Rate:** $100/hour
If we get 1 more hour of **billable** work from each consultant per week: 1 hour = 2.5% increase in utilization (on a 40-hour work week) **Utilization calculation:** 25 consultants x 1 hour = 25 hours of billable work 25 billable hours x $100/hour = $2,500 of additional revenue per week $2,500 x 48 working weeks = $120,000 of extra revenue per year	

The above calculation is a very conservative estimate of the benefit that small improvements to utilization can have on the bottom line. In many cases, the bottom-line impact is even more substantial, leading to better use of resources and more importantly higher revenue and profitability.

Profitability

Companies at a corporate level tend to be heavily focused on the profitability metric, but without a robust and integrated professional services automation (PSA) solution, it is hard to analyze which clients and projects are profitable (and which are not). You most likely already have visibility into how much each client is invoiced, but which ones are making your business profitable?

This is often a tough question as it takes into account a variety of factors including labor costs, number of hours resources are working for the client (billable vs. non-billable), expenses, and other costs such as contractors. Getting control of profitability is of utmost importance, but without a PSA solution it is often easier said than done. Reliance on spreadsheets and disparate systems usually means that profitability can be analyzed only after a project has completed—when it's too late to take corrective action.

In contrast, services organizations that take advantage of PSA technology have a real-time view of profitability, and can slice and dice profitability by client, services type, line of business, assigned personnel and other dimensions. These analytic capabilities enable organizations to adjust on the fly, and leverage historical data to optimize bid preparation for future projects.

Some professional services organizations also face issues with client over-servicing. Client overservicing is not a new issue, but project teams rarely understand the impact this has on the rest of the business. Most often, project teams make a decision to keep the client happy by working extra hours and not billing the client for them—often this occurs with "strategically important" clients or on new projects to make a positive impression to win future business.

Most likely, decisions to over-service clients are not based on empirical data. Having access to client and project profitability enables an informed, data-driven decision either to continue spending money on the client or to find an alternative solution. With that information, you could show the client the value of work above the contract to try to work out a beneficial agreement or change order or, if they are really unprofitable, the information could give you the supporting evidence to terminate your relationship with a client.

Profitability Example

Revenue:	**Costs:**
Invoiced amount (or recognized amount) for time, rebilled or mark-up of expenses, contractors and purchased items.	Labor cost to deliver services, employee expenses (travel, meals, mileage, etc.), contractor invoices and vendor bills.

Equation: Profitability = Revenue – Cost

Scenario:

- Consultant A: Bills at $80/hour and costs the company $30/hour—this consultant has worked 50 hours on the project.
- Consultant B: Bills at $100/hour and costs the company $50/hour—this consultant has worked 100 hours on the project.
- The total expenses charged to the project by consultants travelling are $1,000. The client has agreed to a 4% mark-up on expenses.
- The project team has one contractor and the time for contractors rebilled with no mark-up to the client.

	Billable Rate	Cost Rate	Hours Worked	Revenue	Cost
Consultant A	$80	$30	50	$4,000	$1,500
Consultant B	$100	$50	100	$10,000	$5,000
Expenses				$1,040	$1,000
Contractor				$4,000	$4,000
Totals				$19,040	$11,500
Profit = Revenue – Cost				$7,540	
Margin = Profit ÷ Revenue				40%	

Realization

The realization metric brings both the utilization and profitability metrics together with a clear focus on choosing and delivering work that is profitable to the company, and in comparing what projects should be undertaken to ensure a good profit margin. Realization also is a counterbalance to the utilization metric to make sure that expensive resources are not over-used on lower margin projects. Long used as a standard metric in accounting and management consulting firms, we are starting to see the realization metric used across all industries (marketing, software, IT services, etc).

The realization metric encompasses a lot of information, so an example may be easier to digest as this might be a new concept to some readers. To begin with, realization = actual revenue ÷ revenue if billed at standard rates.

Realization Example

In our fictitious accounting company, we want to make sure our team delivers jobs that are above a 70% realization rate to ensure we have a profitable project.

Consultant's time and standard billing cost:

Name	Project Time	Project Billing Rate	Standard Rate
Sally Jones	50 hours	$100/hour	$125/hour

Let's say we could only invoice for 45 hours (5 hours written off).
Then our realization metric for this project is:

Revenue	= 45 hours x $100/hr	= $4,500
Revenue if all hours worked were billed at the standard rate	= 50 hours x $125/hr	= $6,250
Realization	= $4,500 ÷ $6,250	= 72%

As you can see in the example above, if we do not bill for all of our hours (meaning we have writeoffs) or if we use a resource that has too high of a standard billing rate, then our realization rate decreases. No wonder accountancies and management consulting firms use the realization metric as standard—it is a dial that encompasses many aspects of the business in one single percentage!

A critical point is how the realization rate is calculated. It is crucial that the rate factors in considerations such as anticipated utilization levels for the respective grades as well as acceptable market rates for our consultants. Too often, we find that target realization rates are set centrally by finance with little consultation with the client-facing staff, resulting in unrealistic rates that are ignored by project teams when negotiating client fees.

Conclusion

The above metrics are a great start to building a dashboard that will drive an efficient and effective services team. Tracking these metrics in Excel is virtually impossible, and if you are using separate systems to gather the information, reporting on these metrics in a timely manner can be a daunting task.

The actual implementation of these metrics varies widely from industry to industry and even from one company to another in the same industry. NetSuite business and technical consultants can work with you to identify how these metrics can apply to your business and how the NetSuite OpenAir PSA solution can help address these needs.

Find out more about the NetSuite OpenAir solution for professional services automation at http://www.netsuite.com/openair.