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## Metrics to Live By:

Is the delivery arm of your Professional Services Organization (PSO) towing the line?

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Competition is becoming ever fiercer among Professional Services Organizations (PSO). The public equity markets have shown over the past several months the punishment that can be doled out when a PSO fails to execute its plans. For example, as of December 15, 2000, the market caps of some leading Internet PSOs have fallen 90%. Businesses that want to succeed in the fall-out from 2000 must ensure that the delivery arm of its Professional Services Organization is effective, using metrics that could diagnose potential problems and help executives manage their organizations for success.

Key metrics every PSO should use are:

- [Utilization](#)
- [Headcount](#)
- [Turnover](#)
- [Gross Margin](#)
- [Average Bill Rate](#)
- [Customer Satisfaction](#)

### Utilization

Utilization is the Percentage of Billable Time that is billed to a client. There are generally two ways to calculate this number, gross utilization and net utilization:

- Gross utilization is billed hours over total possible billable hours over a given period.

For example, in the course of a month there may be twenty (20) workdays leading to 160 potential hours. If the consultant bills 120 hours over that period, then the gross utilization is 75%.

- Net utilization subtracts vacation and sick time from the possible billable hours.

For example if a consultant took a week of vacation, totaling 40 hours, then the net utilization would be 100%; 120 billed hours divided by 120 possible billable hours. Calculated under either method, this number is important to overall revenue and profitability of the organization.

With higher utilization there are higher revenues and gross profits, since costs such as salary are fixed over a short period of time. This is illustrated in the example above.

On the surface it would appear that the ideal organization should strive for a utilization rate of 100%. This, however, is shortsighted. An organization needs to provide time for training, sales support, and have resource flexibility to address new sales opportunities. Very often a PSO will need to present a potential team or partial team to close a sales opportunity. If there is no talent available "on the bench" the organization will not have the resources required to respond to sales challenges such as this.

The prudent manager works with the sales organization to forecast upcoming projects and plan staffing and training accordingly. Many of today's Professional Services Automation (PSA) software packages provide the functionality that enables a manager

to review historical utilization information as well as project potential utilization through its opportunity management module.

## Headcount

Headcount refers to the number of billable consultants on staff. All else being equal, revenues go up when the number of billable consultants goes up. There is a positive linear correlation between these two items. Most PSA packages afford you the ability to report on headcount figures and include headcount projections using an opportunity management module. In addition, many of the packages allow you to track skill sets of the consultants on staff. This allows you to track the mix of skill sets within an organization. This will aid the manager in identifying areas where skills are over and under represented. With this information the manager can set hiring plans and develop training programs to keep his or her workforce aligned with the company goals.

## Turnover

Turnover refers to the number of people that voluntarily leave an organization in that particular period. This is an important metric to track since if an organization is experiencing high turnover it may indicate one of several problems: the possibilities may be that the management of the organization is lacking, the pay scales are not competitive, or hiring mistakes are being made. Also the mission of the organization may not match what the employees are looking for.

## Gross Margin

Gross Margin is the percentage of profit divided by the total revenue for a project. What we are interested in here is the project gross margin, not the gross margin for a business unit or the entire organization. Project Gross Margin is a tool that can be used to manage the cost side of the business in the context of a PSO.

There are several items to review if the gross margins are not meeting expectations.

- Are the resource costs too high because the pay scale is out of whack with the value of the skill sets?
- Are the incorrect estimates being used to price the work on fixed fee engagements?

Project Gross Margins can be automatically calculated out of most standard PSA software packages as part of their standard reporting sets.

## Average Bill Rate

Average Bill Rate is used to monitor the revenue variable of the equation, while Gross Margin is used to monitor the cost side of the equation.

The Average Bill Rate is typically expressed as the average hourly bill rate that an organization is receiving from all of its customers for its work. Average Bill Rate is important in two respects:

Average Bill Rate directly drives revenue as higher bill rates lead to higher gross revenues with a constant headcount.

The average bill rate reflects the added value that an organization brings to the table and reveals the value that customers are placing about the services that your company is delivering.

If the only thing that an organization brings to the table is unorganized people, like traditional IT staffing firms, then bill rates will be lower than an organization that brings a process, proprietary tools, and organizational expertise to bear on a customer's project.

Ultimately, the consulting business is a struggle between supply and demand for the resources and expertise of the organizations. On newer, more important technologies, one would expect to see higher Average Bill Rates than on projects that use older technology and that are not mission critical projects.

A PSO manager needs to monitor the trends in the Average Bill Rate. A falling average bill rate may indicate that the company's services are losing value in the marketplace or that the organization is not working on strategic projects and that the sales force is compensating for this by lower proposed costs. On the other hand, if an organization is winning every proposal it may indicate that the services are priced too cheaply.

Average Bill Rate and Gross Margin are two tools managers can use to measure the financial success of the team's work.

## Customer Satisfaction

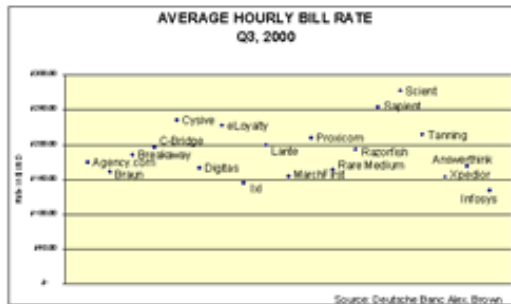
Until this point we have been tracking performance from the internal perspective of the PSO. Ultimately, the goal of any Professional Services Organization is to meet the needs of its customers.

If we are going to be running a top performing organization, we need to measure how our customers perceive our performance. We do this by consistently measuring Customer Satisfaction.

The customer experience should be systematically and objectively measured by sending out surveys at significant milestones on a project and on a predetermined periodic basis. This survey data should be collected and tracked to monitor the results of client engagements. These surveys, while not substitute for proper account management, are a supplemental tool to measure the organization against a standard.

### Putting the Metrics to Work

The first step to put these key metrics to work is to develop a business model for the organization. This business model must include revenue and profit information, for the purpose of projecting the results of the organization. In order to do this, a set of standards for each of the metrics previously discussed needs to be established. Spreadsheets are particularly useful in setting up monthly and quarterly goals that roll to annual projections.



Click thumbnail for larger chart.

Some of the financial calculations that use these metrics are:

$$\text{Revenue} = \text{Utilization} * \text{Average Bill Rate} * \text{Days in Period} * \text{Headcount}$$

To calculate an example month's revenue for an organization with a team of 100 billable consultants would be:

$$\$2,240,000 = 70\% * \$200/\text{hr} * 8 \text{ hrs/day} * 20 \text{ days} * 100 \text{ consultants}$$

If the organization typically achieved 50% gross profit margins on projects, then the profit would be calculated as:

$$\text{Profit} = \text{Revenue} * \text{Gross Profit Margin}$$

$$\$1,120,000 = \$2,240,000 * 50\%$$

It behooves the business manager to develop a series of business models that track the effects of changes in these metrics. This will enable the manager to develop contingency plans. Clearly, the sales component of the organization is not factored into these equations, but there are more sophisticated analysis tools that can make the linkage between sales and delivery.

### How to Establish Your Metrics

As part of the business modeling process one needs to establish targets for the key metrics for the organization. The key step here is to identify competitors in your space, select the best of that competition, and benchmark your results against best practices in your space. One of the best sources for this information is from companies that are publicly traded. Working with a Research Analyst from an Investment Banking firm can help in gathering this information. These analysts gather, collect, and normalize figures from a number of publicly traded Professional Services Organizations.

#### Average Gross Margins of Top PSOs 3Q2000

Inforte	55.5%
Scient	55.1%
Tanning	54.1%
Proxicom	53.1%
Cysive	52.5%
Agency.com	52.4%
C-Bridge	51.8%
Sapient	50.6%
Rare Medium	50.3%
Viant	50.0%
eLoyalty	49.6%
Infosys	48.7%
Breakaway	48.6%
MarchFirst	47.8%

### Tracking Your Organization's Performance

How does one go about keeping tracking of all of this information? PSA software packages can help in this effort. Some PSA software packages allow you to collect and report on these key metrics. In addition, many of the leading packages support some sort of opportunity management, forecasting, and planning tools.

With embedded PSA tools and the use of supplemental analysis spreadsheets, the Delivery Executive should be able to develop models to manage their business. When selecting a PSA software solution, the organization should develop its requirements based upon the business model that it wants to follow; the information necessary to provide transactional support, such as time tracking and billing; and the metrics that are business drivers for the organization.

In conclusion, an executive in a Professional Services Organization needs to develop the appropriate business model, track the key metrics of an organization, and utilize tools such as Professional Services Automation solutions to make the organization more profitable and more effective at solving customer problems.

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Source: Deutsche Banc Alex. Brown

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