Measurement for Professional Services

Driving Operational Performance

Overview

This is part of MRSI's series on measurement for small and mid-size businesses, which includes white papers on various aspects of measurement in a variety of industries. This paper is focused on measurement of Operations in professional services firms, such as those in architecture and engineering.

Measurement is vital to drive performance and, as the saying goes, "what gets measured gets managed." Measures should be selected carefully and then connected to positions in the organization structure through formal reporting relationships and performance evaluation mechanisms.

Professional services firms need to select a variety of measures to track performance. For most small and mid-size firms, key measures will be tied to labor productivity (by individual, job and overall) and quality. These can also be extended to other metrics such as effective billing rates.

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Why Measure Anything?

Many managers in small and medium-sized businesses mistakenly believe that measuring is expensive and therefore only for large companies. Others are self-taught and have never had the opportunity to find out what it is possible to measure. Both types of managers can benefit from awareness that knowing how one is doing is a fundamental human need. One reason people enjoy professional sports is that everyone knows the rules and everyone knows the score. Measures provide a scorecard that people can use to strive to improve against. Measures also allow management to set clear expectations. Consider the difference between "keep resources fully utilized" and "Keep resources operating at 85% productivity or better." Clear expectations have been repeatedly shown to improve performance.

"Measure what is measurable, and make measurable what is not so."
- Galileo

Measuring isn't just about making people work harder. It is also about making people work smarter. With measures in place, people are also likely to get more creative and improve what they are doing. This works on two levels: First, expectations are set and people want to show that they can do better than the expectation, which usually requires working smarter as well as harder. Second, there is a reward for improvement; a significant improvement in process will show in the numbers that are posted and the individuals responsible will know that what they did is having an impact—there is also the belief that this impact will be recognized by others.

Measures also help management with diagnosing problems. For example, management may know that labor costs are up. But do they know that labor costs are up because a particular category of work is being consistently underbid? Management can target the problem and take action.

Are Financial Measures Enough?

In short, no. In the era of cheap small business accounting systems, most companies have a reasonable idea of monthly and annual profitability. However, these figures are very high level and are focused on the overall outcome rather than the specific processes that may have caused the result. It is much like a football coach that focuses on whether they won or lost the game – the information isn't always actionable enough. The football coach is also going to want to know about passing yardage, fumbles, quarterback sacks, first downs, kick-off return yardage, and so on. These figures help the coach focus energy where it can best be utilized. If the problem is quarterback sacks, the coach knows to focus energy on the quarterback throwing more quickly, getting receivers open, or tightening the offensive line. Time spent with the place-kicker would be largely wasted.

Team vs. Individual Measures

Peer pressure has a strong impact on performance

Generally speaking, individual measures are more effective in driving individual performance than team measures because the individual contribution is diluted in the numbers posted by the team. However, team measures are also effective in driving the performance of the individual. From the earliest times, humans have gathered in groups. We all have a strong desire to please the other members of our team and to secure our social standing within the group. Peer pressure has a strong impact on performance.

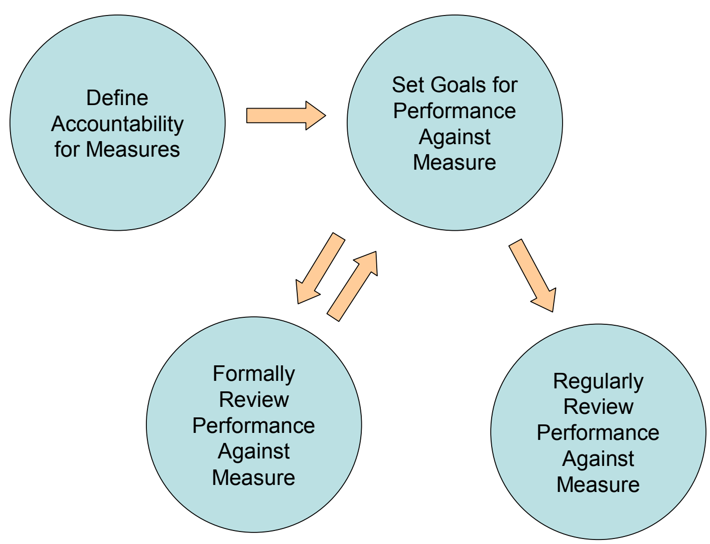
It is also important to consider the dilutive effect as teams become larger. A team on a manufacturing line may be motivated to improve their productivity figures, but in a large factory, the effects of individual effort would be difficult to see in factory-wide productivity. Generally speaking the effect starts to become negligible once it is covered by about 100 people. Of course, if those people report into, say, a Production Manager, that manager can be held accountable as an individual.

In some instances, individual measures can lead people to perform less than optimally. If their performance requires a lot of group interaction and cooperation, it may be necessary to emphasize group measures or give them group measures exclusively. Most companies have experienced someone who focuses on getting their “real work” done, while ignoring their paperwork, creating problems for the next person in the process. In some instances, including that next person in the team’s key measures can help refocus people on the broader impact of their actions.

In summary, individual measures are best at driving individual performance if teamwork is not a major element of the position, but team measures can also be effective at driving individual performance.

Accountability and Measures

It is crucial to identify which measures are important, but if the staff does not accept accountability for performance against those measures, they can simply become an academic exercise. All staff should know who is accountable for performance against which measure, which should be done through the organization chart. These measures should then be reviewed regularly with senior management to create ongoing accountability. Regular informal reviews should then be augmented by a formal performance evaluation process that includes setting goals for performance against measures. At each review or each time processes are changed significantly, the goals should be reviewed. An organization that does this comes to be perceived as fair and objective, while at the same time improving its performance.



Do People Need Total Control Over Results?

People must have the authority to take the actions that they need to in order to perform against the measure.

No, they don't. However, it helps if they can at least see that they can influence the measure. Most people accept that sales people should be measured on sales. But even sales people don't have full control; they are impacted by product availability, competitor activity, pricing policies, manufacturing and delivery issues, and so on. People just need to see that the number is not completely outside of their control. Similarly, people must have the authority to take the actions that they need to in order to perform against the measure.

Risks in Measurement

One problem setting measurable targets is that if they are not designed well, they can become too effective at driving performance against the measure to the exclusion of other things that are important. In 1937, a paleo-anthropologist with the regal-sounding name Gustav Heinrich Ralph von Koenigswald was searching for the bones of early hominids in Java, present-day Indonesia. Since the bones are exceedingly rare (even now, the entirety of the bones of early man that have been found would barely fill the bed of a pickup truck) and because it is difficult to know where to look, he hit upon the idea of using low-paid locals to aid in the search and make his team able to cover a larger area. He offered 10 cents for each piece of bone they could bring him. To his horror, he found his labor force was smashing priceless bones into fragments in order to increase their incomes. Perhaps he could have paid per pound, or paid more for larger segments, or paid by the hour. Regardless, Koenigswald discovered how painful the results of measuring the wrong things can be.

Major Categories of Measure for Professional Services

Professional services firms are unique. They are defined as infrequent, technical, or unique functions performed by independent contractors or consultants whose occupation is the rendering of such services. They include professions such as accountants, business consultants, attorneys, appraisers, architects, law firms, physicians, researchers, and real estate brokers. Typically, most of a Professional services firm's costs are in salaries. In most cases, these salaries must be fixed in order to attract and retain talent with the promise of stable income. This makes measuring the productivity of human assets the top priority.

Ask yourself these questions to gauge how good a handle you have on the productivity of your professional services firm:

- What type of projects are your most profitable? Are you sure?
- A client wants to retain you on a longer-term basis for a full-time, three year contract and is offering 75% of your usual rate. Do you take it?
- What percentage of your time do you spend actually selling? How does this measure up against industry best practices?
- On your last fixed-bid project, what was your effective hourly rate? On which parts of the project did you make the most money? Were any parts of it unprofitable?
- You recently completed a fixed-bid project for a first-time client. It went well, but you have a sinking feeling you spent more time than you originally thought you would. Now the same client wants you to do another, very similar, project for a fixed-bid price. How can you build on your past experience to structure your bid for the new project?

While the range of professional services are wide and there are many firm-specific measures of performance, there are common performance metrics for the industry that allow the professional services executive to answer the above questions with greater certainty, while driving organizational performance forward.

Productivity and Effective Billable Rates

Professional services firms' lifeblood is productive billable hours. Yet many firms do not track where their hours go per employee or even per division. A firm aiming to bill at $100 an hour may bid $20,000 for a month-long project, planning for 50-hour work weeks. Without tracking hourly activities and how the time is spent, it is difficult to know how many hours per week were actually productive. With travel, admin, unexpected IT downtime, a significant portion of the hours get used up, resulting in one of two outcomes: (1) time crunch at the end of the project, leading to unprofessional image and poor deliverable quality, or (2) missing the deadline to meet the agreed-upon deliverable, resulting again in an unsatisfied customer, an unprofessional image and lost billing opportunities for that resource. The math is simple:

Going on "Gut Feel":

Weekly billing: $5,000

Weekly hours: 50

Hourly rate: $5,000 / 50 = $100 an hour

Using Measurement through time logs for a representative week:

Admin time:	6 hours	
Networking time:	6 hours	Non-billable
IT downtime/tech support:	4 hours	
Hours on project directly:	50 hours	Billable

Actual hours spent on the project during the week: 66

Effective billing rate: $5,000 for week/66 hours = $75.76 an hour!

Now factor in a project overage. If, in fact, the project took one extra week, the total time spent is actually 66 hours x 5 weeks = 330 hours.

Hourly Rate: $20,000 / 330 = $60.61 an hour!

Now consider that the partner or salesperson who sold the job may have discounted to get the work. If they had discounted by 10%, that would be $2,000 off.

Hourly Rate: $18,000 / 330 = $54.54 an hour!

So much for the initial target of $100 per hour. This fictitious company has an effective billing rate over 45% below target. In practice, MRSI has seen some firms with figures much worse than this.

Pace Productivity2 is a time-and-motion consulting firm that conducts detailed time usage studies of everything from stay-at-home moms to management consultants. They found that the average consultant worked over 60 hours a week, about 32% of it billable. The exact breakdown is shown in the table below.

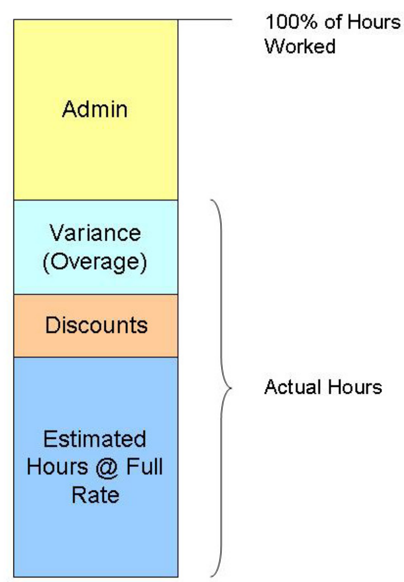
Pace Productivity's Average Consultant Workweek

Category	Hours/week	Percentage
Billable	20	32%
Administration	13	21%
Selling	11	18%
Other	7.2	12%
Travel	6.5	11%
Planning	4	6%
Total	61.7	100%

Non-billable work hours: 41.7 (68%)

The scenario is not unique to consulting firms—any professional services firm experiences similar hazards of failure to measure performance appropriately.

Using the right measures, management and owners get a clearer picture of how much they are actually earning for their time. This allows for better management decisions in areas such as which future project to bid on, how much to bid, and what areas make the most profit to concentrate sales activity on.



Job Profitability

With hours being tracked, it is often possible to track, not just the hours, but also the overall job cost and profitability. This can sometimes provide advantages over merely tracking hours: 1) when some aspects of the job can be outsourced and it is difficult to show contractor hours on the job or when those hours are not comparable for some reason, 2) when senior resources are worth a great deal more than junior resources and one objective of the costing system is to create an incentive to use as junior a resource as possible. Note that this often not worth the complication in the smallest firms but can eventually become worthwhile as firms grow. Such systems can sometimes be simplified by basing costs on the position rather than the wage of the individual involved.

Project Management

A good measurement system includes measures after the fact, but firms that have mid-size to large projects should report on jobs regularly. A commonly employed measure, which can be applied to the overall project or to each phase or task is:

% Consumed / % Complete

If this number is over 100%, it suggests that the project or task is behind schedule. % Consumed / % Complete can be used an early warning measure for top management and for project managers.

Other Measures in Professional Services

There are many other performance metrics specific to professional services firms that affect parts of the business outside of Operations, which is the main focus of white paper. They can include length of contracts, sales pipeline activity, frequency of retainer services, repeat clients, new business, new leads, marketing dollar returns (ROMI), and debt collection performance.

One of the biggest challenges facing professional services firms is talent drain, or "brain drain". Attrition rates are high as talented partners and employees walk out the door, taking the firm's investment in training and development with them. So what can a firm do to retain them? Firms that are successful in retaining talent keep an eye on the key metrics that their top talent is most interested in:

- Hours worked (benchmarked to the region and industry)
- Work-life balance
- Level of Supervision, direction, and support
- Mentoring
- Pay and promotion activities (benchmarked to the region and industry)

Most top talent in professional services firms will give little or no warning if they are unsatisfied—they will simply be up and gone to a better job one day. Companies that proactively measure internal metrics such as those above that are direct contributors to churn and have an open communication structure and systems have a better "pulse" on the satisfaction of their talent and have fewer unpleasant and expensive churn activities.

The list excludes measures for factors such as location productivity in the warehouse. For more on measures in the warehouse, see our white paper on Measures for Distribution & Wholesale.

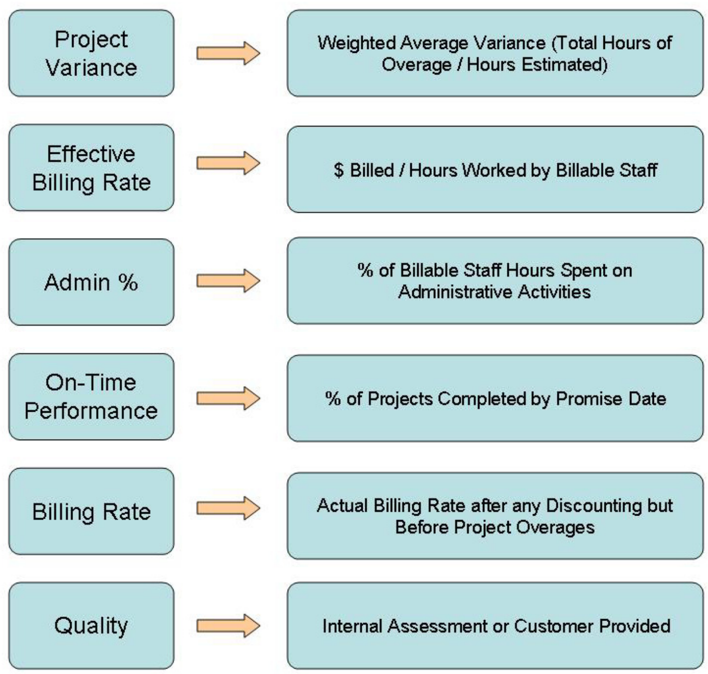


Figure 1: Summary of Key Operations Measures for Professional Services

Although this paper is focused on Operations for services firms, we include here a few measures that are more interesting at the strategic layer of the organization – especially for those firms pursuing a growth strategy.

Average Sales / Client: The average value of an account. Generally growing existing relationships is easier than developing new ones.

Client Churn %: This is usually defined as the total of all clients that have gone "stale" - not done business with the firm over a defined period (usually a year).

New Customers / Customers Added: This ratio must generally be over 100% in order to pursue a growth strategy unless the new customers are expected to be significantly larger accounts that those that are lost.

Implementation

There are numerous potential pitfalls with implementation of measures that can reduce their effectiveness or even lead to their complete failure. The first step in any such endeavor is to see that key staff understand why a measure is important to the business and its strategy. To reduce fear, they must also understand how management will use the information and how it will benefit them. The method of capturing the data must be thought through thoroughly. After implementation, expect hiccups as staff change the way that they work in order to capture the data or get in the habit of using reports. During this period, management usually needs to sustain its focus on the new measures, with more frequent reviews and requests for the data. It is important that staff actually see management using the data and don't believe that they are pointlessly doing work to produce data or reports that are simply filed.

Lastly, be certain that your middle managers are effective at using the data to uncover problems and hold staff accountable. This requires frequent review of projects in process and the application of the art of managing people through the numbers, which is not natural for most people – but these skills can be taught.

Next Steps

Consider the following questions before embarking your endeavor to install new process measures in your professional services firm.

- How will we prioritize the right measures?

- How will we deal with questions about what should be included in the numbers for our environment?
- How will we determine standards or estimated hours?
- How will we connect those standards and estimates to the floor?
- How will we get data on projects that are in-process to projects managers so that they can properly use it?
- Are there risks in implementing this in our company culture? How will we mitigate them?
- Do we have the resources to proceed with this effort alone?
- What other barriers to implementation will we face?

Resources

The Balanced Scorecard, Robert S. Kaplan and David P. Norton, Harvard Business School Press, Boston, Massachusetts

www.aia.org, American Institute of Architects

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