The 2018 Five Key Performance Indicators for Greater Financial Success

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Research Note

INTRODUCTION

The Professional Services (PS) market continues its ascent. Over the past five years, SPI Research has seen it grow at an annual rate of over 10%. This growth is especially true in midsized organizations – with employees between 30 and 300. One reason for this growth is these organizations are nimble enough to move quickly to respond to customer demand. They also lack the overall bureaucracy of their larger competitors.

However, all is not smooth sailing in these midsized professional services organizations (PSOs). Research highlighted in SPI Research's 2018 Professional Services Maturity™ Benchmark shows competitive pressures from above and below, challenging midsized PSOs to improve alignment from top to bottom.

This research paper takes a deeper dive into the needs of the growing midsized organizations, and the important role of finance in aligning strategy, sales, talent, and service delivery to succeed.

Does PS Financial Maturity Matter?

For over a decade, SPI Research has conducted benchmarking on professional services organizations to determine their performance maturity. Figure 1 highlights the five levels of financial maturity for midsized independent professional services providers. The figure shows that as organizations improve the management of personnel, business processes and finances, they can achieve higher levels of growth and profitability. This improvement might seem easy, but it is not. Financial maturity takes rigorous discipline, coupled with visibility across the organization, to better manage every process and cost impacting corporate profit. SPI Research's Professional Services Maturity Model™ shows financial success is only attained if every department (Sales, Human Resources, Service Delivery, etc.) works together. Profit and cash flow are the fuel for growth and profit. In this note, SPI Research will look at the five most important key performance indicators to improve financial success.

FOCUS ON PROFIT IMPROVEMENT

Leading PSOs continually work to better understand operational processes, and their improvement to increase productivity and profitability. Over the past several years SPI Research has seen several issues that face PSOs, which could lessen their ability

Figure 1: Focus on Financial Maturity Improvement

	Level 1 Initiated 30%	Level 2 Piloted 25%	Level 3 Deployed 25%	Level 4 Institutionalized 15%	Level 5 Optimized 5%
Annual revenue per billable consultant (k)	$105	$177	$210	$248	$291
Annual revenue per employee (k)	$70	$128	$171	$204	$238
Quarterly revenue target in backlog	23.5%	40.9%	50.1%	55.8%	60.6%
Percent of annual revenue target achieved	86.7%	92.2%	93.0%	98.5%	103.8%
Percent of annual margin target achieved	81.9%	86.3%	89.0%	93.5%	103.1%
% of billable work is written off	4.4%	3.7%	2.8%	1.8%	0.8%
Project Margin	27.0%	28.9%	34.3%	41.0%	47.1%
Profit (EBITDA)	**5.3%**	**6.9%**	**12.9%**	**22.4%**	**33.3%**

Source: SPI Research, February 2018

to grow and grow profitably. Some of these include:

- Δ Increased client demands and expectations for greater service value for their dollars;
- Δ A shortage of talent due to baby-boomer retirement and not enough STEM (science, technology, engineering and math) university graduates;
- Δ More complicated projects, which depend on geographically dispersed resources; and,
- Δ Different billing structures and more complex accounting, which complicate invoicing and cash flow.

There are literally hundreds of areas where PSOs can improve financial performance. In the following sections, SPI Research highlights five of the most important metrics to measure to improve financial performance.

Billable Utilization

SPI Research defines employee utilization on a 2,000 hour per year basis, and calculates it by dividing annual billable hours by 2,000. This key performance indicator is central to organizational profitability. Utilization is consistently the most measured key performance indicator, but must be examined in conjunction with overall revenue and profit per person along with leading indicators like backlog and size of the sales pipeline, to become truly meaningful. Utilization is a major indicator of opportunity and workload balance as well as a signal to expand or contract the workforce.

As Table 1 highlights, increased billable utilization is highly correlated with growth and profit. However, those organizations with high billable utilization also performed project-based work more effectively. They can minimize disruptive forces, such as non-billable project hours, projects written-off, and even project overrun.

Table 1: Maximize Billable Utilization

KPI	Over 75%	Under 75%	Improve
Year-over-year headcount change	10.9%	6.7%	62%
Non-billable project hours	68.0	146.4	54%
Average project overrun	7.6%	9.3%	18%
% of billable work is written off	2.3%	3.7%	37%
Project margin	36.0%	28.6%	26%
Profit (EBITDA %)	**16.4%**	**12.8%**	**28%**

Source: SPI Research, February 2018

Project Overrun

Project overrun is the percentage above budgeted cost or time to actual cost or time. Project overruns may be expressed in actual time versus, plan or actual cost versus plan, or both.

Monitoring project overrun is important because any time a project goes over budget (in either time or cost), it cuts directly into the PSO's profitability. It also sheds a negative light on the ability of the organization to perform. As the scope changes in project-based work, many PSOs do not adequately plan for the change, which leads to confusion, cost and dissatisfaction for both the client and the PS employees working on the projects (Table 2). To compensate, many of these organizations must increase the discount given when selling services, which further reduces the potential for profit.

Table 2: Minimize Project Overrun

KPI	Under 5%	Over 5%	Improve
Annual PS revenue growth	9.6%	8.9%	7%
Average service discount given	3.3%	5.3%	37%
Non-billable project hours	85.8	113.3	24%
% of billable work is written off	1.9%	3.8%	50%
Revenue leakage	3.1%	6.0%	49%
Employee annual attrition - voluntary	7.8%	9.1%	15%

Source: SPI Research, February 2018

Project Margin

Project margin is the percentage of revenue which remains after paying for the direct costs of delivering a project. In professional services, projects can be fixed price, or milestone-based; they can be time and materials, "not to exceed" or a combination.

Table 3: Maximize Project Margin

KPI	Over 40%	Under 40%	Improve
Annual PS revenue growth	12.8%	6.8%	88%
New Logo Clients - New services	9.8%	5.5%	79%
Deal pipeline / qtr. bookings forecast	212%	152%	40%
Annual revenue per billable consultant (k)	$214	$193	11%
Annual revenue per employee (k)	$175	$148	18%

Source: SPI Research, February 2018

PSOs should always keep their focus on project margin. It is the core driver of profitability in professional services and must be continually monitored. As projects are completed the organization must evaluate budget vs. actual margin attained. This process should be monitored while the project is being conducted.

Organizations that can sell and deliver services at higher margins grow much faster and have much better financial results (Table 3) than those completing work at low project margins. Part of this higher growth is due to increased profits to invest in the future.

Annual Revenue per Billable Consultant

Annual revenue per billable consultant measures the service organization's total revenue divided by the number of billable consultants. Revenue per consultant provides an indication of consultant productivity. SPI Research considers revenue per billable consultant to be one of the most important KPIs, but it must be viewed in conjunction with labor cost.

Revenue per billable consultant should minimally equal one- to two-times the fully loaded cost of the consultant. Revenue multipliers of three and higher are typical for engineering and architecture firms, as well as in management consulting and legal professional services.

For midsize independent professional services providers, SPI Research believes $230k per consultant is attainable and provides the organization with sufficient financial benefits. This figure should be contrasted to embedded service organizations, such as hardware and software PS, where the number is much lower, approximately $190k per consultant. Regardless, those organizations that continue to sell more expensive professional services, and keep their employees highly utilized, see benefits ranging from improved new clients to lower service discounts (Table 4). And perhaps more importantly, project margins tend to be much higher as this figure grows.

Table 4: Maximize Annual Revenue per Billable Consultant

KPI	Over $230k	Under $230k	Improve
Annual PS revenue growth	12.7%	8.5%	50%
Deal pipeline / qtr. bookings forecast	231%	164%	40%
New Logo Clients - New services	10.6%	6.1%	74%
Project margin	38.8%	31.9%	22%
Revenue leakage	3.3%	5.0%	34%
EBITDA %	**18.1%**	**13.8%**	**31%**

Source: SPI Research, February 2018

Annual Revenue per Employee

Annual revenue per employee is different from revenue per billable employee, as it measures overall organizational effectiveness. Like annual revenue per billable consultant, it divides total revenue by the total number of employees, so it includes both billable and non-billable employees.

Revenue per employee is a powerful indicator of the overall profitability of the firm because if the average cost per employee is known, profit can be estimated representing the difference in cost per employee and overall revenue per employee. It also highlights the overall ability of the organization to successfully plan, sell, staff, and collect for services. These individuals are not responsible for service delivery, yet have a very important role in terms of driving the organization forward. While in midsized firms the goal should be to meet at least $230k per billable consultant, they should target $180k per overall employee to pay salaries and other costs, yet also generate sufficient profit (Table 5).

Table 5: Maximize Annual Revenue per Employee

KPI	Over $180k	Under $180k	Improve
Annual PS revenue growth	11.7%	8.8%	33%
Deal pipeline / bookings forecast	234%	163%	44%
Non-billable project hours	58	122	52%
Project margin	39.4%	31.7%	24%
Invoices redone due to error/client rejections	2.5%	2.7%	8%
Revenue leakage	3.3%	5.2%	37%
Profit (EBITDA %)	**18.3%**	**13.8%**	**33%**

Source: SPI Research, February 2018

MANAGE FINANCES

The key to any successful professional services organization meeting their financial objectives is the management of all revenue and cost information. Successful financial management means executives and other decision-makers have access to information in real-time, with the ability to analyze it in a variety of ways. This capability is critical for PSOs to get at the root cause of success or failure, and make the appropriate changes to propel the organization.

Financial management solutions are at the heart of the PSO information infrastructure, but there are many other solutions professional services firms use to successfully manage their business. Significant competitive edge is gained when PSOs are able to choose the best-of-breed solutions that can be easily integrated into the financial management solution:

- Δ ***Client Relationship Management*** (CRM) for sales and marketing, which helps the organization plan and price engagements to optimize revenue and margin
- Δ ***Human Capital Management*** (HCM), to ensure there is a proper balance of skills residing in the organization, and compensation that mirrors the overall strategy of the firm
- Δ ***Project & Resource Management***, to optimize the delivery of services, complete work on-time and on-budget, while maintaining margins, as well as keep highly-compensated employees billable, which without, deteriorates profits.

Integration of these solutions to the core financial management solution is paramount to success. With integration, PSOs can better assess the potential cost and revenue associated with every decision they make. It must help to evaluate budget versus planned costs and revenue, to better analyze financial performance by project, client or practice. The integration should also support automated billing, with multiple billing methods, automated and sophisticated cost accounting.

This information must be available in real-time, for business moves too quickly to wait for weekly or monthly reports. Executives must also have the capability to “slice-and-dice” the information, and analyze it in a way that will optimally help them plan, sell, deliver and collect for services. Ideally this information is available via dashboards, where decision makers from executives to project managers can easily monitor, analyze and make changes to improve performance.

CONCLUSIONS

The global economy has shown signs of more rapid growth for 2018 and beyond, and all industries look to expand. This environment bodes well for professional services organizations, as new strategies, products/services, and methodologies will be required to support significant growth. While there will always be issues that could impede an organization’s ability to meet and exceed profitability objectives, none are so insurmountable that PSOs focused on financial performance, cannot achieve their goals.

The project-centric financial management solution should provide a platform for integration with the other departmental solutions so that information, such as sales and client, employee costs, service delivery costs and revenues, and other relevant information can be seamlessly passed to it. With this information at the fingertips of the executive team, confident decisions can be made to help grow the professional services organization.

SPI Research has found that the “secret sauce” in professional services, as well as most other industries, is *information visibility*. The 2017 Professional Services Maturity™ Benchmark shows a direct correlation of growth and financial success to increased information visibility. When each employee, who has a hand in the overall success of the organization, has the information easily available to make sound decisions, PSOs grow and prosper. Information should never be siloed by department – it should be available and accurate so that the right decisions can be made at the right time. No longer can information be managed on a month-by-month or quarter-by-quarter basis. The economy moves much too fast for that.