

TIPS & TECHNIQUES

Key Performance Indicators for Consultancies: How to Use Per-Project Labor Cost Data to Analyze KPIs for Your Consulting Company

By Curt Finch

Companies that sell services to other businesses—data management, software development or IT consultancies, for example—often track time in order to automate invoicing, but they may be overlooking the other benefits these systems can provide. Real-time access to relevant Key Performance Indicators (KPIs) such as *'percent billable'* and *'completed vs. estimated'* can give early warnings of project problems and lead your company to faster growth and more profitability. I would first like to explain what KPIs are, and then show you how to use some simple ones to improve your business that can be calculated from any time and data labor source.

What's a KPI?

A key performance indicator is 'key,' which means that your KPI has to be one of a *very few things* that you are measuring which you believe will make a huge difference to your business long-term. In other words, a KPI measures progress toward a strategic goal. If you have 100 KPIs, then you're not going to be able to use any of them to drive organizational behavior because your company doesn't have 100 strategic goals. Ten KPIs can be effective, five KPIs are better, and one KPI is ideal.

Martin Luther King Jr. had a morally compelling vision: *interracial peace and equality*. Your business needs a morally compelling vision as well if you want to hire and maintain the best people. King had a strategy to achieve his vision: *nonviolent protest*. In his case, a KPI might have been something like 'number of violent incidents per protester.' He would have encouraged his organization to reduce that number over time, which would have effectively measured the organization's success.

The closer you get to a morally compelling vision, a clear strategy and calculable KPIs, the more successful your company will be, all else being equal.

1 - A Quantifiable Indicator

A KPI must be measurable. "Make customers more successful" is not an effective KPI without some way to measure the success of your customers. "Be the most convenient drugstore" won't work either if there is no way to measure convenience.

It is also important for KPI definitions to remain stable from year to year. For a KPI of "increase utilization rates," you need to address considerations like whether to measure by hours or by dollars.

2 – Performance Measurement

KPIs are used to measure the performance of an organization, frequently through activities such as performance improvement derived from training, labor utilization rates, or customer satisfaction. KPIs are

often tied to strategy through techniques such as the Balanced Scorecard, but they don't have to be as complicated as that to be useful and effective. As with most things, simplicity increases efficacy.

KPIs can differ depending on strategy. They help an organization to measure progress towards their organizational goals, such as increased penetration of existing customers or markets, on-time delivery or reduced scope creep.

A KPI is part of a 'SMART' goal—one that is Specific, Measurable, Achievable, Relevant, and Time-based—which is made up of a direction, KPI, target and time frame. An example of this would be to "increase average revenue per sale to \$10,000 by January." In this case, 'average revenue per sale' is the KPI. The aforementioned goal wouldn't be SMART if it wasn't achievable, if the word 'January' was left out, or if was not relevant, e.g. if this was a portion of the organization that had nothing to do with sales or marketing, like HR.

Simple, Useful KPIs

Billability

Billability (often termed 'utilization rate') is the percentage of time in a given period during which employees are working in a revenue-producing capacity. You must configure your timesheet system to track whether or not work is considered billable to the customer. Once you have this information, utilization for any period, group or person is found by the formula B divided by T, where:

B = billable hours for the employee/group in the period

T = all hours worked for the employee/group in the period

Most organizations try to keep their utilization rate above 70% or so. The higher, the better, until you've reached a point where administrative tasks that are necessary to the business (like tracking time) are not getting accomplished. Then you know you've pushed it too far.

Adherence to Estimate

Customers do not like it when you underbid, but you won't win the business if you overbid. Many consultancies do a poor job in this area. The KPI you want to minimize here is defined by the formula $[(E-A)/E]$ where:

E = estimated hours to complete project

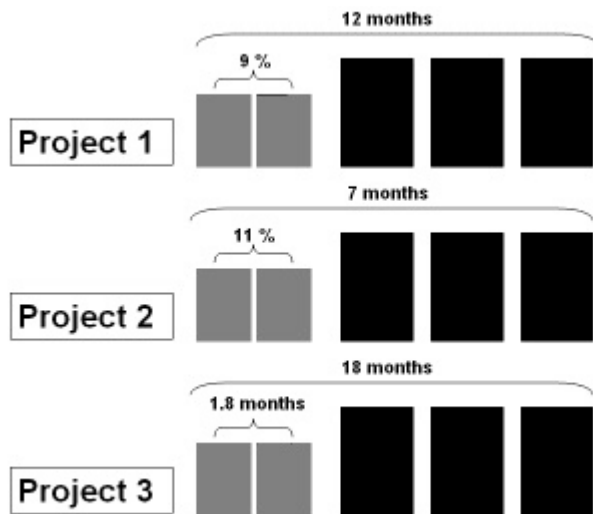
A = actual hours used to complete project

Just tracking this KPI is a good start, and you can get the data to calculate it from any timesheet system, even paper ones. Automated systems, however, often have reports to calculate it for you. Improving this number can be difficult for some companies until they understand a simple truth—that *similar projects often have a strikingly similar ratio of early phase cost to overall project cost.*

The early phases of a project are usually referred to as the 'requirements,' 'design,' or 'specification' phases, depending on what your consultancy is doing. If you find that after carefully tracking time on a batch of

similar projects, the first two phases usually take about 10% of the total project time, you can use that data to predict the length of future projects.

The following diagram shows how tracking the time it takes to complete a project helps in planning future projects. By tracking time and subsequently learning that the first two phases of Projects 1 and 2 took 10% of all project time to complete, the projected length of Project 3 becomes easy to determine. If the first two phases of Project 3 take 1.8 months to complete, you can estimate that the entire project will be completed in 18 months. This project estimation technique has proven itself to be extremely accurate for similar projects in a variety of companies.



Percentage of projects profitable

‘Percentage of projects profitable’ is a KPI that can really affect your business in a positive way. As an analogy, consider the Journyx customer, British Petroleum (BP), and their experiences in drilling for oil. They created a strategic vision for their company which they termed ‘no dry holes’. Drilling for oil and not finding it is expensive. Rather than try to make up for all the dry holes by finding an occasional gusher, BP decided to try to never have a dry hole in the first place. Changing the attitude that dry holes were an inevitable cost of doing business fundamentally changed their culture in very positive ways.

Consultancies also have dry holes: projects which lose money for the company. Due to an inadequate understanding of costs, many of these go unnoticed. If you set a strategic goal for your company of ‘no unprofitable projects,’ it will change the nature of discussions in your business. For example, it empowers frontline employees to legitimately push back when a project is being taken on for political reasons. Conversely, having the attitude that the winners will make up for the losers doesn’t do this. Getting direct per-project cost data from a timesheet system is easy. Correctly applying indirect data (such as sales or accounting time) to the direct costs is a bit more complicated. Connecting all of this to revenue data gives you per-project profitability. Once you have that data, you can work on your KPI of ‘percentage of profitable projects’ and try to maximize it. The formula for this KPI for a given time period (usually a quarter or a year) is:

of profitable projects / # of projects

You should seek to maximize this number. Even if you are willing to lose money on a few strategic projects in order to enter a certain market, you should determine how many you're willing to do that on, and keep your losses around that area reasonable.

Conclusion

These are three examples of KPIs that may be useful for your consultancy, with information on how to calculate them. None of these require an automated system (although that dramatically lowers the effort of data collection). Other KPIs that could be useful are 'calendar time to complete a job' (because overhead costs increase substantially due to all the status communication problems when there are delays), 'percentage of customers satisfied' and 'time to complete initial free estimate.' Any of these may be right for your business once you've chosen a strategy, but a strategy without metrics won't get you very far. KPIs are the answer.



Curt Finch

PM World Today Correspondent



Curt Finch is the CEO of Journyx (<http://pr.journyx.com>), a provider of free Web-based software located in Austin, Texas, USA that automates billing, payroll & project management by tracking time, expenses and mileage. Finch is a software industry veteran. In 1997, Curt created the world's first Internet-based timesheet application and the foundation for the current Journyx product offering. Curt has managed development teams creating enterprise-level software solutions since 1985, with a focus on distributed workforce management. In 1992, Finch led the team porting Tivoli's product line to the AIX operating system, which led to the company's acquisition by IBM. As a member of the executive team, Curt helped launch The Kernel Group (TKG), a venture-backed firm that grew to 50 employees and \$7.5 million in sales during his tenure. Curt has a B.S. in Computer Science from Virginia Tech University in the USA. Curt Finch can be reached at curt@journyx.com