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Cutting Costs the Smart Way: Per - Project Profitability!

By Curt Finch

The global financial marketplace has recently become quite volatile, as fears of an American recession affect economies all over the world. In addition, the Dow Jones Industrial Average currently hovers at around 12,400, while it was at around 14,000 in October 2007. A drop of 11% in just four months is cause for concern for many people.

At times like this, executives typically search for ways to cut costs, which can be a sticky business. And yet, what if you could know where your company is profitable and where it's not, and then figure out a way to do more of the profitable work? In other words, what if you got rid of unprofitable *customers* instead of loyal, productive employees?

The truth is, many companies that slash costs in response to an economic recession find it difficult to achieve top-line growth when the recession ends. This is not hard to believe, considering the fact that their best workers are gone and their long term projects were cancelled. A company cannot grow on short term plans alone. Overzealous cutting of people and projects can, however, be avoided, or at the very least, they can be performed with more intelligent precision. All that are required to handle such problems the right way are per-customer per-project profitability metrics.

Understanding costs is the first step to understanding profitability. Most companies know their profitability company-wide, but few of them know it on a per-product or per-customer basis. Such precision of understanding is necessary in order to develop and implement the right growth strategy.

Here is a five step process that will take your company there.

1. Current situation: “Chaos”

If you don't know your costs on a per-project basis, then you have no way to validate future project estimates. Without knowing how long your last project took to complete, how can you determine how accurate the initial estimate was? Calibrating project estimates is not just about calendar time, since a project that was delivered on time may not have been delivered on cost. For example, some organizations provide on-time delivery by adding resources to projects that are behind schedule, and they do it without drawing attention to the fact. This is something you must know in order to avoid *overcommitment* and *underpricing*.

You also need this information in order to repeat past successes. Not knowing which projects were on-time and on-budget means you cannot know which projects were successful, and therefore, which processes to continue following and which to improve.

Overcommitment, underpricing, inability to repeat past successes and abandoning proven processes in times of crisis leads to chaos, which is especially dangerous during a recession.

2. Track project labor hours

Having your employees track their time on a per-project basis lets you know when projects are in trouble much earlier than you otherwise would. Contrary to what you might think, 100% compliance is not necessary to gain significant insight into project progress, profitability, and adherence to estimates.

The basic time tracking data you obtain from this system will surprise you. You can figure out, for example, which projects are consuming more labor hours than you thought, or which of your customers are cheap to service.

What many project managers don't realize is that the noisiest customers are often the ones who pay you the most. While these are often labeled as "problem customers," they may account for much of your revenue. A simple basic level of employee project time utilization data can give you insight into the profitability of each customer, so you don't have to wonder anymore.

In recessionary times, your best bet is to "fire" unprofitable customers and kiss up to the profitable ones.

3. Put labor rates on time data and track all expenses

Travel expenses represent the second largest controllable corporate expense for most companies, and some projects, products or customers utilize more travel expense than others. Collecting all this data on a per-project basis can help you understand true direct per-project cost. Once you've got that, profitability is not far behind.

Now is also the time to aim for nearly 100% compliance on time and expense data collection so that management will have better insight into how to cut costs *without a chainsaw*.

4. Allocate indirect costs

Indirect costs, such as the cost of office space or HR, apply to different projects in different ways. There are two basic kinds of indirect costs: general indirect costs, like rent, that must be allocated across every project in the company, and semi-indirect costs, like

customer relationship management, which should be applied to all projects for that customer.

Every company is different and allocation of indirect cost is specific to each company. At my company, Journyx, we allocate more marketing cost to software license sales than we do to professional services or software maintenance sales. We do this because marketing expenses are directly related to winning the customer in the first place, more than they are to maintaining the customer relationship over time. We have found that marketing matters most during the customer acquisition phase, which is when most of our licenses are sold.

You must also create a general indirect cost allocation formula for each type of indirect cost in your company.

Then there are semi-indirect costs. If you have a large customer whom you do multiple projects for, or a suite of related products that are treated as a group, there are probably some costs that apply to that *group* of projects, but not any particular project on its own. Examples of this include management of the customer relationship or marketing of the product suite. In this case, you may want to allocate these semi-indirect costs by revenue or by direct cost over those projects.

Another thing to note is that input from all of the managers involved is not only useful, but necessary. You may want to alter the allocation formulas over time if they are generally perceived as inaccurate, unfair, or leading to bad decisions.

Once you have allocated indirect and semi-indirect costs across all projects, you will be fully aware of what your complete per-project costs are. Whether or not you are facing a recession, you will have a very precise tool for making intelligent changes to company resource utilization and direction that are likely to lead to increased profits.

Step 5 - Universal Awareness of Per-Project Profitability

Imagine if your engineers, developers, services team and salespeople all knew which of your customers were making money for you and which were not. Wouldn't this information alter their behavior in ways that would make you more money?

$$\text{Revenue} - \text{Cost} = \text{Profit}$$

That formula may seem simple, but sometimes it is necessary to use a proxy in order to gain an understanding of per-project revenue. For example, if you manage an internal IT shop for a large Fortune 500 firm, you must ask your customers for an estimate (in dollars) of the value their projects provide to the company overall. Allocating business value delivery – a proxy for revenue – can be every bit as complex as allocating indirect costs, but it is well worth the effort.

On the other hand, if you're running a consultancy, you can use bookings or billings data right out of the CRM system.

As new data becomes available, you may have to revise your method. Yet once you have an estimate of per-project profitability, you will be in the nirvanic state of understanding per-project per-customer per-product profitability, which gives you an enormous advantage over your competitors, both during a recession and in general. You know where your profits are coming from, and they don't. Now you can cut out the unprofitable work, or at least perform it consciously if it has to be done for strategic reasons. You can also easily calculate ROI on anything and your estimates will keep improving.

An understanding of per-project profitability will make your company more solid in bad times and more flexible in good ones. When times are hard and you need to cut, you will be able to cut *intelligently*, with the assurance that you're making the right long term decision for the company. Though recessions come and go, having great procedures in place is the key that will allow you to weather any financial storm.

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Curt Finch is the CEO of Journyx (<http://pr.journyx.com>), a provider of Web-based software located in Austin, Texas, that tracks time and project accounting solutions to guide customers to per-person, per-project profitability. Journyx has thousands of customers worldwide and is the first and only company to establish Per Person/Per Project Profitability (P5), a proprietary process that enables customers to gather and analyze information to discover profit opportunities. In 1997, Curt created the world's first Internet-based timesheet application - the foundation for the current Journyx product offering. Curt is an avid speaker and author, and recently published "All Your Money Won't Another Minute Buy: Valuing Time as a Business Resource".