Driving Growth and Profitability: Why Growth-Oriented Professional Service Organizations Require Integrated Client-Relationship, Resource, and Financial Management Solutions

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Driving Growth and Profitability: Why Growth-Oriented Professional Service Organizations Require Integrated Client-Relationship, Resource, and Financial Management Solutions

Introduction

The core offering of any professional services organization (PSO) is the set of knowledge, experience and skills their people possess. Leveraging those assets profitably via a time and materials approach tends to be a fairly straightforward proposition when such organizations are small. But managing resources and the work they perform becomes more complicated with growth – with client-service agreements that span service offerings, expansion into multiple domestic or international locations, sharing of skilled talent across offices, or the need to manage risk and client expectations across more engagements.

The initial business solutions that leadership implemented to manage client-relationships, resource engagement, and financial management at its founding, or in early-stage growth, do not serve the business effectively as it expands. And continuing to employ these same tools and processes will ultimately have a negative effect on growth and profitability for the enterprise. There is only so much manual processing an organization can handle before coordination costs begin to smother profits.

PSOs can achieve success by leveraging integrated practice management systems (PMS) to help manage their businesses. Such software solutions are designed to provide seamless control over three central aspects of PSO operations:

1. Client acquisition and relationship/retention management;
2. Talent (human capital) acquisition and project-based deployment; and,
3. Engagement-centric financial controls, reporting and risk management.

This paper discusses the challenges facing PSOs in managing their business operations, with emphasis on the three central aspects of client-relationship, resource-planning, and financial management processes, and the benefits of integrated business solutions. It also offers examples and benchmarks of selected PSO operations where improved control has translated into meaningful gains in profitability.

At the conclusion of this paper, we will recommend the three action items readers should take in order to evaluate the effectiveness of their own PMS performance.

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What Are the Key Levers of PSO Profitability?

In order to drive growth and deliver on target margins, the PSO leadership utilizes four operational levers to manage its business:

1. Fees – The monetary rate charged to the client for staff or professional time.

2. Compensation – The amount the PSO pays its client-serving staff.

3. Leverage – The firm's structure in terms of the leadership-to-staff ratio.

4. Utilization – The percentage of staff time that is billed to clients.

There are substantial differences among PSO industries in terms of the relative importance of these levers. Fees offer a good example of this variation or diversity. For example, in the legal field, fees for similar types of professional staff at like-sized law firms are fairly consistent within certain regions. On the other hand, within the highly competitive IT consulting industry, fees for the same services can vary widely due to offshoring capabilities, and are further adjusted based on specific competitive factors (e.g. providing discounted consulting services within an outsourcing engagement).

Utilization and leverage are equally varied among providers. For example, a mid-sized law firm might have a 2:1 leverage ratio that skews more towards senior-level professionals and minimal numbers of junior-level lawyers. At an IT consulting firm, on the other hand, the leverage ratio might be 100:1, given that engagement partners might be managing several offshore teams.

While variability between professional disciplines can yield markedly different benchmark values for the levers, the reality is that the fundamental operational mechanics remain the same. And, as PSOs scale their businesses, minor adjustments in any of the levers – adjusting fees, increasing utilization, boosting leverage and changing compensation plans – will have a profound effect on growth and profitability.

The Unintended Consequences of Adjusting Operational Levers

PSO leadership will often make adjustments in reactive fashion, whether in response to market situations or client demands. Unfortunately, adjusting one operational lever with limited visibility into the financial and operational consequences among the other levers creates unintended long-term consequences. A PSO may lower fees in a competitive bidding situation, but then find itself buttonholed to the same rate structure for future engagements with that client. Or, early into an engagement, a firm may decide to augment its service team with senior staff to address perceived client concerns. In turn, the profitability of that engagement suffers, and client expectations become anchored around a high level of attention.

Relying on the natural predisposition for PSOs' fortunes to surge or recede based on general economic conditions is less than optimal. Figure 1 shows actual utilization rates within consulting organizations from 2009 and projected through 2011. While rates have been rising due to a better business climate, well-managed consultancies can't dependably solve their profitability problems by linking their business performance to what may be their clients' discretionary buying habits.

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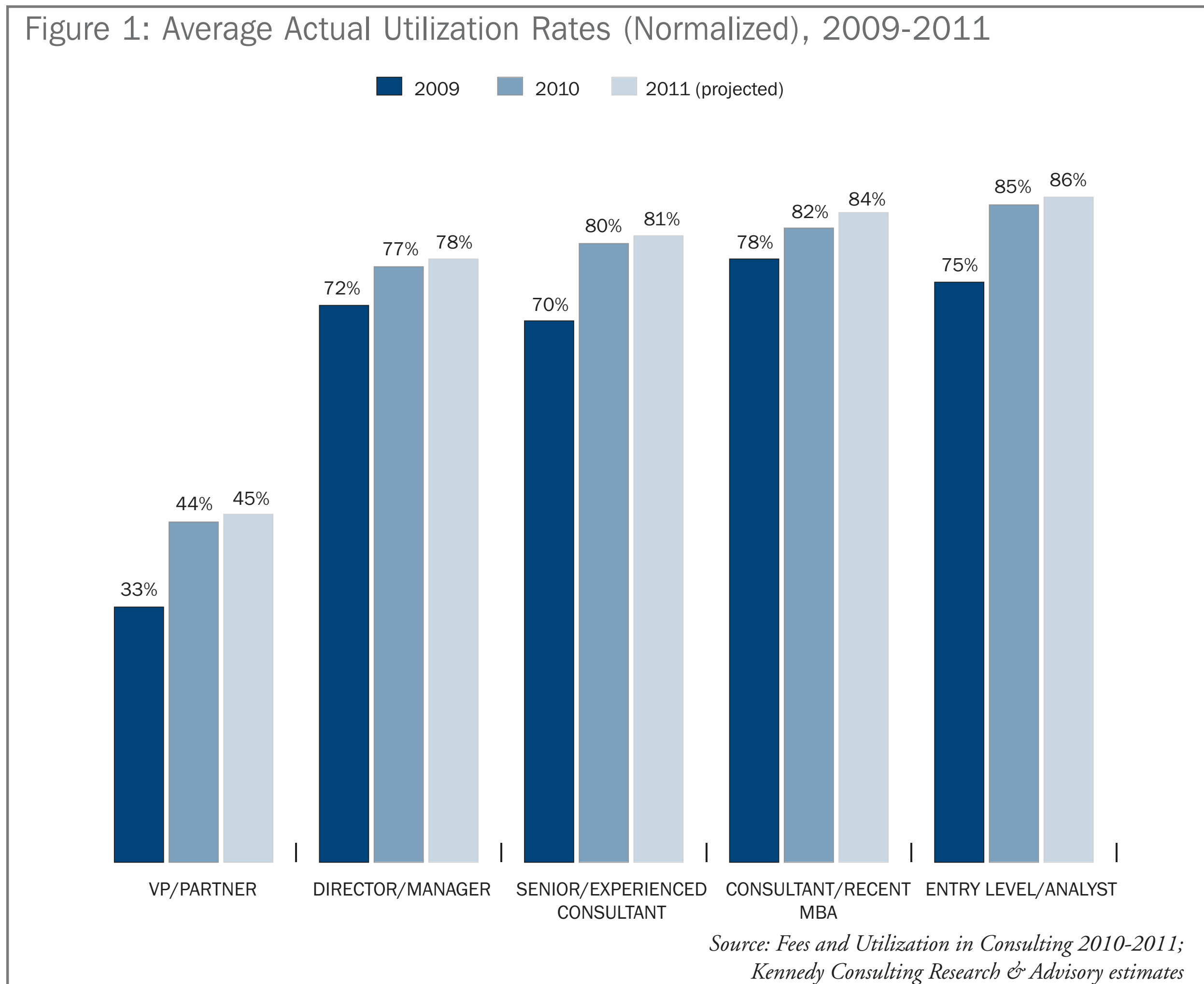

Figure 1: Average Actual Utilization Rates (Normalized), 2009-2011

Source: Fees and Utilization in Consulting 2010-2011; Kennedy Consulting Research & Advisory estimates

More precise management of individual staffing assignments could allow leadership to balance fees and compensation costs more effectively. Boosting utilization within specific engagements by another percentage point beyond marketplace levels could add revenue and increase overall profitability. As well, granular-level control over engagement utilization would afford leadership the ability to manage staffing efforts in a manner that minimizes burnout. But successful execution of any of these actions requires deep visibility into operations, a precise grasp of interdependencies, and nuanced control of levers of the business.

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Mind-Shifting from Operational Levers to Process Controls

In order to manage margins, PSOs typically maintain standards at the top-most level over the four operational levers, based on a combination of market conditions (leverage, utilization) and the competitive environment (fees, compensation). The operational levers are straightforward enough: fees are set; compensation is paid, leverage is exerted; and utilization is realized. But in reality, the levers are embedded within myriad, interconnected PSO business processes; clients are identified and nurtured; proposals are developed and delivered; new services are devised and refined; invoices are generated and payments are tracked.

Rather than managing against the four levers, PSO leadership (C-level executives and all practice heads) recognizes the complexity of the organization and its processes, and focus instead on three key processes:

1. Client acquisition and relationship/retention management
2. Talent Acquisition and Project-Based Deployment
3. Engagement Reporting and Financial Controls

Client Acquisition and Relationship/Retention Management

The management consulting industry provides a good example of how increased visibility into operations delivers greater opportunity, particularly in leveraging client relationships and engagements for maximum value.

According to Kennedy Consulting Research & Advisory (KCRA), the average gross margins at the consultant level decreased to just below 10% in 2010. In order to understand why margins are sinking, management requires engagement-level control over such contributing factors as the conflicting nature of rising compensation and discounted rates. By effectively managing margin expectations engagement by engagement, firms can address the three foremost drags on profitability, namely:

- Failure to maintain client-quality in terms of profitability and retention.
- Failure to align the correct resources with the project at the proposal stage, which leads to increased costs further into the engagements.
- Failure to identify and then manage hidden costs in the client engagements.

The vast majority of PSOs strongly prefer cross-selling new services to existing clients. The cost-of-sale is lower and client expectations are better managed. At the same time, a firm's natural business turnover and long-term growth demand that it continue gaining new clients. Maintaining control, therefore, begins with client selection. According to benchmarking research from KCRA, the typical mid-sized management consultancy generates a little more than 12% of revenue from "new" clients (vs. new services). For broader and larger practices, the average percentage of revenue generated by new clients was almost double, at 23.7%. The problem is that many PSOs take on engagements (and clients) that appear attractive, only to find the clients prove problematic over time. So it's important for PSOs to probe client churn and measure their most successful engagements to gain insights on attractive profiles.

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Once clients are retained, cost control is vitally important, particularly given the increased client-side involvement of procurement professionals in acquisition of services across all PSO industries. Indeed, procurement has made clients more discerning in purchasing services. In 2009, according to research from KCRA, procurement departments at client companies managed more than $60 billion in spending for consulting services, more than double the spend managed in 2005. So firms can no longer pass along major (and minor) costs to clients. As a result, firms must manage the expense side of the business engagement by engagement.

The point is that the central operational process of managing client relationships cannot be accomplished with a stand-alone system. Client service professionals and account managers need relationship management systems that tie into engagement management tools to scope and resource work with experienced professionals who know the client's business – and they need for those same systems to tie into accounting processes to monitor work-in-process and burn-rates across client engagements and keep a finger on the pulse of the client profile.

While many PSOs can (and do) manage their operations with disparate systems for engagement and client management, an integrated PMS ties together the players with the activities. The result is a holistic view of the clients and the work being conducted – past and present. In turn, this allows PSO leadership to chart future engagements for current and prospective clients with an extremely high degree of confidence.

Talent Acquisition and Project-Based Deployment

As noted in the preceding paragraph, resourcing or staffing alignment is another issue. Over the last decade, PSO staffing models have evolved from pyramid-style organizations of fulltime professionals to flatter or diamond-shaped organizations where commodity-level services, such as analyst research and data compilation, are contracted or outsourced to lower-cost resources. As a result, virtual engagement teams have become more prevalent, and resulted in a significant change in service provision. The engagement team still has an engagement manager who leads a project onsite. But it's common for the bulk of the engagement team to work from offshore or near-shore locations, and to be comprised of a blend of direct employees and sub-contracted resources.

As shown in Figure 2, based on a KCRA research, for each partner/VP in a typical management consulting firm in 2001, there were an additional five to six full-time equivalents (FTE) reporting up from other positions. This included other professional positions, leveraged at 1.25 to 1.75, and a support staff position.

Figure 2: Comparison of Average MC Staffing Responsibilities, 2001 and 2009

2001	2009
Partner/VP	Partner/VP
• 1.25 Project Managers	• 3.5 Project Managers
• 1.75 Consultants	• 5.0 Consultants
• 1.5 Associates	• 4.0 Associates
• 1.0 Support Staff	• 0.5 Support Staff
	Source: Kennedy Consulting Research & Advisory estimates

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By 2009, the leverage had more than doubled, with partners/VPs assuming more management oversight on multiple engagements. This practice has been adopted by many mid-market firms, which are also adding the same lower-cost capabilities as larger providers. Based on KCRA research, in 2001 the average partner-to-consultant leverage ratio was 4:1 for management consultancies, where revenues-per-professional ranged from $200K-$350K (rev-per levels that are representative of mid-market firms). In 2009, that same ratio for that group jumped to 8:1.

As mentioned, the greater leverage is primarily the result of the increased use of virtual engagement teams, which can be cost effective by allowing professionals to work remotely. The offshoring of basic research and analytical capabilities is a well-documented trend among PSOs. But the wholesale move to deconstruct on-site engagement teams has abated over the last three years as PSOs reinforce the importance of a physical presence between advisor and client. As a result, the delivery of services continues to be a complex blend of onsite engagement teams augmented with offsite/offshore resources. This requires a PSO's management and control systems to cross multiple time zones, language barriers, and cultures.

The challenge of managing across distance is further exacerbated when matching skilled professionals and the services they provide to clients. Aligning the best-equipped team for engagements is a long-standing issue for PSOs. Traditionally, assigning people to projects has been the task of an administrator, or a process imposed by a legacy system. However, both alternatives often lack the detailed insights and data necessary to engage teams that satisfy both the client's business problem and the PSO's own profit expectations. Simply put, such legacy systems are often extremely inefficient when it comes to matching the skill sets of the people within the organization, and forecasting the potential profitability of those individuals for the engagement.

As with client relationship management, talent management and allocation to client projects cannot be accomplished consistently and profitably with stand-alone systems. Practice and operations leaders need to collaborate real-time with staffing coordinators across geographies and be able to identify best-fit resources, budget for costs, forecast revenue, settle intercompany transactions for bought and sold time, and manage profitability over the lifecycle of projects that frequently change in scope.

A primary concern for any PSO is retaining its best professional staff. Retention starts with resource allocations that balance the needs of the firm (client satisfaction and engagement profitability) with the requirements of the individual (satisfying and rewarding work). The benefit of an integrated PMS in relation to resource deployment is that an effective solution allows leaders to efficiently balance both objectives and achieve the firm's ongoing goal of profitable growth.

Engagement Reporting and Cost Management

In the past 10 years, PSOs have witnessed a tremendous change in the way engagements are performed. As noted, engagements have fewer team members onsite. Furthermore, projects have more built-in milestones and more complex fixed-fee, contingent and other contractual structures. PSO clients have also become more sophisticated about how they purchase professional services, in part because talent often moves on to work for industries they once serviced, bringing with them firsthand inside knowledge of how to interact with a PSO.

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Collectively, these changes are forcing PSOs to focus on:

- Managing costs
- Increasing the use of virtual engagement teams
- Employing contractors
- Aligning the services provided by skilled professionals with client engagements

The flood of new local and offshore firms has put pressure on the pricing models of more established firms. As an example, 2010 hourly realized fee rates for analysts (0-2 yrs. experience) at U.S.-based management consulting firms were $120, compared with $50/hr for offshore competitors. While elite consultancies can resist discounting, the tradeoff is reduced utilization. Average utilization for analysts at the aforementioned U.S. firms was 75%, a full 10 percentage points lower than that of offshore competitors.

To compete against the challenges presented by lower-cost competitors and still maintain margins, established firms must be far more diligent about how they manage their own internal expenses. Managing client quality and engagement costs are the most controllable elements for PSO leadership.

Management consulting (MC), like all PSOs, reflects the enormous allocation cost in human capital (Figure 3). In 2009, compensation, benefits, and development costs constituted nearly two-thirds of total revenue.

Figure 3: Human Capital Cost Breakdown for Management Consulting as % of Total Revenue, 2009

	Average
Base Salaries	52.5%
Bonuses	6.4%
Healthcare Benefits	2.0%
Retirement Benefits	4.5%
Training & Development	1.5%
Total Human Capital	**66.9%**

Source: Benchmarks in Consulting 2009; Kennedy Consulting Research & Advisory estimates

Further, an additional 15.2% of costs were consumed by sales, governance, and administrative (SG&A) expenses (Figure 4).

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Figure 4: SG&A Cost Breakdown for Management Consulting as % of Total Revenue, 2009

	Average
Sales	2.8%
Marketing	2.4%
Information Technology	2.4%
Occupancy	4.2%
Intellectual Capital Development	1.3%
Other	2.1%
Total SG&A	**15.2%**

Source: Benchmarks in Consulting 2009; Kennedy Consulting Research & Advisory estimates

Maintaining intense focus and absolute control over these expenses is an important condition for effective management. But the day-to-day reality is that PSOs are complex organizations involved in multiple engagements where client-facing professionals must work seamlessly with support staff.

Breaking Down the Process Silos

Disparate, unconnected process applications do allow firms to track operational metrics and they can even permit firm leaders and engagement managers to access this information in real time. But truly integrated PMS solutions deployed across functional silos go well beyond streamlined metric-reporting to afford PSO leadership the ability to smoothly manage enterprise-wide operations.

Many PSOs start with off-the-shelf applications for separate functions (e.g., customer relationship management [CRM], accounting/invoicing, engagement tracking) that operate in relative silos and are managed by individual teams. As the business grows, such systems rapidly reach their limitations in terms of connectivity and functionality. Inefficient practices, such as poor prioritization of resources to satisfy problematic clients, or overstaffing/understaffing projects, can waste time and effort. Likewise, inaccurate budgeting and billing, and other imprecise controls over the financial aspects of the business create friction and drag that limit the organization's ultimate potential.

Cobbling together multiple applications into a cohesive and comprehensive PMS is a challenging prospect at best. Even if a modicum of cross-platform efficiency is achieved, the complexity and cost of maintaining this forced-fit solution undermines any potential gains. Further, the very foundation of an integrated practice management system – clarity across the entire PSO – is compromised by the weakest application. And absence of clarity affects decision-making, which has a negative effect on the overall business.

For example, consider client recruiting and engagement-management activities. PSOs traditionally employ multiple tools and processes that track prospecting activities from acquisition through engagement. These include everything from list and collateral creation to conversion and ongoing relationship marketing. Such efforts may be the responsibility of specific practices (e.g., geographies, industries, services) or supported by enterprise-wide staff – or some combination thereof.

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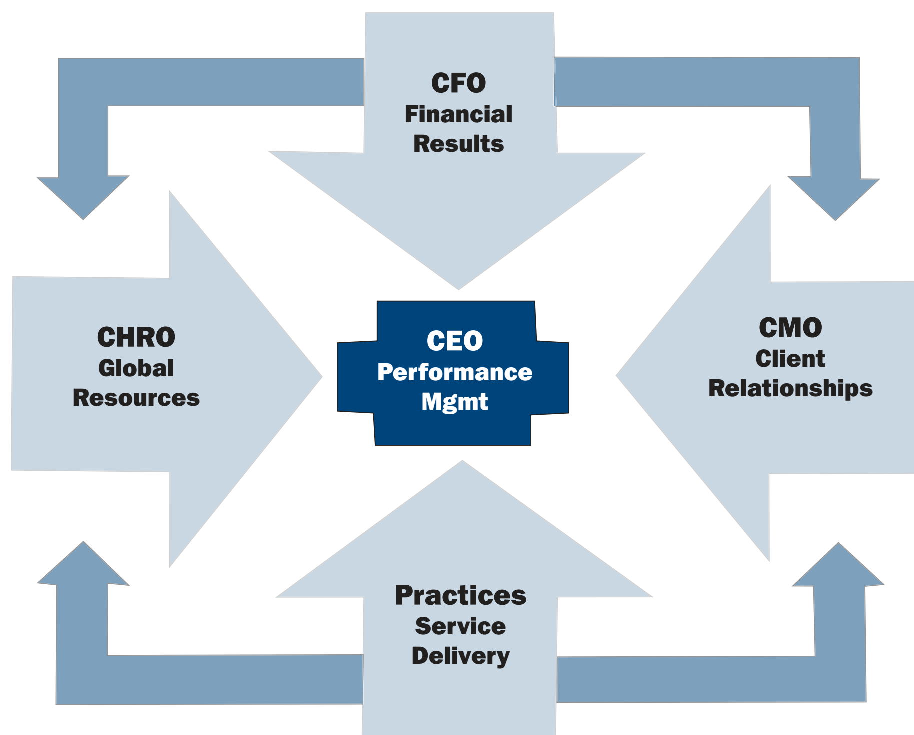
Figure 5: Input Responsibilities for PSO Leadership



Source: Kennedy Consulting Research & Advisory

CRM systems provide robust reporting capabilities from both a prospecting and retention-relationship standpoint. Furthermore, CRM systems are designed to build the trusted relationship between advisor and client through complete management of client communications and deliverables. These activities greatly assist PSOs in securing future business.

Breakdowns occur, however, when CRM systems fail to connect relationship-management tasks with other financial and project-management systems. For example, separate invoicing systems might trigger automatic payment notices to clients without alerting the client-relations team. Similarly, pro bono work conducted for a key client to strengthen an existing relationship may exceed thresholds set to minimize the effect of such work on firm-wide margins.

The trend towards accelerated situational awareness and responsiveness to business conditions demands a real-time, holistic view of PSO operations, and firms must re-think their portfolio of business applications. The individual business solutions that leadership implemented to manage client-relationships, resource engagement, and financial management in its early stages, might be scalable within separate functional silos (i.e. CRM). But these solutions cannot effectively bridge the gaps between processes as PSOs grow. So continuing to employ these same tools and processes will ultimately have a negative effect on growth and profitability for the enterprise. To achieve a sustainably high level of profitability, PSOs must possess integrated internal operational systems that provide real-time visibility and control across all processes central to the business.

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The Benefits of a Truly Integrated Performance Management System

Just as transparent communication is fundamental to successful relationships between PSOs and their clients, so too is seamless integration of PMS a prerequisite of all the processes associated with client-relationship, resource engagement, and financial management.

Recognizing the CEO/Managing Partner of a PSO bears ultimate responsibility for the firm's performance, other key PSO leadership positions must work in concert with integrated business applications to provide complete and crystal-clear visibility and control across the enterprise (see Figure 5). Only then does PSO leadership possess the detailed operational insights that allow the type of informed decision-making that drives consistent and profitable growth.

A key benefit of a successful PMS is that it provides a 360-degree view into a firm's project accounting, allowing the engagement manager and the CFO to control costs, monitor variations in estimates, speed billing cycles, and reduce risk. In addition to project and cost controls, a PMS offers precise management of expenses, such as occupancy and training; savings in these areas affords a PSO the opportunity to invest more in sales and staff or simply allow professionals to focus on true value-add work.

As a practical matter, PSOs face an ever-increasing need to generate more information through portals or by customized management reports in real time. PSOs require key performance indicators that measure performance and alert management to deteriorating results before they become critical.

This is especially important when dealing with the increasingly complex reports required for demanding clients. These clients want additional project milestones, as well as detailed financial analysis of the ongoing project, embedded within these reports. At the same time, stringent country-specific governmental regulations force greater reporting detail.

In this fast-paced global economy, PSOs need more ad hoc reports that can be generated with up-to-the-minute information to help leadership analyze actual costs and gain new intelligence about internal operations. Decision makers can then scrutinize projects in greater depth to identify profitability and cost by client, project type, and project teams. One of the dangers firms face is that of forecasting project costs incorrectly. This can be highly detrimental to any PSO, particularly when bidding on a large, long-term project. PSOs also need to access data immediately to show return on investment (ROI) on their proposals.

Beyond their visibility and control over internal cost controls, firms must devote resources to comply with increasing and ever-changing corporate regulations for the regions in which they do business. For many mid-sized and smaller PSOs, this will lead to a further decrease in billable time for senior consultants, who are often tasked with that compliance.

Already, most senior client-facing consultants at mid-sized firms spend too much of their time running the business and not enough time with their clients. Total hours worked for this group has remained consistent over the last decade (Figure 6). And while billable hours have increased, the fact remains that fully one workday per week is consumed by nonbillable functions.

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Figure 6: Comparison of Management Consulting Billable and Nonbillable Hours Worked, 2001 vs. 2009

	2001	2009
Total Hours Worked	**50.9**	**50.0**
Billable Hours	37.7	41.2
Nonbillable Hours	13.2	8.8

Source: Kennedy Consulting Research & Advisory

Seamlessly integrated business management applications cut nonbillable time by allowing firms to better manage budgets, create and consolidate reports, and look for trends and relationships in all parts of the business. Firms also gain more visibility into financial and project accounting, and this allows them to maintain tighter control over costs, shorten billing cycles, and monitor variations in estimates.

Effective PMS solutions provide PSOs with real-time financial intelligence about their business operations, which helps streamline operations and increase efficiency. In turn, these efficiencies allow more time for senior managers and partners to focus on clients and provide billable services. Converting even a small percentage of non-billable time into revenue generates enormous returns when applied across the enterprise.

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Conclusions

The historical measure to running a successful PSO was maximizing the staff's billable time. To achieve those results, PSOs often implemented – in silo fashion – very effective solutions for individual operational processes.

Individual PSO leaders take ownership of these processes – and the legacy systems – with the best of intentions for driving growth and profit. Unfortunately, the client-prospecting and tracking application championed by the CMO to measure campaign effectiveness fails to connect with the CHRO's resource engagement tools. The result: prospecting calls are made on behalf of one PSO practice into the client of another practice from the same firm. Or the CFO's engagement invoicing system is not transparent to engagement-relationship partners. Subsequently, automatically generated late-payment notices blindside onsite engagement teams.

According to research from KCRA, more than 50% of small and mid-sized consulting firms ($5 million-$200 million annual revenues) maintain multiple legacy systems for client-relationship, resource, and financial reporting. Even today, many boutique consultancies (<$5 million annual revenues) manage their businesses with a series of spreadsheets.

In early stage growth, PSOs overcome the inefficiencies of these systems through "hands-on" management … literally. Leaders for each of the process-silos share information via weekly reports or operations meetings, and staff steps in when necessary to manually compile or reconcile conflicting data. PSOs will rationalize such ad hoc efforts against the perceived costs associated with, and disruptions created by, enterprise-wide PMS solutions.

The decision-point for PSOs to implement an integrated PMS is never definite. PSOs regularly advise their clients very effectively about how to improve their businesses, but often ignore or simply forget to optimize their own business management processes. But as the speed of business increases and PSOs reach scale, their legacy systems can crumble to the point of relative ineffectiveness.

When the economy is up, many PSOs do so well that they are too busy to implement solutions for their own business. And when the business slows, budget constraints usually forestall upgrading or implementing the needed solution. In order to create sustainable and strong businesses that optimize profit independent of economic conditions, PSOs must implement complete PMS solutions that seamlessly integrate the tools and processes for client-relationship, resource engagement, and financial management.

Recommended Next Steps:

1. Evaluate interconnectivity and real-time visibility provided by current Practice Management Systems. Are you reliant on individual applications or integrated solutions? Are performance metrics available via dashboards in real time, or lagging through report-based outputs?

2. Analyze senior roles and responsibilities assigned for client-relationship, resource management, and financial management. Are achieved performance metrics for each functional role available and visible to peers? Are systems optimized so that firm-level performance metrics can be instantly shared by senior leadership?

3. Measure the stated profitability goals of the organization against the firm's forecasting ability. Can you confidently predict (and consistently achieve) those goals at future engagement levels? Do the past results of specific engagements offer an accurate picture of future potential?

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About Microsoft Dynamics

Microsoft Dynamics is a line of integrated, adaptable business management solutions that enables you and your people to make business decisions with greater confidence. Microsoft Dynamics works like familiar Microsoft software, such as Microsoft Office, which means less of a learning curve for your people, so they can get up and running quickly and focus on what's most important. Built to work with Microsoft technologies, it works easily with the systems your company already has implemented. By automating and streamlining financial, client relationship, and project lifecycle management, Microsoft Dynamics brings together people, processes, and technologies, helping increase the productivity and effectiveness of your business and helping you drive business success.

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