Beyond Utilization: Why Profitability Matters
Over-Reliance by PS Execs on Utilization Metrics May Mask Critical Business Problems

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A Joint White Paper from NetSuite OpenAir and TSIA
Beyond Utilization: Why Profitability Matters

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EXECUTIVE SUMMARY

Among the many metrics a technology professional services (PS) business must monitor and track, billable utilization is one of the most popular, with TSIA corporate members submitting frequent inquiries on the topic and rapidly consuming research related to utilization as soon as it is published. Clearly, to successfully run a PS business, managers must understand how productive their consulting staff is, and billable utilization is the primary indicator of that productivity. However, precisely defining the right utilization metric is difficult, especially as utilization metrics differ greatly by the company’s service strategy profile, and by the type of products being implemented. Furthermore, in some environments new sourcing strategies make utilization tracking less useful—if not obsolete.

In this report, TSIA and NetSuite OpenAir will explain why tracking resource utilization alone can be misleading, and explore additional metrics, such as profitability, that help provide a better end-to-end view of the success of PS. Additionally, how technology is enabling more accurate and granular financial tracking will be discussed, with suggestions for creating a services resource planning (SRP) strategy, complete with project and departmental profitability tracking. Service management should learn to look beyond individual metrics to see the “big picture” of departmental operations and leverage innovative technology to provide more sophisticated reporting, including profitability dashboards.

RESOURCE UTILIZATION TOP OF MIND FOR PS EXECS

Billable resource utilization is easily the most frequently requested topic in the TSIA member inquiry process: it is the metric that tells PS managers how productive their delivery staff is, and it is one of the few metrics that virtually every PS organization tracks and cares about. In fact, of the top ten search terms used to access TSIA content, three relate to utilization: billable utilization, utilization calculation, and calculating utilization. When asked how to boost services revenue or improve profitability, improving utilization is always the top member response.

According to the TSIA PS Benchmark, the average target utilization across all members is 66.3%, with companies setting targets at or below 50% and as high as 75% or greater. The distribution of target utilization for all TSIA members can be seen in Figure 1.
Figure 1: Target Utilization for TSIA Members

Companies should be warned, however, that over-reliance on utilization as a leading indicator of the health of the PS organization can lead to overlooking critical operational problems. Isolated resource-utilization tracking is problematic for multiple reasons, including:

- **Utilization is radically different by type of PS organization.** Hardware manufacturers, software vendors, and pure services firms have very different utilization averages, and TSIA research also shows utilization rates differ by the company’s service strategy profile (solution providers, product providers, product extenders, systems providers).

- **Utilization is changing as the sourcing world evolves.** The labor pool for the technology industry has globalized, and PS organizations have multiple types of resource pools they can leverage to actually deliver a services offering. Additionally, today’s PS firms are using subcontractors and cost-effective offshore resources to assist in the delivery of engagements, often removing utilization from the equation.

- **Utilization metrics are only one piece of the puzzle.** So many factors and additional metrics influence utilization that it is critical to also view related metrics, such as billable rates and rate realization, to better understand and interpret your current utilization landscape.
This report will analyze each of these issues, and make recommendations on moving toward a more holistic reporting approach that provides a more strategic view of end-to-end operations, shifting from focusing solely on professional services automation (PSA), to the more encompassing SRP—services resource planning.

Utilization Varies by Company Type, Purpose of PS

When analyzing the TSIA benchmark data, it is clear that utilization targets and actual performance differ greatly by type of organization, creating a great deal of confusion for companies who want to achieve levels bragged about by some organizations, only to find their own cost models seem to prevent those results. An easy way to show how utilization differs is to compare target utilization for hardware manufacturers, software vendors, and pure services firms, as seen in Figure 2.

Figure 2: Utilization Differs by Product Type

- **Hardware manufacturers.** Half of hardware firms report average utilization for PS resources, with only 14% reporting high utilization. More than a third of hardware firms, 36%, typically see low utilization rates.

- **Software vendors.** Software firms have an even greater percentage in the average range, 68%, with an equal distribution of high and low utilization (16%).
• **Services firms.** Pure services firms have the highest utilization, with half of services firm members falling in the high utilization category, and only 13% consistently seeing low utilization.

**PS Sourcing Strategies Change Meaning of Utilization**

Professional services organizations deliver project-based services using expert consultants. Delivery resources are traditionally deployed on site to work directly with the customer to craft a custom solution. For this model to be profitable, the customer must be willing to pay a premium price for a high-touch experience. In other words, the billable rate for consultants must be higher than the cost of that consultant. This labor margin must be large enough to cover all of the expenses associated with developing and deploying this delivery resource. Historically, professional services organizations have built their sourcing models around the classic “consulting pyramid.” In this model, all the energy is focused on getting the right ratio between senior and junior resources and keeping billable utilization rates at target levels. But the game has become much more complex. The labor pool for the technology industry has globalized.

Professional services organizations have five types of resource pools they can leverage to actually deliver a services offering:

- **Direct local resources.** These are PS consultants employed directly by the product company and residing locally, close to customer engagement sites.

- **Corporate practice resources.** These are PS consultants who have hard-to-find, specialized skills. They are leveraged across multiple geographies.

- **Centralized solution center resources.** These are delivery resources that can be leveraged to deliver portions of a PS engagement without being on the customer site. These resources are typically clustered where labor costs are lower.

- **Local delivery partners.** These are services delivery partners that are identified and engaged by an individual country or specific region.

- **Global delivery partners.** These are services delivery partners that are identified, selected, and enabled at a global level.

Increasingly, professional services firms are using subcontractors and cost-effective offshore resources to assist in the delivery of engagements. TSIA reports that a majority of IT services companies benchmarked use subcontractors to deliver at least 20% of a services engagement. This
20% of partnered delivery creates both scalability and cost advantage. Managing this lever has become more complicated and critical with the advent of offshore resources.

As the number of resource pools grows, and companies begin to leverage non-traditional sources more, utilization tracking alone does not provide insight into profit margins since each group of resources has different costs and billing practices. PS organizations should consider tracking some of the key metrics associated with optimizing the talent supply chain to form a fuller picture of resource costs and utilization, including:

- Time to identify new delivery consultant candidates.
- Time to make new candidates billable.
- Time to develop new service offerings.
- Time to train delivery staff on new offerings.
- Time to identify and enable service delivery partners.
- Accuracy of the services pipeline.

The more efficient the PS organization is regarding these metrics, the more optimized the overall talent supply chain will be for the organization, and the more likely it will be that the PS organization can deliver the right people at the right time on customer projects, with the maximum profit margins achieved.

**Utilization Only One Piece of the Puzzle**

As we’ve seen, different types of companies and PS organizations can have very different utilization targets and results, making it difficult for companies to perform “apples to apples” comparisons. Another challenge to using utilization as a primary indicator of PS health is that so many factors, and other metrics, influence utilization that it is critical to also view related metrics to better understand and interpret your current utilization landscape.
As seen in Figure 3, averages for billable rates and rate realization differ greatly. To maximize revenue and profit margins, the most expensive consultants should be billed out at their target billable rate as much as possible. When rate realization is low, it means that highly paid consultants are not receiving their maximum rate, so overall project revenues and project margins are lower.

Companies that put too much emphasis on utilization rates are encouraging project managers to prioritize keeping consultants busy over charging maximum rates, which can lead to accepting more low-value projects to inflate utilization, at the expense of revenue and profit. Blindly managing by utilization not only impacts profitability, but frequently assigning specialized resources to non-specialized projects can create consultant burnout and raise employee attrition.

**Focus on Profitability**

As this paper has shown, while utilization rates are a helpful metric to ensure you are leveraging your available staff, utilization rates can be very different from company to company based on a number of factors. Profitability monitoring is the key to make sure whatever operational levers you have to pull—including utilization—ultimately maximize profitability for the company.
For the purpose of analyzing the profitability of companies, TSIA tracks the Service 50, the financial performance of 50 of the largest technology companies in the world. The companies were ranked by net income percentage and assigned a ranking. Based on these rankings, the companies were divided into three net income rating segments: Pacesetters (top 10), Middle of the Pack (next 30), Laggards (bottom 10).

As seen in Figure 4, the profit margins for services at Pacesetter companies dramatically outperform companies in the middle of the pack and also those at the bottom end of the scale. Pacesetters are able to generate very high services margins, typically with very robust reporting that measures how each individual metric, including utilization, impacts profitability.¹

**Figure 4: Services Profit Margins by Net Income Segments**

<table>
<thead>
<tr>
<th>Services Profit Margin</th>
<th>Pacesetter</th>
<th>MOP</th>
<th>Laggard</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>72%</td>
<td>59%</td>
<td>58%</td>
</tr>
</tbody>
</table>

Source: TSIA Services 50
Project Profitability in the Real World

To illustrate the importance that all of the above can have on a professional services organization (PSO), let’s use the example of an embedded services organization within a software company. While most embedded professional services teams are involved in multiple stages of the sales process, they do not generally have control over the pricing and/or discounting of the services being sold. This means that embedded services organizations are typically tasked with an extra challenge—balancing projects that will bolster their department’s bottom line with projects that are good for the long-term product licensing business, but aren’t inherently profitable for the services organization.

If an embedded PSO chooses to only measure and report on resource utilization, this addresses only part of the above challenge. In general, your resources are a fixed cost—but sales discounts on licenses and billable rates have a range, and are never fixed. Even when an embedded services organization is maximizing their utilization rates, their profitability depends on the combination of billable rates and utilization—especially when billable rates are not maximized.

But for an embedded services organization which empowers their PSO’s management with a PSA tool that provides visibility and reporting on overall project profitability, the organization can proactively identify problem projects. PSO management can address the issue before it impacts overall profitability by proposing an adjustment or solution, including requesting a project change order, declining the project, or moving the project in another direction.

Real-time visibility into your PSO can be achieved with a PSA solution that encompasses project management, resource management, and time-and-expense tracking, as well as project accounting. Furthermore, true visibility into the entire bid-to-bill or quote-to-cash cycle can only be achieved with SRP. The director of a PSO can proactively monitor the sales pipeline and better predict resource needs. The CFO can monitor project status to anticipate when and how each client can be billed for work completed. With true integration between systems, manual double entry is eliminated, reducing human error associated with double entry and disparate systems and reducing administrative overhead, contributing even more to the overall health and profitability of a PSO.
NETSUITE OPENAIR AND TSIA RECOMMEND

According to the 2010 TSIA Member Technology Survey, 62% of PS members have a professional services automation (PSA) solution in place, and our data clearly shows that members with PSA have better operational metric results due to the visibility and reporting the application software provides.²

- Gross margin for overall PS operation: 12% higher for PSA users.
- PS average project gross margin: 12% higher for PSA users.
- PS revenue growth over the last three years: 48% higher for PSA users.
- PS revenue growth over the last 12 months: 11% higher for PSA users.
- Average hourly billable rate: 8% higher for PSA users.
- Average rate realization: 5% higher for PSA users.
- Average annual revenue by consultant: 18% higher for PSA users.

But to accurately create a resource plan, and track end-to-end project profitability, companies need to invest in more than just PSA—they need to integrate PSA to CRM (customer relationship management) to allow reporting and analysis on the demand side, and integrate to ERP (enterprise resource planning) to streamline reporting and provide profitability analysis on the financial side of PS.

This end-to-end solution is known as SRP—services resource planning. With SRP, PS execs have a true understanding of the health of the organization, without over-reliance on individual metrics like utilization that only tell part of the story. Whether you invest in an end-to-end SRP suite, or integrate your PSA solution to your existing CRM and ERP platforms, the SRP approach offers a number of benefits, including:

- **Real-time visibility.** With an end-to-end integrated system, data about customers with booked projects flows dynamically from sales to the services department; data about invoices and expenses resulting from service delivery then flows from services to the finance and sales departments. This gives everyone in the organization the real-time visibility required to deliver the best client management possible.

- **Flexible and tailorable business processes.** Redundant data entry is eliminated with the seamless integration between CRM, PSA, and ERP, saving valuable time and increasing productivity. In addition, business processes are tailored around best practices for end-to-end management of services organizations and can be customized to accommodate specific business rules and workflows.

- **Metrics-driven management.** Services organizations can manage their businesses by key metrics and be empowered to make timely, fact-based course corrections with dashboard
analytics ranging from resource and project management, to key performance indicators (KPIs), graphical report snapshots, trend graphs, and KPI scorecards.

ENDNOTES

1 For more detail on analyzing profitability, see the September 2008, TSIA DataView, “Analyzing the Profitability High Performers.”

2 For more information on how companies leveraging PSA software have improved operational metrics, see the July 2009, Executive Insight, “What Keeps PS Executives Up at Night? The Role of Professional Services Automation in Achieving Business Goals,” co-authored by OpenAir and TSIA.