A Balanced Scorecard for a Professional Services Business

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### About the Author

Steve Anderson is an experienced and successful company director and entrepreneur who worked in start-up, growth and multinational companies in the technology sector. His experience includes starting, growing and exiting IT businesses twice and working in senior roles in US and Japanese multinationals. He now works as a Managing Partner at Capitalise, in a non-executive, advisory capacity for a number of technology businesses, and has a track record of investing in technology start-ups.

Capitalise brings together some of the UK’s most experienced technology founders and VC professionals to provide investment and advisory services to entrepreneurs looking to grow and exit their software or services business. Having realized shareholder value from multiple exits, Capitalise is unique in the composition of its partner team and focus, its combined investment and advisory proposition and its extended industry network.

### About Kimble

Kimble is the most comprehensive Professional Services Automation (PSA) solution on the Force.com platform. Designed by experts specifically to enable the overall management of a services business, Kimble provides a complete integrated end-to-end solution. Kimble integrates the sales, operations and delivery elements into the only ERP solution designed for Professional Services, significantly reducing the bid to bill cycle and improving operational efficiencies.

Opportunity Management, Resourcing, Time and Expense, Delivery management and Billing with KPI reporting give complete and instant visibility into the health of your business. Providing a comprehensive view of current, historic and future performance. Based on social networking principles, Kimble’s uniquely participative PSA environment enables greater knowledge sharing and collaboration across the workforce, resulting in rapid adoption.

Kimble is designed specifically to enable the overall management of an entire business, rather than having just an Operations, Sales or Delivery focus. In a single PSA product it provides functionality traditionally requiring a combination of separate CRM, PSA, Resourcing, Time & Expense and Financial reporting systems. Kimble has been designed by individuals with experience in what is needed to successfully run a professional service firm. Kimble understands the data needed to make informed business decisions, and ensures that operational transactions capture this data in an intuitive and process centric fashion.
Introduction

A professional services business can be a complex beast; it involves managing several groups of people, and people, of course, are often neither rational nor predictable. In any business it is important to manage customers, suppliers and partners successfully. In a professional services business employees are also important. And to complicate matters even more, consultants, contractors and salespeople all have to be managed differently. The key elements to consider alongside people when growing a professional services business are:

- **Strategy**
  - An overall view of what the business wants to achieve and how it plans to achieve it
- **Propositions**
  - The products, services and annuity services that the business delivers
- **Business Development**
  - How the propositions are sold
- **Organization**
  - The structure of the organization, how resources are managed and how the business operates to execute the growth plan
- **Finance and Operations**
  - The Financials that back up the growth plan and the financial and operational processes and controls which are part of delivering it
- **KPIs**
  - How the performance of the business is measured – both in achieving operational targets and strategic goals

This paper concentrates on the last of these – measuring the performance of a professional services business.
**Balanced Scorecard – What and Why?**

It is not uncommon for management reports to consist only of historic financial information and for small businesses this is often enough; the management team understands the business well and the directors can hold a full picture of the business in their heads. As a business grows it gets more complicated: There are more people involved; responsibilities must be delegated or growth is strangled by lack of bandwidth. Common objectives are required that are shared throughout the business, and everyone needs to know how they are contributing to success. Looking at indicators of future performance is as important as analyzing historic numbers and measuring achievement of strategic goals sits alongside operational running of the business.

**So how does a balanced scorecard fit in?**

A balanced scorecard is defined as ‘a strategic planning and management system that is used to align business activities to the vision and strategy of the organization, improve internal and external communications, and monitor organization performance against strategic goals.

Its origins were to ensure a business focused on its strategic goals and not just operational performance. Operational performance, however, is still important. If a business is not performing well operationally it doesn’t matter about the strategic goals because it’s not going to be around to achieve them. It’s important to ensure the business is running successfully as well as heading in the right strategic direction.

The balanced scorecard considered here, therefore, includes both operational and strategic measures for a professional services business. It provides an overview of current business health and strategic direction, and it highlights problems and opportunities earlier to enable pre-emptive action to be taken.

**Information in a balanced scorecard**

A balanced scorecard contains a number of different kinds of information:

- Operational and strategic goals
- Financial and non-financial measures
- Leading and lagging indicators
- Variances and trends
- Analysis

A strategic financial measure might be revenue for a particular service line the business wants to grow; a non-financial operational measure might be utilization. In fact, for a business doing work on a time and materials basis utilization has to be one of the fundamental KPIs.
A lagging indicator might be revenue or profit or utilization for the previous month. A leading indicator might be sales pipeline, or attrition, or, of course forecasts. It is important to look at leading indicators so that action to address any issues can be taken in advance as well as lagging indicators to analyze past performance. If the sales pipeline is weak or a project is varying off plan or even that there are too few staff to deliver the work that has been already sold the appropriate action will result in better business performance.

Trends and variances are important because they look at performance against target or at how performance varies over time. Variances may be against budget or forecast, against last month or last year. Trends are often more important: It may be more important to notice that this month is 10% below last month’s performance and the trend is downwards rather than that it’s still 5% above budget.

Analysis of which parts of the business are performing better and worse highlights where attention is needed. This might be across different business units, service lines, sales channels etc. Although none or only some of this analysis will be part of a balanced scorecard, it is important managers throughout the organization are aware of their own performance and how it compares and contributes to the business as a whole. Business unit and other managers may well have a balanced scorecard of their own area of the business. These reports must be consistent with the high-level view and objectives of the management team. A careful perspective should be taken of any potential problems across the organization. Sometimes more difference can be made by getting better performing areas to perform even better.

A balanced scorecard should be presented on a single screen or sheet of paper. This allows all the information to be scanned at the same time. If it’s on a screen it should also allow a drill down to more detailed analysis because although a balanced scorecard will give an overall picture it is unlikely to provide all of the detail necessary to analyze or diagnose the root cause of any items which need further action. Some of the contents of a balanced scorecard should also be items that are reported on an exception basis. For example, space should not be used up reporting on the progress of every project, but any that are varying from plan should be highlighted if intervention is likely to be required.
A Balanced Scorecard

Balanced Scorecard: February 2013

- **Revenue**
  - This Month: 5,000
  - Year to Date: 5,500

- **Costs**
  - This Month:
    - Sales: 50%
    - Net: 50%
  - Year to Date:
    - Sales: 50%
    - Net: 50%

- **Projects**
  - DAC Ltd: delay in project due to an unforeseen event
  - IC Ltd: software migration is being delayed due to unforeseen issues

- **Managed Services %**

- **Offshore Revenue**

**Service Level Agreements**
- **Actual**
  - Jan: 3
  - Feb: 2
  - Mar: 1

**Target**
- 5

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Categories and Measures

The categories relate to the important areas for a professional services business. The outer four categories may contain strategic measures as well as operational ones but, in addition, it is worthwhile reporting on some strategic measures as a specific category. Success in the implementation of Strategy can be difficult to measure. Sometimes the indicators are not clear. By reporting as a separate category a business must define how it will measure that it is achieving its strategic goals.

Financial

The financial measures are fairly obvious and fundamental numbers from the management accounts:

- Revenue
- Gross Profit
- Gross Margin
- EBITDA
- EBITDA Margin
- Cash
- WIP
- Deferred income
- Debtors
A balanced scorecard is not trying to replace the management accounts. It is collecting together the most important information for a business on a single page to give a balanced overview of performance. Financial performance is one of the key areas and revenue and profit are the two most obvious measures.

The best way to look at revenue is often to look at the trend over the past 3-6 months and the forecast for the next 3 months. This gives a good picture of the direction the business is heading. If performance is being reported on a calendar month basis then different numbers of working days because of different month lengths, bank holidays or vacation profiles need to be taken into account. If budgeting has done this a comparison against budget can allow trends to be seen more easily providing performance is tracking reasonably close to budget. Whether a comparison against last year is useful will depend on the business profile. For fast growing businesses reporting the change from year to year may be of limited value.

Measurement of profit is more complicated than revenue. Whereas most businesses will report revenue in the same way, as the value invoiced to clients (though some will adjust for re-billed expenses or include only net commission or contractor profit), profit can be measured at a gross or net level and each of these might have a different definition for different organizations. Within an organization this does not matter but care is required when benchmarking different companies. It is also important to look at margin (profit as a percentage of revenue) at both a gross and net level. The £ profit may compare well against budget but if this is higher because of increased use of contractors and the % profit is low it may have an impact on cash and require action to increase the working capital available to the business.

Cash is, of course, the single most important resource needed to ensure a business can continue to operate. With customers requiring longer payment terms, suppliers demanding earlier settlement and
Banks reluctant to provide finance it is ever more important to ensure there is enough cash. Unless a business has a large reserve of cash available, an alert if future cashflow falls below a defined threshold is vital.

WIP is important if the billing cycle for projects is long. For example, if the project is only billed at the end or there are fixed price milestones or fees retained until completion. Then it becomes important to monitor how much work has been done but not billed. On the other hand, if projects or services are billed in advance, it is important to know how much work has been paid for but not yet delivered. Both of these items are closely linked to revenue recognition policy that many companies, and even auditors, sometimes struggle with. A robust revenue recognition policy and process is a must to maintain control of a business.

Debtors also need to be watched and, to a lesser extent, creditors. An alert if debtors get too large or too overdue can prompt action to make sure revenues are collected.

**Operational**

For a professional services business, utilization and average rate are the two most important indicators of business performance and project performance is the biggest risk. These are some of the operational measures:

- Utilization
- Average rate
- Revenue per head
- Project status
- Project profitability

There is no common definition of utilization. It is usually expressed as a percentage, but is it a percentage of all days (Monday-Friday), working days (excluding bank holidays), available days (excluding also holiday and sick days)? Are only billable days counted or are planned internal projects also included? What if a consultant works a ten-hour day? A fairly standard definition of billable utilization, the measure of most interest, is:

\[
\text{Billable Hours} \quad \frac{\text{\text{Billable Hours}}}{} \quad 2080
\]

Billable hours are the hours billed to a customer. Careful consideration should be given to working longer days on either time and materials or fixed price projects and to time written off because it can't be billed. If this time is not included in calculations, perhaps because there is no additional cost when consultants work ten-hour days, there may be a false picture of average rate. This could result in a problem situation
not being noticed, or an opportunity for additional billing being missed. 2080 is equivalent to an 8 hour day, 5 days per week for 52 weeks.

Average rate is:

\[
\text{Revenue (excluding re-billed or included expenses)} \div \text{Billable Hours}
\]

Often there is a correlation between average rate and utilization with one going up whilst the other goes down. This is most often due to incorrect revenue recognition resulting in additional unplanned effort being required at the end to complete a fixed price project. It would be better, of course, if it was because unused contingency was released to revenue at the end of a fixed price project completed ahead of time though this seems to happen less frequently. The key to avoid these circumstances is, as above, to ensure the revenue recognition policy and process is sound.

To smooth out the impact of holidays, problem projects and other factors the trend of utilization and average rate should be used – either month by month or year to date or on a rolling 12 month basis.

The biggest single threat to profitability is a project going wrong. The extra effort required to correct issues can quickly wipe out profits so projects must be monitored closely. At a high level the best indicators are missed milestones, unresolved or any ‘red’ project issues, or a sudden increase in total project days. In fact a sudden decrease would also be a cause for concern or, indeed, total days not changing at all for a couple of months. This would indicate that insufficient effort is being put in to check what the real progress has been. For a balanced scorecard an alert for any of these items is useful. This is no substitute, however, for a full project reporting and monitoring process.

Project profitability, although linked to successful delivery, can be used as an indicator of project status and client management as well as sales and delivery team performance. It can have a lot of contributing factors so will rarely feature on a balanced scorecard.

**Customer**

There are a lot of measures that relate to customers in terms of both sales and delivery. The ones used will depend, to an extent, on specific business characteristics and strategy.

- Deals closed (Average, Number)
- Pipeline
- Backlog
- Win/loss ratio
- Win/loss reason
- Number of customers
- Customer satisfaction
• New customers (Number, Revenue)
• Lost customers
• Bids submitted
• Pre-sales days
• Contract size (Average, Number over £x)
• Revenue concentration
• Reference Visits
• Case Studies published

Two good measures are backlog (the value of contracted business not yet delivered) and pipeline (the value of opportunities not yet closed). Pipeline can be considered as total pipeline, possibly split by probability, or overall weighted pipeline. Weighted pipeline should be treated with caution if only a few opportunities make up the total, or if there is a particularly large opportunity that skews the number. It is much more reliable if there are a large number of smaller, similarly sized opportunities. The same issue can occur when the pipeline is divided by probability, but any skewing is easier to see.

Deals closed is also useful, but must be reported on a year to date basis as well as last month because deals closed in a particular month can vary. A forecast is also vital for sales. Any sales targets should reflect the growth ambitions of the business. If the growth target is 20% per annum, this year’s sales target should be 20% higher than the revenue target.
**Employee**

Employee measures include:

- Headcount (billable, non-billable, contractors)
- Recruitment (joiners, open positions, pipeline)
- Attrition
- Annual reviews conducted
- Training days

Headcount drives revenue and costs so headcount, headcount mix and joiners and leavers are key measures. Future headcount, taking known joiners and leavers into account should track in line with revenue forecasts and any variance will indicate whether recruitment or sales should be the top business priority.

One of the common reasons for staff leaving is lack of career progression. This is often more important than salary so monitoring some indicators that staff are being developed and managed such as completion of reviews or training can be useful.

**Strategic**

Strategic measures depend on the business plan and objectives for a specific business. They might include:

- Business mix (e.g. % managed services, % fixed price, offshore vs. onshore)
- New office revenue
- Backlog
- Rolling 12 month margin
- Growth – revenue/day
- IP development
- Average deal size

Is the business strategy to:

- Grow revenue?
- Increase the proportion of business that is managed services?
- Improve EBITDA margin?
- Grow a new office or service line?
- Build a portfolio of intellectual property?
All of these goals could contribute to a business’s ability to sell more services, the predictability of revenue and ultimately the value and attractiveness of the business to potential buyers. To determine whether a strategy is being successfully executed the achievement of the objectives needs to measured and reported. If progress against strategic goals is not measured, focus will only be on operational performance and the business won’t grow as fast or be as successful as it could be.

Summary

A dashboard giving a balanced view across a business can help ensure that operational performance and achievement of strategic goals are being monitored and that indicators of future performance as well as historic actuals are visible.

The key steps to implementing this balanced scorecard are:

- Understand which are the most important indicators of performance for the business – looking backwards and forwards
- Define and communicate the strategy and know how to measure if it’s being achieved
- Produce a balanced scorecard as a dashboard with all essential information on one page
- Report regularly, consistently and on a timely basis, and share performance information throughout the organization
- Ensure everyone knows how their contribution affects overall performance
- Analyze the performance and anticipate the future
A sample balanced scorecard dashboard containing the most important measures might include:

- A line graph of revenue and margin vs. budget covering the past 6 months and future 3 months
- An alert is future cash falls below a threshold
- A table showing revenue, gross margin, GM%, net margin and NM% for this month and YTD with actual, budget, variance
- A bar chart of backlog, pipeline and value of deals closed by month for the last 6 months and future 3 months
- A table showing average Rate and utilization for the last 6 months
- A project status alert if total effort for a project increases by >5% in a month or has not changed for 2 months or any red project issue exists
- A table of joiners and leavers for the past 6 months and future 3 months
- Some strategic measures linked to the business goals