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HAVE YOU CONSIDERED KEY PERFORMANCE INDICATORS FOR A PROFESSIONAL SERVICES FIRM?

BY JOSEPH CAPLAN

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To have a high performing professional services firm, you need more than just talented individuals and A-list clientele. Management must a keep an eye on key performance indicators (KPIs) to help measure the success and health of the organization so that no surprises crop up.

Important KPIs

- Net income per partner/shareholder is computed by dividing net income by the total number of partners. This is similar to an entity's earnings per share and can be used as a baseline when evaluating the actual net income of a partner's or shareholder's book of business.

- Realization is a measure of *efficiency*, indicating how well revenues are billed and collected compared to the time accrued on billable matters. This metric is critical and should be properly managed, since it has a direct effect on income and cash flow.

- As they say, time is money; therefore, it is critical to engage the right clients for your firm. The last thing you want to do is spend time on a matter that yields no benefit and a low realization. The commonly used baseline is a 70% realization. Chances are realization would jeopardize net income if it were to below this. Ways to manage this KPI are to: (1) properly budget engagements, (2) manage client expectations with regards to project delivery dates, fees, and expenses, and (3) constant client communication. A happy client is less likely to question fees.

- Utilization is calculated by dividing total billable hours over the standard available hours. This represents the level of "effort" put forth by chargeable professional resources. A higher utilization percentage can be a "real time" indicator the firm is on track financially. A lower percentage may mean you have excess capacity or too many people for the amount of work available. On the other hand, there may be instances when certain business models require low utilization rates for certain professionals, especially when it surrounds business development. Those who spend most of their time bringing business to the firm are probably most effective doing just that. As a result, their individual utilization percentages would be low.

- Margin is net income divided by net revenue. The biggest expense item for a professional services firm is salaries, which have the most weight on net income. If margin is higher, it likely means that staff is more efficient as a result of effective training and mentoring. As such, it is critical to invest in staff improvement.

- Average Days Outstanding (ADOs) is the average work-in-process and average accounts receivable over total production. This KPI is useful in determining the health of accounts receivable, as it measures the time it takes to collect on accounts from the time they are billed. Cash flow will improve as this ratio decreases. This is especially useful in identifying a client's payment patterns and aids decision making on a firm's billing, time entry, and collection policies.

The metrics above are only a handful that should be used when evaluating a firm's performance. They should not only be measured at a macro level but also at a micro level, by applying them to specific practices or divisions. Reviewing the financial statements just to see if the firm made a profit or incurred a loss doesn't cut it. By applying a few meaningful ratios such as the ones described in this article, management can make educated decisions that will enhance a firm's net income.

Joseph Caplan, CPA, is a Senior Manager in the Mazars USA's Edison, New Jersey office. Joseph has over 14 years of experience providing tax, advisory, and accounting services to closely held businesses in a variety of industries including real estate, manufacturing and distribution, entertainment, medical and dental professionals, and architecture and law firms. He can be reached at 732.475.2115 / Joseph.Caplan@MazarsUSA.com.

FOR MORE INFORMATION CONTACT:

JOSEPH CAPLAN, CPA
SENIOR MANAGER
+1 732.475.2115
joseph.caplan@mazarsusa.com

VISIT US AT www.mazarsusa.com