Breaking the Barrier

Identify, leverage, and profit from the inherent value found in every professional services firm to break the 6% performance barrier.

By Brad Dawson

BUSINESSES ARE incredibly inefficient. Owners and staff work countless hours to squeeze out incremental increases in revenues and corresponding profits. And expensive business development schemes are devised that focus corporate growth on new customer or business acquisitions. But in reality, there is a significant level of untapped revenue and profit potential already inherent in any business. In fact, on average, businesses are only realizing 6% of their revenue potential.

This is a composite case study that identifies specific areas where immediate value can be found in any services business. The examples used to support the assertions are based on actual corporate entities. The results will surprise you; some will irritate you. That's good. Only by seeing the real opportunity in your business will you be able to break the "6% performance barrier."

Opportunity Identification

Optimal revenue potential. How much revenue is already inherent in your business? Optimal revenue potential is the amount of revenue that would be generated if every customer bought every product and service offered by your firm. Multiplying the number of active customers by the revenue realized by the largest customer yields an optimal revenue figure. And, while the largest customer might not be buying all the offerings, this equation provides a glimpse at the quality of your customers and offerings portfolio.

An $8 million architecture and design firm has 207 customers with the largest customer spending more than $900,000 a year. Beyond the issues associated with a single customer comprising such a large percentage of the firm's revenue, the calculation for optimal revenue potential is modified to dilute the impact of the single largest customer. Accordingly, for purposes of the calculation, an average revenue value of the top three customers is used—an amount of $590,000. When the "best" customer value of $590,000 is multiplied by 207 customers, the resultant value is $122 million—the revenue that would have been realized if every customer "acted" like the firm's very best customers.

When this optimal revenue amount is compared with the actual revenue realized for the year ($8 million), it is concluded that this firm is only achieving 6.6% of its potential revenue value. Of greater consequence is the realization that the average revenue per customer amount is only $38,647 (total realized revenue divided by number of customers). In simpler terms, if the firm's largest customers are generating revenues of nearly $600,000 a year, there must be a large contingent of customers that are generating revenues far below $10,000.

Corporate capacity. Most firms already know how to calculate their corporate capacity—the amount of revenue that could be realized if all chargeable employees are working 2,000 hours a year. However, many firms "cheat" their calculations to arrive at higher levels of chargeability. This cheating takes the form of discounting the professional fees of senior level management, excluding large contingents of administrative (non-chargeable) employees from the calculation, and not charging all the time expended by firm owners. In reality, actual corporate chargeability levels fall far below potential capacity.

The same architecture and design firm has 65 employees of which 57 provide chargeable professional services. When the revenue of the 57 chargeable employees is optimized (assuming 2000

hours at the chargeable rate), the potential revenue is $11.2 million—an amount that is $2.2 million more than the actual revenues. From an optimization perspective, this firm is achieving a low but still reasonable rate of 71%. Unfortunately, timesheets indicate that chargeability levels are exceeding 95%—an amount not consistent with the calculated rate. When the administrative employees are introduced to the equation, the corporate chargeability rate drops to 63.7%.

There are two primary issues.

- Actual chargeability (per the timesheets) indicates that far more hours are being accumulated than depicted by the billed revenue. The concern, of course, is that professional fees are being "discounted on the fly"—resulting in a loss of profit and, potentially, only partial recovery of indirect expenses.
- The administrative segment of this firm is too large. The "bloated" administrative arm is further reducing the firm's generation of free cash flow.

The Tools

The Assessment, Implementation, and Maintenance (AIM) model. A large underperforming customer base is the result of one-off selling—only selling a single project solution to every customer. Firms with this problem are often "order takers," only responding to explicit customer needs—a condition also referred to as reactive selling. The bad news is that if the customer never asks for a specific solution, no other revenue is ever generated from this customer. However, on the positive side, reactive selling does generate a wealth of diverse services solutions that can be wrapped together under the guise of AIM.

AIM represents the full cycle of services that can be offered by a professional services firm. Many firms focus on selling and delivering only implementation offerings—as these offerings are the "big ticket" projects that generate the predominant amount of corporate revenue. Unfortunately, unless a firm is in the right place at the right time, the chance of winning these "big ticket" projects is usually based on having the lowest professional fees—a commodity as opposed to value solution.

A mid-sized consulting engineering firm built its business bidding on design and implementation projects—usually as a subcontractor to an architecture firm. When a project was completed, the firm had to wait for the architect to once again contract with it on behalf of another building owner. To add insult to injury, every new project opportunity provided an opening for the architect to beat down the engineer's professional fees—a practice that eroded profitability. The consulting engineering firm was a commodity component of the architect's bid—a victim of working for an end-user's agent.

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Remedying the situation required the consulting engineering firm to change its definition of customer. The building owner, not the architect, was the real customer and the potential target for a more complete suite of products and services. For this firm, the key to success was recognizing that the building systems represented the asset to be leveraged—the focus of all its product and service offerings. Using AIM, the firm expanded its offerings portfolio to include the following:

- Assessment offerings included conducting energy and building system performance audits—specifically addressing ways for the building owner to save operating costs and limit building failure (a significant issue for government-owned buildings).
- Implementation offerings remained the same—traditional building system design and implementation. However, the consulting engineering firm now operates as the prime contractor—often securing the subcontract services of architecture firms.
- Maintenance offerings took the form of periodic building system performance audits, risk assessment studies, and being the "caretaker" of the current building system specifications. As a result, any time a new vendor sought to implement a potential building system solution, the consulting engineering firm was tasked with conducting "what-if" performance analyses and updating the building system documentation—a service that kept it tied to the building owner for the life of the building.

The benefits to the consulting

engineering firm of this approach included the following:

- The customer relationship lifespan increased from approximately 1.5 years (the duration of a large building system design and implementation project) to nearly 15 years (the longevity of the building system solution). This, in turn, reduced the consulting engineering firm's need to be in a constant customer acquisition mode—a large component of its administrative costs.
- Professional rates increased in-line with reasonable profit expectations. Eliminating the architect (and the architect's cut of the engineer's fees) from the contractual relationship allowed the consulting engineering firm to negotiate rates directly with the end customer.
- Win rates on large implementation projects increased from 30% to 78%. Higher win rates reduced the cost of sales adding more to the bottom-line profits.
- The revenue-per-customer metric doubled with the addition of the assessment and maintenance offerings.

The Services, Information, and Product (SIP) model. AIM provides organizations with a series of complementary service offerings that encompass a customer cycle and serve to leverage an identified customer asset. Proactive selling effectively moves a customer down a predetermined and predictable revenue path. An added complexity (and revenue stream) is introduced when product offerings are combined with services. This evolution into an integrated product and services offerings platform is the basis of the SIP Model.

Through the conduct of service-oriented engagements, organizations learn unique information about their customers. This unique information represents an asset to be leveraged for the benefit of the organization. One form of information leverage is the development of tangible products.

The same consulting engineering firm that implemented AIM found a segment of its customer base was not satisfied with traditional off-the-shelf building system components. Custom-built system components were developed, fabricated, and (at the request of the customer), tested to ensure they satisfied this unique customer's unusual requirements. The consulting engineering firm then wondered as to the applicability of the custom-built components in the larger industry markets. In time, after effective market analysis, several of these products were introduced into more mainstream markets.

For the consulting engineering firm, the departure from a pure services environment necessitated several changes in its business makeup. As a first step, office space and equipment had to be acquired to develop a true fabrication and testing environment. In addition, changes in selling philosophies and pricing structures had to be adapted to exploit a product market vs. a services approach. Finally, the consulting engineering firm had to learn to dovetail its services offering cycles into the shorter product lifecycles so, at no single time, were product and service offerings both bottoming out on the shelf-life curve—a situation that would spell disaster for the firm.

Customer Optimization

How much is a customer worth? As we saw with the architecture firm, the revenue-per-customer metric was only $38,647—even though some customers were returning nearly $600,000 a year.

Exhibit 1
Scenario 1

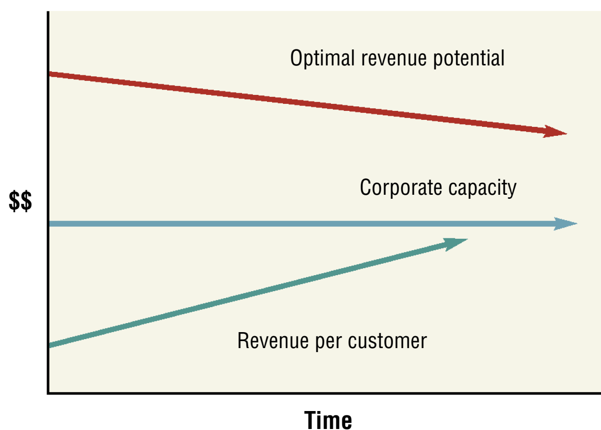
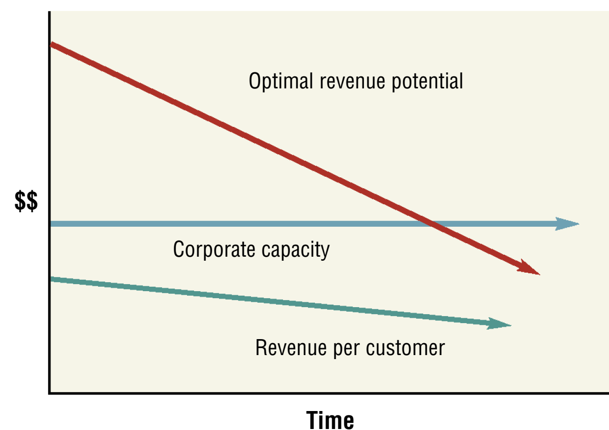


Exhibit 2
Scenario 2



The reality is that nearly 80% of your customers should not be customers—unless they have the capability to purchase a substantial portion of your product and service portfolio.

A $6 million technology products and services firm was diligently increasing its revenues each year. Unfortunately, this growth was as a result of the firm's owner selling any project as a way to "feed the cash-flow monster"—his phrase for ensuring the monthly bills got paid. While the financial statements told one story, reality was telling a far different tale. The delivery resources, constantly being bombarded with new and different requirements daily, were gasping for breath. It was no surprise that most projects were behind schedule and losing money.

In 2004, an analysis of the firm concluded that the annual revenue-per-customer metric was only $52,000—with the largest customer generating $1.3 million. Using the AIM and SIP tools, the firm developed a customer track that incorporated eight different product and services components—with an estimated predictive value of over $3.0 million per customer. Although the owner was reticent, he forced himself to stop selling low-end engagements unless it fit the eight-offering component solution. By the end of 2007, the firm had doubled its revenues to more than $12 million, reduced the size of its active customer base by 63%, and moved its average revenue-per-customer metric to more than $627,000.

In 2008, the focus of this firm now is to expand its target market horizon from the research and development divisions of large-scale aerospace firms into the more mundane production and maintenance environments. The eight-component offering portfolio has morphed into 12 different segments with the lower-end offerings now being accomplished by an acquired firm—the only vendor that was competing with this firm in that offering component space. The expected revenue-per-customer metric has increased to more than $5 million and corporate revenue growth is expected to continue to increase by 30% annually.

Monitoring and Maintenance

Achieving higher levels of revenue potential is an ongoing process. Over time, analyzing the direction and interdependencies of the various metrics tells a story more powerful than traditional financial statements. Simplified, your firm wants to be measuring the changes of its revenue-per-customer metric and percentage of penetration into its optimal revenue potential. Effectively, there are four scenarios that can tell your corporate story:

Remedying the situation required the consulting engineering firm to change its definition of customers.

Scenario 1: The revenue-per-customer metric increases and the percentage of penetration into the organization's optimal revenue potential increases. Under this scenario, the value of the customer relationship has increased, signaling that a higher level of products and services are being sold to each customer. Conversely, the increase in the percentage of penetration may indicate a static or declining revenue potential. (See Exhibit 1.)

- **Positive attributes:** When the revenue-per-customer metric increases, it indicates that higher levels of revenue are being achieved through either increased sales of existing offerings or the introduction of new offerings. The higher score might also indicate that the firm has begun to shed marginal customers—those that were never qualified nor able to purchase a higher percentage of the firm's offerings.
- **Negative consequences:** Higher levels of penetration into the revenue potential indicates that the offerings portfolio might have decreased in value. This occurs when obsolete offerings are eliminated from the portfolio, thereby streamlining the customer's value continuum. Although this exercise is positive as it excludes low-value offerings, it is imperative that the offerings portfolio remains competitive—including offerings that have differentiated lifecycles and timelines.
- **Resolution:** The corporate strategy should be to continue to elevate the revenue-per-customer metric and, at the same time, look to increase the value of the products and services portfolio.

Scenario 2: Revenue-per-customer metric decreases and percentage of penetration into the organization's corporate potential increases. This is the worst combination. The value of the revenue-per-customer metric indicates that the organization is selling fewer products and services to its customers. At the same time, even with decreasing levels of revenues per customer, the organization is achieving higher levels of penetration—indicating that the potential revenue value of the organization is falling at a rapid rate. Companies that exhibit these signs are heading toward disaster. (See Exhibit 2.)

- **Positive attributes:** None.
- **Negative consequences:** These results indicate a "dying" firm as customer revenues are dwindling and the firm has less to sell in market.
- **Resolution:** A significant resurgence would be needed to resurrect this

firm. It is possible through aggressive customer acquisition efforts to begin to increase the absolute size of the customer base. The revenues from these efforts can be used to fund the costs associated with either developing or acquiring new offerings to build out the offerings portfolio. The process would be one of survival.

Scenario 3: Revenue-per-customer metric decreases and percentage of penetration into the organization's corporate potential decreases. This combination indicates an organization with poor selling skills or antiquated products and service solutions. As revenue-per-customer metrics decrease, the first culprit is usually sales: Are sales professionals aggressively seeking to up-sell existing customers? If the answer is yes, the problem often resides with the marketability of the corporation's product and service portfolio. In many cases, the existing portfolio is dated and a full refresh is necessary to ensure continued growth in the market. (See Exhibit 3.)

- **Positive attributes:** The decreased level of penetration into the organization's revenue potential might be attributable to increasing the portfolio offerings. However, with the revenue-per-customer metric also declining, it is assumed that the diversity of the portfolio could be in question—meaning that the firm is maintaining offerings that are not consistent with targeted customer needs. If, in fact, the comparative calculation was done at a time when the new offerings had just been introduced to the portfolio, it might be a timing issue related to the realization of actual sales—not the quality of the actual offerings.
- **Negative consequences:** It is never a good sign when the revenue-per-customer metric decreases. It indicates an ineffective sales culture—a condition that can be blamed on either the quality of the sales professionals or the quality of the offerings for sale.
- **Resolution:** Investigate the qualifications of the sales professionals and the appropriateness of the offerings portfolio. Although not definitive, the issue will probably reside with the quality and approach of the sales professionals.

Scenario 4: Revenue-per-customer metric increases and percentage of penetration into the organization's revenue potential decreases. From a corporate growth perspective, this is the best combination. With increases in revenue-per-customer metrics, the value of customer relationships is increasing and, at the same time, the corporation is investing in its future potential by developing a product and services suite and/or potential customer base with a higher valuation. (See Exhibit 4.)

- **Positive attributes:** This combination of results indicates strong upside performance and future valuation for the firm—an ideal combination should the firm wish to be acquired in the near future. The higher revenue-per-customer metric indicates that the firm has aggressively sought to sell additional offerings to existing customers, as well as perhaps eliminating underperforming customers from the roster. The decrease in penetration into the revenue potential indicates that the continuum for the customer offerings is increasing in value—hopefully consistent with

Exhibit 3

Scenario 3

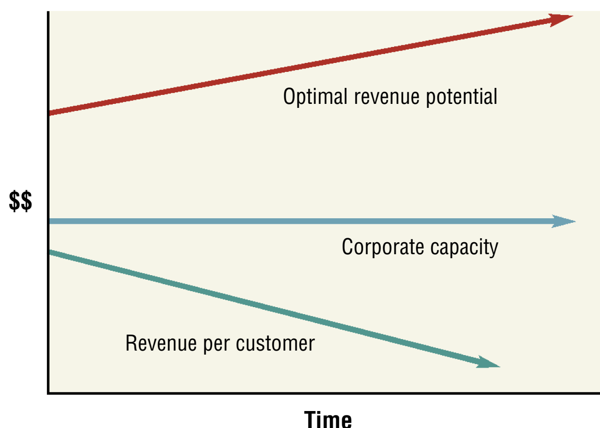
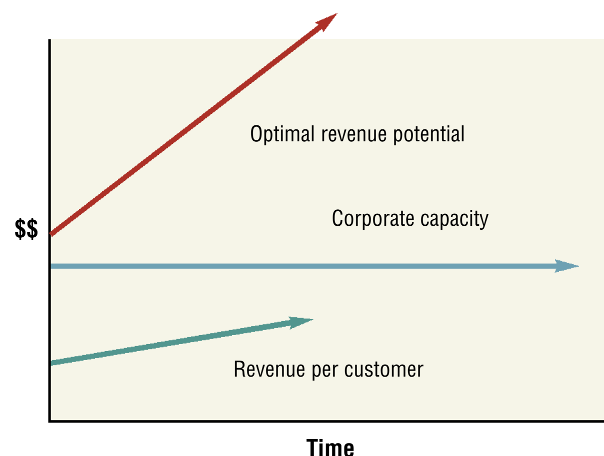


Exhibit 4

Scenario 4



customer needs, as opposed to a diversification for its own sake.

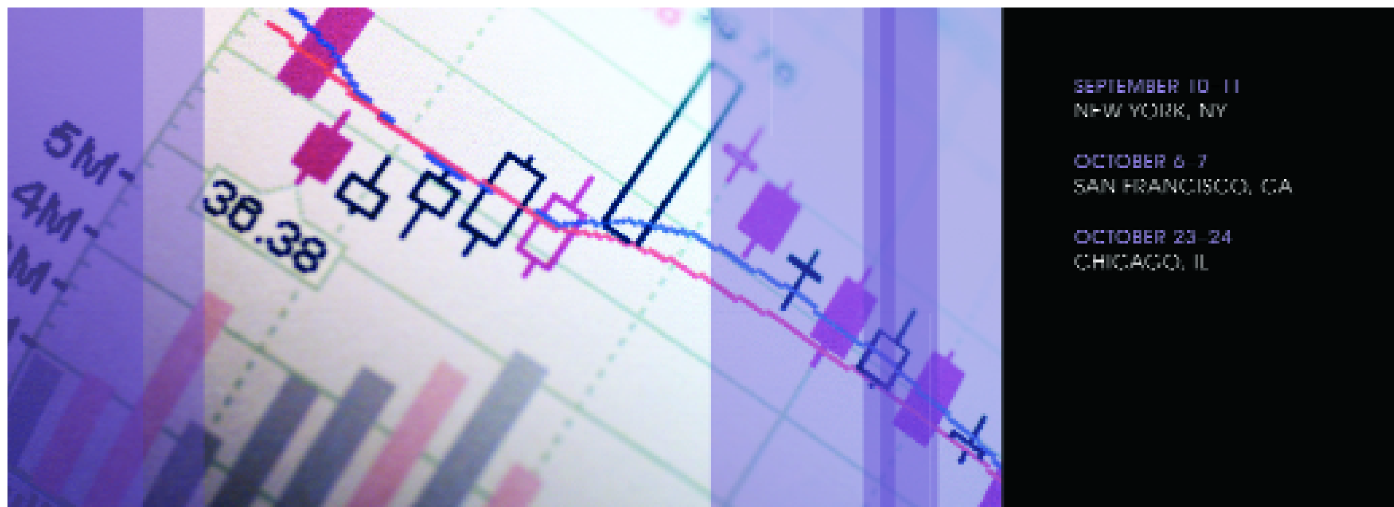
- **Negative consequences:** When penetration into an organization's revenue declines, it is often a reflection of increased diversity in the product and service offerings portfolio. Care must be taken to ensure that inclusions into the offerings portfolio are of value to the end customers and fit into the proactive sales model of the firm.
- **Resolution:** Assuming the offerings portfolio remains competitive and vibrant, this scenario is ideal for increasing long-term corporate value. The resolution would be to continue on this path—certainly if the firm is positioning itself to be acquired. If there were ever a universal primer on how to grow a business, this set of metrics would be the foundation for success.

Work Smarter

Traditional business practices just don't work effectively. They assume growth is predicated on the expensive philosophies of acquiring new customers or businesses. On average, businesses are only achieving 6% of their optimal revenue potential. With the wealth of opportunity already inherent in your businesses, are you ready to break the 6% performance barrier? ■

About the Author

Brad Dawson is the managing director of LTV Dynamics and has more than 25 years of management consulting experience—with an active customer base in the United States, Russia, China, Mongolia, and Latvia. Prior to starting LTV Dynamics in 1997, he was a senior-level sales director and management consultant for Electronic Data Systems, a national practice manager for Coopers & Lybrand's Consulting Practice (now, International Business Machines Corporation), and a senior consultant for KPMG Consulting (now, Bearingpoint, Inc.). He may be reached at bldawson@ltvdynamics.com.



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