



Achieving profit improvement in professional services firms

The opportunity for profit improvement

Professional services organisations have a unique set of economic drivers that influences its profitability. Most of these are known to experienced practice leaders and managers and certain key drivers, such as utilisation rates, are generally monitored and managed. Very few organisations however actively use the economic drivers to explicitly develop strategies that will maximise profitability and the economic output of the people in the organisation.

Maximising and improving gross margin is essential in all businesses. In the current economic environment there are added market pressures on fee rates. Delivering gross margin increases through productivity improvement is therefore even more critical. As you undoubtedly know, a gross margin increase will result in a direct and corresponding bottom-line profit increase.

A focused approach to profitability improvement, starting with a detailed analysis of the profitability across all of the professional services economic drivers and then flowing through to clear strategies and implementation plans, is required in order to identify and achieve the profit improvement potential.

In our experience, virtually all professional services organisations have significant profit improvement potential which goes untapped. Over the span of 20 years in executive management roles in professional services organisations, William Masson (the founding principal of New Light Strategies), has directly and in a hands-on role identified and implemented profit improvement strategies that have delivered significant gross margin and bottom-line profit increases.

The opportunity for profit improvement will exist in your organisation.

Project objectives and deliverables

Objectives

The objective of a profit improvement project such as this is to analyse and identify the areas within the business where profit improvement potential exists and then to develop strategies and implementation plans that ensure that the profit improvement is achieved.

The overall objective is to increase the value of economic output of the people in the organisation, measured as Output per Employee and Profit per Employee, **by doing things better and smarter.**

In order to achieve the overall objective, the professional services economic drivers are analysed and strategies developed and implemented that will maximise the performance of the economic drivers in a mix and quantum appropriate to the organisation's goals and values.

The more detailed objectives and the deliverables of this profit improvement project are as follows:

- Analysis of and commentary on the level of profitability of the business across the key professional services economic drivers, namely productivity (throughput, utilisation and realisation), value (actual or implied charge-out rates achieved), leverage ratios (staffing structure) and overhead expenses as a % of revenue;
- Identification of the business areas where performance improvement is required in order to increase profitability, including commentary on the reasons why these areas should or could be improved;
- Assessment of which profit improvement areas would generate the highest profit increases with an indication of the \$ profit increase you can expect from x % improvement in the economic drivers' key measures. What we mean by this is that we would for instance be able to indicate what the \$ profit improvement would be if utilisation (or productivity) increased from (say) 65% to 70%;
- Assessment of the profit improvements required across each of the professional services economic metrics in order to achieve a gross margin of 66.7% and net profit of 33.3%. These are the traditional professional services profit targets. Whilst these margins are difficult to achieve, and often can't be achieved, they play a key role in challenging one to identify what's required in order to achieve this "third/third/third" profitability performance. Many important insights are gained and lessons are learnt during this assessment;
- Diagnosis of the underlying causes of both strong and weak areas of profitability;
- Identification of strategies required to address the issues and opportunities and maximise gross margin and net profit margin;
- Review of current strategies and initiatives that the organisation has already implemented and that are associated with profit improvement. These will be reviewed and assessed against the findings of the analysis and diagnosis phases of the project in order to assess the effectiveness of these existing strategies and to identify whether these strategies need to be adapted;
- Development of detailed executable action plans to ensure the successful implementation of the identified and agreed strategies; and
- Identification and implementation of the performance metrics required to track progress, monitor the outcomes of the strategies implemented and provide a continuous feedback loop that will facilitate assessment and adaptation of the strategies and implementation plans.

Deliverables

A detailed written report will be prepared at the end of each of the phases of the project.

In addition to the written reports, it is proposed that the findings and proposed actions are presented to the appropriate people within the organisation in order to allow for debate and discussion.

New Light Strategies' approach to working with clients is to be actively engaged in communication throughout the process. We will communicate regularly. Thoughts, insights and preliminary findings will be discussed verbally at regular intervals as we progress through the project. These interactions are considered to be an essential element of ensuring that value is delivered to our clients.

The output delivered as informal communication, the written report and presentation will be pragmatic, detailed and real. The deliverables will be something that you can use and gain value from.

The deliverables and outcomes will be a mix between quick wins delivering immediate profit increases, improvements delivering steady ongoing results and innovation which would take longer, but ultimately deliver the highest returns.

You will see positive returns on this investment.

A structured approach

Overview of New Light Strategies' approach to profit improvement

The approach as set out below, has been developed and refined over many years in executive management roles in a number of professional services organisations. These have included organisations in the legal, accounting, IT professional services, IT services, creative design and consulting services industries.

The approach is based on the following core principles:

- Analyse using professional services economic drivers as the base and then use these metrics to monitor the achievement of the desired target performance;
- De-aggregate the business to an appropriate sub-level;
- Target to achieve the traditional professional services margins of 66.67% gross margin and 33.33% net profit;
- Maintain a client-service focus throughout the diagnostic, strategy identification and implementation phases. Delivering value to your clients must be enhanced and not compromised in any way;
- Involve the people in the organisation to an appropriate and agreed organisation level. This ensures that there is a true sense of involvement, awareness is created and a clear understanding is established of what's required to achieve success and profit growth; and
- The overall objective is to do things better and smarter, driving for a balanced mix of improvement and innovation strategies.

The achievement of increased profitability is an outcome of the process; it's an outcome of doing things better and smarter.

Growing the profit in a professional services business has very little to do with cutting costs (although appropriate cost control is an essential discipline); growing the profit is about achieving better quality revenue. This means that your revenue is more profitable, derived from clients who value the service your organisation provides and delivered efficiently and effectively.

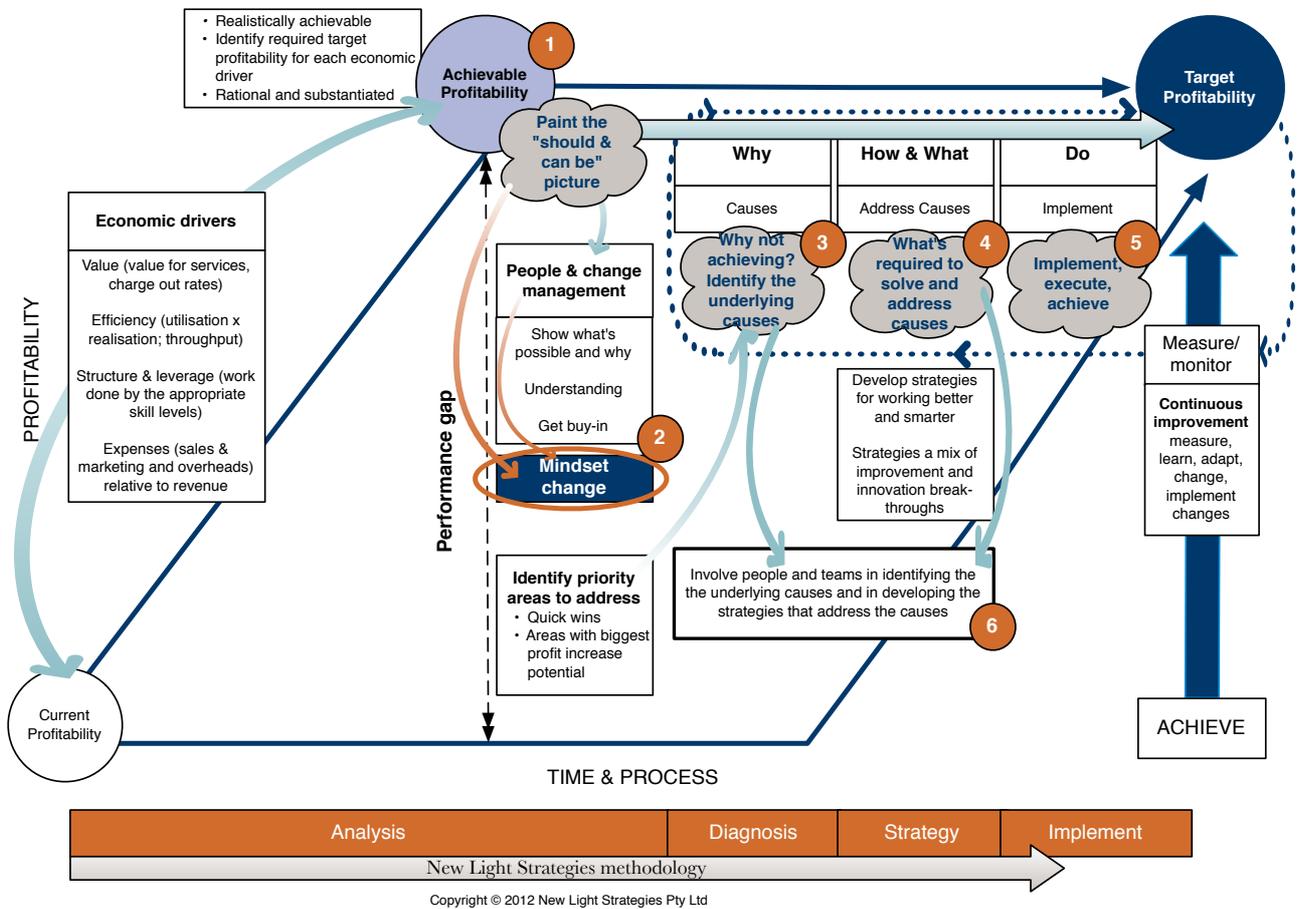
The identification, development and implementation of a profit improvement process is made up of multiple phases. The full process is divided into 4 main phases. These phases are analysis, diagnosis, strategy identification and implementation. Each phase can be completed as a discrete or standalone project, with specific deliverables which provide actionable outcomes to management at the end of each phase.

The profitability analysis is essential as a first step in the process. It provides the organisation with a "profitability health check", identifies areas that require improvement and quantifies the profit improvement potential and targets.

Ultimately the real value is derived from the diagnosis, strategy identification and implementation phases as it is only once the profit improvement strategies are identified and implemented that the profit growth potential can be achieved and realised.

Profit improvement process

The full profit improvement process is made up of the following phases.



The key principles in our approach is:

- 1 Identify the achievable profitability and the performance gap across each of the professional services profit drivers;
- 2 Create a mindset change by clearly showing what's achievable;
- 3 Diagnose the causes for the performance gap;
- 4 Develop the solutions and strategies that address the underlying causes;
- 5 Implementation, performance measurement and continuous improvement; and
- 6 Involve your people and teams - change only comes from involved and committed people.

A more detailed description of each of these phases is set out on the following pages.

The profit improvement phases in more detail:

Phases	Purpose	What / How	Outcome
1. Analysis	<ul style="list-style-type: none"> Identify the areas of the business where performance improvement is required in order to drive profit increase 	<ul style="list-style-type: none"> Develop a fact base of the business performance Identify and analyse the economic drivers, down to the lowest practical level of granularity Analyse the business performance and establish the relative performance of the different business areas and economic drivers 	<ul style="list-style-type: none"> Determine which areas of the business should be delivering greater profitability Calculate the potential \$ profit increase that could be generated from the identified areas List and prioritise the profit improvement areas that require further diagnosis
2. Diagnosis	<ul style="list-style-type: none"> Understand the underlying reasons for the business performance (covering reasons for both good and poor performance) 	<ul style="list-style-type: none"> Analyse the relevant areas of the business and determine the underlying reasons for the performance - "peel the layers off the onion" until the core is identified Interviews, workshops and insights based on experience (requires client staff involvement) 	<ul style="list-style-type: none"> Identify the underlying reasons Identify the areas and underlying causes that will be addressed in the next phase. Identify quick wins and strategically important areas.
3. Strategy identification	<ul style="list-style-type: none"> Identify and develop the strategies that address the underlying causes and that deliver improvements and innovation that lead to profit increases 	<ul style="list-style-type: none"> Develop strategies to address underlying issues and/or leverage off underlying strengths Collaborative and interactive approach - interviews, workshops and experience 	<ul style="list-style-type: none"> Identify the strategies required to address the issues and leverage off strengths so as to drive the greatest profit increases
4. Implementation	<ul style="list-style-type: none"> Develop detailed implementation action steps and implement the strategies that have been identified Successfully execute the strategies and deliver profit increases 	<ul style="list-style-type: none"> Clear accountability and responsibility established for the execution of each identified strategy Proper program and project management is required Detailed executable action steps developed and implemented 	<ul style="list-style-type: none"> Systematic and program management approach taken to ensure the successful implementation of the strategies in order of prioritisation.

Analysis phase

The analysis phase is the critical first step in the process. During this phase we establish the fact base and identify the areas in the business where profit improvement is required and those areas where the biggest opportunities for overall profit improvement exist.

The analysis, for each of the professional services economic drivers, will be completed across a matrix of practice areas, work groups and other relevant areas within the organisation. The extent to which the business is de-aggregated and analysed will depend on the structure of the organisation.

The analysis phase will be comprised of the following broad steps:

- The business's performance is assessed across a number of criteria, with a particular focused assessment of the performance of the professional services economic drivers.
- The professional services economic drivers are comprised of the following elements:
 - ▶ productivity (utilisation and realisation);
 - ▶ value (actual or implied charge out rates achieved);
 - ▶ leverage ratios (staff structure); and
 - ▶ expenses and overheads as % of revenue
- Other performance measures that are considered and assessed, if available, are a "people measures" (e.g. level of engagement, turnover, skills and skill shortages), "client measures" (e.g. average client engagement size, client concentration, client satisfaction levels) and engagement or job performance measures.
- Performance measures like revenue growth, gross profit margin, net profit %, performance against budget, etc are also assessed, but these types of measures are "outcomes" and not necessarily drivers of performance. These outcome-measures are therefore not particularly useful in identifying underlying causes during the diagnosis phase.
- The analysis will be done to the lowest level of granularity that's possible within the constraints of management information and reports available.
- The approach used in performing the analysis and in drawing conclusions, will include a review of the financial and performance information, discussions with key individuals and scenario-testing through the use of spreadsheet modelling of the business.

This analysis-phase is relatively non-intrusive on the organisation as most of the work is performed by New Light Strategies using available financial and other data.

At the conclusion of this phase, the areas requiring profit improvement are identified and prioritised.

It is possible that potential profit improvement strategies will be identified as part of the profitability analysis. This should however not be relied on and is not a specific deliverable within the profit analysis phase. Identifying such strategies during this initial phase will be more opportunistic and ad hoc. Identifying profit improvement strategies requires proper diagnosis of the underlying issues and a structured approach to identify what's required to address the underlying causes.

Diagnosis phase

During the diagnosis phase, the underlying reasons for both good and poor performance is identified. This is an essential step before any strategies are developed. By understanding the underlying causes, appropriate strategies can be developed to address issues and leverage off areas of strength.

This phase will require involvement from executive management and other people within the organisation. Some organisations prefer that only certain key executives are involved in discussions and workshops, whereas other organisations have a culture of broader involvement across more levels and people within the organisation. The extent to which people will be involved in this process will be discussed and agreed with the yourselves. The objective will be to get sufficient people involved without it being intrusive or distracting to the organisation.

The process for this phase is a combination of interviews with people, personal insights gained during the profitability analysis, insights and knowledge of underlying causes experienced at other professional services organisations and finally, a workshop where the findings are presented, debated and tested. Following the workshop (or workshops), a written report will be prepared and a presentation made to the executive management.

Whilst it is proposed that the profitability analysis (phase 1) is performed on a “whole-of-organisation” basis, the diagnosis phase can be done on any combination of whole-of-organisation or limited to specific practice areas or other relevant sub-sets of the organisation. The findings of the analysis phase will provide the basis for the organisation’s executive management to decide which areas to focus on for the detailed diagnosis. This is ultimately a decision for management and not for the consultant.

As a general rule, we select those areas for diagnosis that will generate the biggest profit increases as well as areas where quick wins and immediate profit increase can be achieved.

Strategy identification phase

Strategies for profit improvement are developed based on the findings of the diagnosis of the underlying causes. Here again, people from the organisation will be required in workshops. In some instances the strategies will be known and familiar to New Light Strategies based on prior experience. It is nonetheless essential that strategies are developed and agreed with appropriate people within the organisation.

The strategies and initiatives need to have an appropriate balance between improvement strategies and innovation. During the workshops people will be challenged to identify the required strategies.

We will also assess current and existing strategic plans and initiatives to assess the extent to which they are addressing profitability improvement. We would expect that you already have such strategies and initiatives and an assessment of their success or otherwise, needs to be carefully considered.

A detailed list of the required and agreed strategies and initiatives are prepared at the end of this phase.

Implementation phase

Once strategies and initiatives have been identified and agreed, these need to be translated into detailed executable action plans. This phase ensures that “theory becomes reality”.

New Light Strategies has developed templates and approaches for strategy implementation action plans, including tools and templates. It is however proposed that the implementation action plans align with and are adapted to any existing or preferred approach that your organisation currently uses. As a principle we believe in minimising the introduction of new tools, templates and methodologies. The appropriate implementation approach will be discussed and agreed with executive management.

A final critical element in the implementation phase is to structure and introduce appropriate performance metrics. These metrics will monitor and track the success of the strategies implemented and will serve as a basis for identifying which strategies are not delivering on the expected outcomes and consequently need to be refined, adapted or changed.

It is also recommended that these performance metrics are incorporated into your organisation's performance management and remuneration review processes.

The work plan, timing and fees

Who performs the work

All of the work as set out in this proposal will be performed by New Light Strategies' Founding Principal, William Masson together with a Senior Consultant working under direction and supervision.

How long does it take?

The whole process is quicker than most people realise.

The **profitability analysis phase**, start to finish including a final report and presentation, will generally take up to 2 weeks for a 100 person firm and up to 4 weeks for an organisation with 400 to 1,000 service delivery staff. The length of time is dependent on the level of performance information available.

It is not possible to estimate the duration of the **diagnosis, strategy identification and implementation phases** until such time as the exact extent and scope of these phases have been identified. It is expected that this will be capable of being scoped and estimated once the analysis phase has been completed and will be discussed with management at that stage. As a general guide, these final three phases will take about one to two months, depending on the size of the organisation and the extent of strategies that are required to be developed.

The profitability analysis phase is typically completed in one continuous block of time, whereas the diagnosis, strategy identification and implementation phases can be spread over a period of time. The work plans are scheduled to ensure minimal disruption to the organisation.

Fees - approach

Our approach to fees charged is that we estimate a fixed fee for each phase of the engagement. This is determined and agreed with the client prior to the commencement of the work.

Why work with New Light Strategies?

An independent external assessment of one's business, performed by a suitably experienced person, almost always produces a fresh perspective and new ideas. It is very difficult for management to focus on day-to-day operational responsibilities and also address strategic development areas.

With extensive experience in the professional services industry (and specifically, amongst others, law, IT services and accounting firms) and with 20+ years of executive-level responsibility for profit improvement, William Masson has the level of experience and expertise that can provide this independent analytical assessment.

William's career has included being a partner in one of the leading accounting firms and General Manager and Chief Operating Officer of several professional services businesses, which included legal, accounting and the IT industries. In each of these instances his core objective was to drive increased sustainable profit through the identification and implementation of improvement and innovative strategies.

Experience and insight are brought to every client engagement.

As well as formulating ideas and gaining insights, William can help you communicate with stakeholders. The ability to influence, persuade and sell ideas is an essential component of any strategic change programme.

Ultimately we deliver real-world pragmatic solutions and strategies to our clients. The proven methodology is combined with experience gained in operational executive roles, leading to practical business solutions.

Profile: William Masson

William has worked in executive roles at professional and IT services organisations including Com Tech Communications, Corrs Chambers Westgarth, Dimension Data Australia and Grant Thornton. He has also held chief executive officer roles in services companies and been an executive director of an ASX-listed IT services company.

William is a qualified Chartered Accountant and was a partner at Coopers & Lybrand (now PwC). He has a Bachelor of Accountancy (Honours) degree from the University of Stellenbosch, South Africa, and has completed the Advanced Management Program at INSEAD, the European business school in Fontainebleau, France.

Throughout his career, William has developed and implemented strategic initiatives which have led to significant bottom-line profit increases.

William's focus is on developing strategies that maximise the bottom-line profitability of organisations by increasing business growth and improving service delivery productivity and operating profit margins. New Light Strategies's strategy implementation plans are underpinned by William's extensive change management experience.

Case studies

The following case studies apply specifically to two separate professional services organisations where significant profit improvement was achieved through the use of the profit improvement methodology as set out in this document.

Increased professional services firm's bottom-line profit by 90% over two years by focusing on economic drivers

Business need	Solution	Outcome
<ul style="list-style-type: none"> Office profitability lower than market benchmarks Low profit per partner made it harder to retain and attract quality principals and partners into the firm 	<ul style="list-style-type: none"> Analysed economic drivers Developed and implemented strategies to address the economic drivers that would deliver the greatest improvement in performance. These strategies focused on: <ul style="list-style-type: none"> revenue growth initiatives service delivery productivity and profitability improvement appropriate performance management measures reporting and remuneration management, sales and soft skills development training 	<ul style="list-style-type: none"> Grew revenue by 50% and bottom-line profit by 90% over two years Significantly increased take-home profit per partner, leading to better attraction and retention of principals and staff

Increased profits by \$20 million by improving service delivery and implementing performance measures to identify opportunities for further improvement

Business need	Solution	Outcome
<ul style="list-style-type: none"> Organisation experienced significant growth in professional services revenue, however this revenue increase did not translate into acceptable operating profit margins The organisation did not have effective and efficient service delivery processes and could not understand the profitability impact of its core economic drivers 	<ul style="list-style-type: none"> Developed and implemented professional services strategy Improved service delivery methodologies by addressing key economic drivers including utilisation, realisation, leverage, charge-out rates and overall productivity and profitability Developed and established performance metrics to increase business performance visibility 	<ul style="list-style-type: none"> Significantly increased operating profit margins as the business achieved 40% compounded revenue growth over three years Growth in operating profits of \$20 million directly attributable to the improved profit margins

In conclusion

We would welcome the opportunity to work with your organisation and help you achieve superior profitability and maximise your full potential.

You will find that a profitability improvement process such as this, when done properly, leads to an enthused and motivated organisation. People want to work in a successful organisation and they want to be involved in driving its ongoing and increasing success.

Should you find this proposal to be of interest, please contact William Masson for a further discussion in order to clarify any points, answer any questions you may have and expand further on the detail and outcomes that you can expect from an engagement such as this.

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