CLIENTEK

KEY METRICS

Part 1: Leading Financial Indicators

2/18/2021

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Written by: Kirk Hoaglund, Chief Executive Officer

Very many, well-known business metrics are trailing indicators. They can only be computed and analyzed after-the-fact. They help you know how you did and, likely, ways to improve, but they describe the past. Watching for developing trends so that you can make mid-course corrections, though, requires leading indicators. Metrics that predict an outcome before it materializes.

Trailing indicators are guaranteed to be accurate. You know how much money you made on a project when it has completed, you've been paid, and you've paid all your expenses. Leading indicators are imperfect, but essential. Over the next few posts, I will describe some that we use. Here, leading financial indicators.

One indicator that does double duty for us is "average days late". Our projects progress through a series of fixed-fee increments called "sprints". We agree with our clients to complete a well-defined set of items in each, two-week sprint. If we need a little extra time to finish the sprint, we do not change the price. Most projects are made up of many sprints, each targeting a subset of the whole, each fixed fee, and each two weeks long. When we take longer than those ten business days to finish the list, that bites into the timeline, demonstrates possible risk, and reduces the profitability of the project. Taking one extra day is a 10% hit in efficiency, which translates, as a leading indicator, into a clear predictor of project profitability.

When accumulated over a project, sprint by sprint, the "average days late" is a great indicator of project performance from a delivery point of view and from a profitability point of view. This is an indicator easy to track and easy to calculate. Perfect.

A second indicator, easily tracked and easily computed, is “revenue per headcount”. A service company has person-hours as its inventory and converts them to revenue by executing against a paid engagement. Whether you pay by the hour or not, whether you charge by the hour or not, you are converting work hours into revenue. And, for a service company, all the variable costs are tied up in people, with a generally low fixed-cost rate. Every person getting paid is a cost and every person contributes to activities that generate revenue. Dividing total revenue by total headcount, gives us “revenue per headcount”. Through accrual-based accounting, that could be computed on a daily basis. With careful contract management, it can be forecast accurately based on booked engagements – and forecast further by looking at pending proposals.

The ranges of acceptable values for both metrics will depend on the kind of work you do, the kinds of employees you have, and other factors. Finding the low/high ranges takes a little time and some comparisons between your trailing indicators and your leading indicators. But it is well worth it. Here are a few examples:

- If “average days late” is zero you may have overstaffed your teams, dropping your efficiency.
- If “average days late” is one, that means every single sprint is late by a day – probably not good planning. And you are spending one sprint in ten without getting paid for it.
- If “revenue per headcount” is trending down, you may be overstaffed for current demand.
- If “revenue per headcount” is trending up, you are likely headed for the opposite problem – short staffing.

We review these kinds of indicators at least twice per week with the leadership team. Everyone in the company is aware that these are important predicators of the health of our company and the quality of work we do for our clients.