A Service Performance Insight
White Paper

Service Compass: Charting the Course to Professional Service Excellence

Introducing the Service Maturity Model

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Service Performance Insight

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Introduction

The professional services marketplace has been vastly underserved from a research perspective. Perhaps this oversight is because service organizations are both so busy and profitable that this work was not a priority. Well, it is now. Caught between economic uncertainty, global competition and a more value-conscious client base, professional service organization (PSO) executives must now concentrate their efforts on improving all aspects of their business in order to succeed and prosper.

In 2007 Service Performance Insight introduced "The Professional Service Maturity Model", which benchmarks the correlation between professional service organizational performance and the adoption of "best practices" and business process maturity. The study focuses on professional service excellence across **five service performance pillars — Vision and Strategy, Finance and Operations, Human Capital Alignment, Service Execution and Client Relationships**. Currently, over 130 service firms have participated in this research.

Through the analysis of industry benchmarks and practical guidance from experts in the field, the study measures which key elements are the most important predictors of overall success, and provides both diagnostic and prescriptive insight for PSO executives to improve their organizations.

If interested, please follow this link to participate in the study: http://www.spiresearch.com/research/research.htm

A Catalyst for Transformation

The change factors driving the professional services sector emanate from a few key forces. With service sector expansion and global competition, PSOs must differentiate themselves from the thousands of firms that have a global reach. Intense on and off-shore competition exerts downward pressure on margins, and at the same time sets a high bar for innovation in the services offered and delivery models. The complexity of these cumulative pressures only accentuates the urgency to increase organizational flexibility, speed and quality of delivery.

Until now, little if any research examined professional service strategies and benchmarks within the context of a rapidly maturing technology environment. The questions around these issues include:

- What are the most important focus areas for professional service organizations (PSOs) as business processes mature?
- What is the optimum level of maturity or control at each phase of an organization's lifecycle?
- Can diagnostic tools be built for assessing and determining the health of key business processes depending on an organization's level of maturity?
- Are there key business characteristics and behaviors that spell the difference between success and failure? If so, do they change depending on the maturity of the company or industry?

PSO executives that can answer and act upon these questions are in high demand and provide their organizations with a significant competitive advantage, and those that don't face increasing commoditization and the potential to be acquired or driven out of business altogether.

THE FIVE SERVICE PERFORMANCE PILLARS

SPI Research developed a model that segments and analyzes a PSO into five distinct areas of performance that are both logical and functional.

1. **Vision and Strategy:** (CEO) A unique view of the future and the role the service organization will play in shaping it. A clear and compelling strategy provides a focus for the organization and galvanizes action. Effective strategies focus on target customers, their business problems, and how their solutions solve those problems differently, uniquely and better than their competitors. For a service strategy to be effective, the role and charter of the service organization must be defined, embraced and supported throughout the company. Depending on whether the service strategy is to primarily support the sale of product or to drive service revenue and margin; service organization goals and measurements will vary.

2. **Finance and Operations:** (CFO) The ability to manage services profit and loss — to generate revenue and profit while developing repeatable operating processes. Elements of this pillar provide long-term financial visibility and stability, which enables PSOs to manage growth and provide an acceptable level of return to shareholders.

3. **Human Capital Alignment:** (HR) The ability to attract, hire, retain and motivate employees. With changing workforce demographics, human capital strategy has increased in importance. As executives work to manage costs, they must assure clients have the best/cost-effective personnel working on projects. As PSOs adopt new staffing models designed to achieve these goals, they must also be diligent to keep their best people on-board and motivated.

4. **Service Execution:** (Engagement/Delivery) The methodologies, processes and tools to effectively schedule, deploy and measure the quality of the service delivery process. Service execution involves a number of factors: from assuring utilization rates remain high, to delivering services in a predictable and acceptable time frame, to reducing costs while improving project quality and harvesting knowledge.

5. **Client Relationships:** (Sales, Marketing and Partnering) The ability to effectively communicate with employees, partners and customers to generate and close business and win deals. Effective client management involves improving relationships to better

understand client needs, while ensuring "the right" clients continue to buy and provide references and testimonials.

Figure 1: The Five Service Performance Pillars

Source: Service Performance Insight, November, 2008

These five pillars identify specific areas in which PSOs of all types (product or service) strive to improve capabilities that both optimize profitability and improve quality, human capital and client satisfaction — providing the best environment for long-term success. However, maximizing performance in one pillar could lead to performance degradations in the other four. The objective is to optimize the results within each pillar, while driving overall revenue, margin and customer satisfaction.

MATURITY LEVELS PROVIDE INSIGHT FOR IMPROVEMENT

Within each of the **service performance pillars**, SPI Research developed guidelines for process maturity. These guidelines cut across the five service dimensions to illustrate examples of business process maturity. This study has been developed to measure the correlation between process maturity and service performance excellence.

This model is built on the same foundation as the Carnegie Mellon Capability Maturity Model (CMM), which has been adopted for software development; but is specifically targeted toward billable PSOs, that either exclusively sell and execute professional services, or complement the sale of products with services to optimize a product's use. The five maturity levels include:

- ∆ ***Level 1 — Initiated***: At maturity Level 1, *processes are ad hoc and fluid*. The business environment is chaotic and opportunistic, and the focus for a PSO is primarily on new client acquisition and reference building. Often professional service employees at this level are chameleons — able to provide presales support one day and develop interfaces and product workarounds the next. Success depends on the competence and heroics of people in the organization, and not on the use of proven processes, methods or tools.

- ∆ ***Level 2 — Piloted***: At maturity Level 2, *processes have started to become repeatable*. Best practices may be demonstrated in discrete functional areas or geographies but are not yet documented and codified for the entire organization. Basic processes have been established for the five Professional Services performance pillars but they may not be universally embraced or institutionalized.
- ∆ ***Level 3 — Deployed***: At maturity Level 3, *the PSO has created a set of standard processes and operating principles* for all major service performance pillars but renegades and "hold-outs" may still exist. Management has established and started to enforce financial and quality objectives on a global basis.
- ∆ ***Level 4 — Institutionalized***: At maturity Level 4, *management uses precise measurements, metrics and controls, to effectively control the PSO*. Each service performance pillar contains a detailed set of operating principles, tools and measurements. Organizations at this level set quantitative and qualitative goals for customer acquisition, retention and penetration, in addition to a complete set of financial and operating controls and measurements.
- ∆ ***Level 5 — Optimized***: Maturity Level 5 *focuses on continual improvement of all elements of the five performance pillars*. A disciplined, controlled process is in place to measure and optimize performance through both incremental and innovative technological improvements. Quantitative process-improvement objectives for the organization are established. They are continually revised to reflect changing business objectives, and used as criteria in managing process improvement. New initiatives for quality, cost control or client acquisition are in place to ensure optimum performance. The rough edges between disciplines, functions, and specialties have been smoothed to ensure unique problems can be addressed quickly without excessive bureaucracy or functional silos.

THE PROFESSIONAL SERVICES MATURITY MODEL

If the service performance pillars are mapped against process maturity a **"Service Excellence Roadmap"** can be developed. Table 1 provides insight into where an organization fits within the service maturity model as well as a guideline to move from one level of maturity to the next. It allows organizations to diagnose their performance strengths and develop plans to bring lagging areas into alignment.

Table 1: Performance Pillars Mapped Against Service Maturity

	Phase 1 Initiated	Phase 2 Piloted	Phase 3 Deployed	Phase 4 Institutionalized	Phase 5 Optimized
Vision and Strategy and Culture	Initial strategy is to support product sales and provide reference customers while providing workarounds to complete immature products.	PS has become a profit center but is subordinate to product sales. Strategy is to drive customer adoption and references profitably.	PS is an important revenue and margin source but channel conflict still exists. Services differentiate products.	Service leads products. PS is a vital part of the company. Solution selling is a way of life. PS is included in all strategy decisions.	PS is critical to the company. Service strategy is clear. Complimentary goals and measurements are in place for all functions.
Finance and Operations	The PSO has been created but is not yet profitable. Rudimentary time and expense capture. Limited financial visibility and control. Unpredictable financial performance.	5 to 20% margin. PS becoming a profit center but still immature finance and operating processes. Investment in PSA to provide financial visibility.	20 to 30% margin. PS is a complete P&L. Standard methods for resource mgmt., time & expense mgmt., cost control and billing. In depth knowledge of all cost elements at the employee, subcontractor & project level.	PS generates > 20% of overall company revenue and contributes > 30% margin. Well developed finance and operations processes and controls. IT Automation & integration for all areas.	> 40% margin. Continuous improvement and enhancement. High profit. Integrated systems. Global with disciplined process controls and optimization.
Human Capital Alignment	Hire as needed. Generalist skills. Chameleons, Jack of all Trades. Individual heroics. May perform presales as well as consulting delivery.	Begin forecasting workload. Start developing job and skill descriptions and compensation plans. Rudimentary career paths. Start measuring employee sat.	Resource mgmt., skill mgmt, career mgmt, employee satisfaction surveys. Training plans. Goals and measurements aligned with compensation. Attrition <15%	Business process and vertical skills in addition to technical and project skills. Career ladder and mentoring programs. Training investments to support career. Low attrition, high sat.	Continually staff and train to meet future needs. Highly skilled, motivated workforce. Outsource commodity skills or peak demand. Sophisticated variable on and off-shore workforce model.
Service Execution	No scheduling. Reactive. Ad hoc. Heroic. No consistent project delivery methodology. No consistent project or knowledge management.	Skeleton methodology in place. Initiating project mgmt. and technical skills. Starting to measure project satisfaction, starting to harvest knowledge.	Collaborative portal, begin looking at Earned Value Analysis. Project dashboard. Global Project Management Office, project quality reviews and measurements. Effective change management.	Integrated project and resource management. Using portfolio management. Global PMO. Global project dashboard. Global Knowledge Management. Global resource management.	Integrated solutions drive performance. Continual checks and balances to assure superior utilization and bill rates. Complete visibility to global project quality. Multi-disciplinary resource management.
Client Relationship	Opportunistic. No defined solution sets or Go to Market plan. Focus is on new customers and references. Individual heroics, no consistent sales, marketing or partnering plan.	Start to use marketing to drive leads. Multiple sales models. Start measuring customer satisfaction. Start developing partners and partner plans. Some level of pricing controls.	Marketing, inside sales, solution sales with defined solution sets. Deal, pricing and contract reviews. Partner plan and scorecard. Tight pricing and contract management controls. High levels of customer satisfaction.	Business process and vertical solutions in addition to horizontal applications. Centers of excellence. Top client and partner programs. Global contract and pricing management. Key partner relationships. Strong customer reference and testimonial programs.	Executive relationships. Thought leadership. Brand building and awareness. High customer satisfaction. Integrated sales, marketing and partnering. High quality references.

Source: SPI Research, November 2008

FINANCE AND OPERATIONS RESULTS

As the professional service market has matured, financial key performance measurements have continued to improve in all areas. Until the recent financial meltdown, almost all respondents were experiencing significant revenue and headcount growth. **Reported backlog has significantly declined from last year from 48.5% to 42.8%** (Table 2) which indicates significant market erosion is starting to penetrate the professional service sector. Backlog decline precedes and predicts increasing pricing pressure and lower utilization and revenue growth in the future. Net contribution margin is still healthy at 22.7% but **annual revenue per billable employee has declined from $215K a year ago to $195K in 2008**. Project gross margin has declined slightly from 35.3% to 33.1% but **there has been a sharp decline in off-shore margins from 44.4% to 38.6%.** As technology companies and their clients tighten their belts to weather the storm, the percentage of services delivered by subcontractors and off-shore resources will be the first to be affected. A majority of respondents use some level of offshore resources and are less reliant on subcontractors than in the past. Reported margin from offshore resources versus subcontractors is 38.6% versus 28.4% — showing that hybrid on and offshore delivery models have increased service profits. The reported margin for time and material projects is significantly better than fixed price projects – 36.1% versus 31.7% indicating in general, professional service firms perform better if they working on a time and materials basis. The reported average is 65% time and material, 32% fixed price and 3% shared risk and “other”.

Table 2: Finance and Operations Averages

No.	Finance and Operations	Value
1	Annual professional services net margin	22.7%
2	Annual revenue per person for billable employees (*1,000)	$195
3	Average project gross margin	33.1%
4	Average subcontractor margin	28.4%
5	Average project margin for fixed price projects	31.7%
6	Average project margin for time and materials projects	36.1%
7	Average margin for offshore resources	38.6%
8	Percentage of quarterly revenue target in backlog	42.8%
9	Average quarterly revenue forecasting variance	13.8%
10	Percentage of overall revenue unable to bill (Revenue Leakage)	5.4%

Source: SPI Research, November 2008

One area stands out as an area for significant improvement — service selling, deal pricing, deal discounting and responsibility for pricing. There was little commonality in reported pricing, discounting and deal authority. Very few organizations reported defined guidelines for pricing and discounting resulting in discount authority all over the map. Control of service sales and pricing is a "process maturity" focus area which will result in dramatic service profit improvement.

Another indicator of the need to improve service selling is "Bid-win rate". Respondents reported slightly better than a 50% average win rate; the ratio of "wins" to "bids" should improve with a greater focus on deal qualification and enhanced solution selling capability.

Level of discounting is a leading indicator for the overall quality, uniqueness and operational excellence of the organization. High levels of discounting negatively affect almost all aspects of performance. Organizations with the highest level of discounting produced the lowest average bill rates and high levels of employee attrition. A significantly high percentage of heavily discounted projects (50%) were not delivered on time. However, the most telling statistic is that high levels of discounting did not result in improved bid/win ratios.

One of the primary reasons organizations discount is because they believe that discounting will increase the probability of winning the business. In this study, Service Performance Insight found that organizations that discount less than 5% won approximately 4.5 bids per ten delivered. Yet companies with the highest level of discounting (over 30%) had only a slightly better bid/win ratio of 5.8.

SERVICE PILLAR IMPORTANCE AND ORGANIZATIONAL MATURITY

The results and insights gained in the past year have confirmed SPI Research's original hypothesis that service organizations must develop a balanced and holistic approach to improving all aspects of their business as they mature. SPI Research has discovered that the emphasis on individual service pillar performance shifts as organizations mature. Excellence in one individual service performance pillar does not create overall organizational success – rather it is the appropriate balance and integration of improvement in each service performance pillar with one another which ultimately leads to continuing organizational success.

Figure 2 depicts the relative service performance pillar importance by organizational maturity level. Many professional service organizations are established without a particular initial focus toward optimizing performance.

They begin with the goal of establishing a client and reference base. They may be operated as a cost center or as an adjunct to the product engineering function to establish alpha and beta customers and to provide early product feedback. Initially they often perform presales, quality assurance and service delivery tasks. They hope to deliver services that are both profitable to them as well as valued by their clients, but in reality, they take the position that "just about any deal is a good deal."

Figure 2: Service Pillar Importance by Organizational Maturity Level

Pillar	Initiated	Piloted	Deployed	Institution.	Optimized
Vision & Strategy	○	◔	◑	◕	●
Finance & Operations	○	◔	◕	●	●
Human Capital Align.	◔	◑	◕	◕	●
Service Execution	◔	◑	◕	◕	●
Client Relationships	●	◕	◕	◕	●

Importance by Maturity Level ○= 1 ◔= 2 ◑=3 ◕= 4 ●= 5

Source: Service Performance Insight, November, 2008

The emphasis at Level 1 maturity is on building client references and recruiting highly skilled generalist consultants who are experienced enough and flexible enough to perform heroic feats to ensure early customer success.

By Level 2, although primary focus is still on creating reference customers, more emphasis is placed on human capital alignment for recruiting and ramping skilled employees, partners and contractors. Service execution starts to focus on developing repeatable project delivery methods. At these early stages, many embedded professional service organizations have a strong product-driven focus and the role of the service organization is subordinate to products. Conflicts between service profit, client success and driving product revenue are often characteristic of Level 2 embedded service organizations.

By Level 3 the organization must move toward a more balanced focus on all elements of the business by investing in systems, operating processes and repeatable methods to sustain growth and ensure quality. At Level 4 the organization has implemented structured business processes and utilizes integrated information systems to assure there is "one view of the business". Finally, at Level 5 the organization is running very efficiently and the focus is on continual improvement. Currently, very few firms run at Level 5 performance.

Conclusions and Recommendations

With increased global competition for business and resources PSOs must continually improve. These improvements cut across every aspect of the organization, and all departments and individuals must work together to drive service performance excellence. Executives need key performance indicators and a plan for continual advancement.

The leading financial indicators – backlog, revenue per person and sales pipeline in this year's study are all starting to trend lower, indicating tough times and flat to declining revenue and margin are ahead. More than ever before, winning professional service firms must seriously benchmark their operations and develop improvement plans to bring lagging areas into alignment.

This white paper provides a glimpse into areas where PSOs can improve by showing statistics for average performance reported by over 130 professional service organizations. Subsequent analysis performed by SPI Research will show how the service performance pillars can be optimized and will provide prescriptive advice to help organizations enhance their business process maturity while improving bottom-line results.

The performance pillars and statistics produced by SPI Research are by no means the definitive answer to improving performance in every PSO. Each PSO is different and operates to its highest capability by uniquely providing services and optimizing each pillar in a way that makes them successful. The purpose of performance pillars is to highlight key operating processes and potential areas of improvement, and provide guidance as to how PSOs can advance.

As the technology professional service industry has matured, the stakes and the “ante” to play have been raised. Today’s PSO requires significant investment in tools, methods and process in all areas of ***Vision and Strategy, Finance and Operations, Human Capital Alignment, Service Execution and Client Relationships*** to be successful. High-performing organizations must optimize each service performance pillar and take advantage of technology and process advancements to be competitive.

While much progress has been made in service revenue and margin achievement; significant gaps in strategy, service sales and pricing, project methods, service quality and human capital alignment persist. Variable on-shore and off-shore workforce models have made a disciplined approach to managing all facets of the business more important than ever before. We believe this study and continued focus on developing a “Service Maturity Model” provide a roadmap for achieving Service Excellence.

About Service Performance Insight

Jeanne Urich, Service Performance Insight Managing Director, is a management consultant specializing in service organization improvement and transformation for small to large technology companies. Her focus areas include vision and strategy, finance and operations, human capital alignment, service operations and service sales and marketing. She has been a corporate officer and leader of the worldwide service organizations of Vignette, Blue Martini and Clarify, responsible for leading the growth of their Professional Services, Education, Account Management and Alliances organizations. She has a Bachelor's Degree in math and computer science from Vanderbilt University. She serves on the advisory board of www.psvillage.com, a preeminent on-line community for services executives and is a contributing author of *Tips from the Trenches: the Collective Wisdom of over 100 Professional Service Leaders*. She is also co-author of the ground-breaking new 2008 benchmark "The New Professional Service Maturity Model" www.spiresearch.com

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David Hofferberth, Service Performance Insight Managing Director, has over 20 years experience in information technology (IT) serving as an industry analyst, market consultant, and as a product director at Oracle. Hofferberth is focused on the services economy, and in particular, on white-collar productivity issues and the technologies that help people perform at their highest capacity.

Hofferberth's background also includes the management of application development teams and analytical tool development to support business decision-making processes. Hofferberth earned an MBA from Duke University and a BS in Industrial Engineering from the University of Tennessee. He is also a licensed Professional Engineer (PE).

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Service Performance Insight (SPI Research) is a globally-focused research and consulting firm specializing in business improvement and transformation for service oriented firms. SPI uses its industry standard Professional Service Maturity Model to help service organizations assess and prioritize their service improvement and transformation plans.

The firm closely follows professional services organizations (PSOs), independent software vendors (ISVs) and other technology providers, analyzing how organizations best use technology to make their people more productive and profitable. SPI Research pays particular attention to the integration of the three key assets of a PSO: its people, (business) processes and capital, and how technology can help optimize their use.

Visit www.SPIresearch.com for more information on Service Performance Insight.

