Trashing the Timesheet

by Ronald J Baker

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DEDICATION

To my colleagues: It is my sincerest hope that, after reading this book, you will sign VeraSage Institute's Declaration of Independence and free our profession, once and for all, from the tyranny of time.

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Preface

*Perhaps the sentiments contained in the following pages are not yet sufficiently fashionable to procure them general favour; a long habit of not thinking a thing **wrong**, gives it a superficial appearance of being **right**, and raises at first a formidable outcry in defence of custom. But tumult soon subsides. Time makes more converts than reason.*

– Thomas Paine,
Common Sense,
14 February 1776

The purpose of this booklet – to get rid of your timesheet – is daunting. I am challenging the conventional wisdom of over 50 years, and seriously questioning a practice so ubiquitous that it is hard for accountants to even conceive there may be a better alternative. Ever since I made it publicly known that my one mission in life is to bury the billable hour in the accounting profession, I have frequently been asked how I came to embark upon this rather strange quest.

The answer is that I am passionate about wanting to better the quality of life in the professions. It is a mission I take very seriously, because it goes to the heart of what being a professional is, what we offer to the public, how we perceive ourselves, how we measure the results we achieve, and the wealth we create for the customers we are privileged to serve.

I entered the accounting profession in 1984 as a young, eager and determined accountant in the ranks of one of the then Big Eight, and believed my destiny was to become a partner. I was taught from day one what approximately two generations of accountants had been taught before me: "You sell your time". I had no reason to believe this conventional wisdom was not true. After all, I now had an hourly rate, which defined my status and rank in the pecking order of the firm. I completed a timesheet every two weeks, in increments of 15 minutes, or my pay cheque was dutifully withheld.

We have sunk so low that a statement of the obvious is the first duty of a thoughtful person
– George Orwell

It seemed quite logical and rational that all I had to provide to the customers of the firm was my time.

When I launched my own firm, I was the epitome of what statisticians call *path dependent* – that is, the older you are, the greater the chance that what you will be in the future is influenced by what you were in the past. It was not until after a few years out on my own that I started to seriously wrestle against the conventional wisdom of my chosen profession. I suppose I took Mark Twain to heart: "When you find yourself in the majority, pause and reflect."

Today, accountants are among the ultimate knowledge workers, creating wealth for their customers from the ideas and intellectual capital they generate. Yet, too many of us still believe we are *service* workers, not *knowledge* workers, and there is an enormous difference. We are operating under a theory of the firm that is increasingly irrelevant to the critical success factors which determine our – and our customers' – destiny. We are still mired in the notion that the way to create wealth in the professional service firm is to leverage people and hours.

In professional firms today the timesheet serves three main purposes, at least according to its biggest defenders. First and foremost, it is a *pricing* tool, allowing the firm to track the labour on any one job and set a price accordingly. Of course, this is nothing but the manifestation of Marx's labour theory of value, which has been totally repudiated in the companion to this work, *Burying the Billable Hour*. Second, the timesheet is used to gauge the *productivity and efficiency* of team members and keep control over their workflow. Third, they are used for *cost accounting* – or Activity Based Costing – in order to determine the profitability of any customer or job. I have serious doubts that the timesheet is the most effective tool for all of these purposes, and the link between time and pricing has already been broken. In this booklet I want to challenge the other two defences and offer an alternative measurement system –

known as Key Performance Indicators – to replace the timesheet.

In that spirit, you will read about an accountancy practice, O'Byrne and Kennedy, that eliminated timesheets on 1 July 2002, and has not looked back. Paul O'Byrne, partner, has written about his firm's experience with Value Pricing and the challenges presented in replacing the timesheet with Key Performance Indicators. His firm's struggle – and ultimate success – is indicative of other firms who have decided to trash their timesheets. I urge you to learn from both his mistakes and – more importantly – his success.

The accounting profession is a noble calling, providing the opportunity to serve and contribute to others, and make a difference in the world beyond one life. Despite this, the passion and morale in the profession – leading indicators of the health and vitality of any calling – have been in decline for decades. I believe this is in part caused by the component in the old theory of the professional service firm that says that the road to success is paved with ever-higher billable hours. No one enters the profession in order to bill the most hours. This theory – which is at the core of the thinking of most professionals – is slowly eating away at the very sustenance of our calling. It is time to consign it to the scrap heap of history. I will attempt to do just that, not so that you can make more money, but more of a difference in the lives of those important to you.

This booklet sounds a tocsin to my colleagues around the world in the hope that they will join me in restoring quality of life in the accounting profession.

Ronald J. Baker
Petaluma, California
1 November 2002

The Old Theory

Theories are powerful because they seek to do one of three things: explain, predict or prescribe. Yet, when one reads a typical business book today the author will usually begin by saying something to the effect that “this book is not based on some ‘ivory tower’ theoretical model, but based on practical, real-world experience and examples”. Whether we know it or not, and especially in a business environment, we are guided to a large degree by theoretical constructs that have been developed in order to simplify – and thus explain, predict or control – our various behaviours.

“ANALYSING” THE PREDOMINANT PRACTICE EQUATION OF THE PAST

In Greek language the word *analyse* means to “break down”, which I will proceed to do with this theory before positing what I believe to be a better theory in the next chapter. When you think about the traditional theory of a professional service firm, you will no doubt construct a model such as:

Revenue = People Power x Efficiency x Hourly Rate

Since this model has dominated the thinking of firm leaders, it is worth explaining the model in greater detail in order to understand both its strengths and – as will be increasingly detailed – its fundamental weaknesses.

The archetypal pyramid firm model rested on the foundation of leveraging people power. The theory is this: since the two main drivers of profitability are leverage (number of team members per owner) and the hourly rate realisation, if each partner could oversee a group of professionals, this would provide the firm with additional capacity to generate top line revenue, and thus add to the profitability and size of the firm. If a firm wanted to add to its revenue base, it had two primary choices: it could work its people more hours, or it could hire more people. It is no secret which option the typical firm tends to choose, much to the chagrin of its already overworked team members.

If this part of the theory makes sense, pause for a moment and consider this axiom. Compared to other industries, this process of adding capacity *after* revenue is backwards. If you think of any other industry or company – from Intel to General Electric, from FedEx to Microsoft – capacity is almost always added *before* revenue. Think of FedEx. Before Fred Smith could deliver his first overnight package, he had to have trucks, drivers, aeroplanes and facilities throughout the country, all at enormous fixed costs (indeed, those large fixed costs almost bankrupted FedEx in the early days). Yet the typical firm will not add an additional person until they are assured of a large utilisation rate (usually between 60 and 80%). This has several debilitating effects, but perhaps the two worst are that it continuously keeps the firm running at an overworked pace, which in turn limits the firm's ability to go out and acquire even more profitable customers. It also leaves very little time and few resources to be devoted to new growth areas and new service offerings for existing customers.

Let us look now at the third element in the old theory – efficiency. Efficiency is one of those words that can be said with perfect impunity, since no one in their right mind would dispute the goal of operating efficiently. In fact, and this is well known to economists, efficiency is critical since it ensures a society's resources are not going to waste.

It is also well established that different levels of productivity partially explain differences in wages across countries. An American farmer will earn more ploughing with a tractor than a Cuban farmer using an ox and hand plough; the American farmer is more productive, hence higher wages and more profits.

In a service firm, efficiency has always been measured based upon the number of hours required to complete various jobs, and average utilisation rates achieved by the team members. In fact, if you were to study the average hours realised and the average productivity rate per person, you will find the hours average between 1,050 to 1,500, and the utilisation rate is from 62 to 95% (depending on the size of the

There is nothing so practical as a good theory
– Ikujiro Nonaka and Hirotaka Takeuchi

firm). These numbers have been typical for as long as firms have kept such statistics. Even with the adoption of technology, there have been no major movements in these two measurements. In other words, whether the accountant is using a quill pen or a Dell computer, billable hours remain within the same boundaries.

There is no doubt that increasing efficiency – or at least not sliding into inefficiency – is important. But the pendulum has swung too far in the direction of efficiency over everything else. It seems innovation, dynamism, customer service, investment in human capital and effectiveness have all been sacrificed on the altar of efficiency. It is critical to bear in mind that a business does not exist to be efficient; rather, it exists in order to create wealth for its customers.

Peter Drucker is fond of pointing out that the last buggy whip manufacturers were models of efficiency. So what? What happens if you are efficient at doing the wrong things? That cannot be labelled progress. In fact, one indicator that an industry (or profession) is in the mature or decline stage of the Service Life Cycle is when it is at the apogee of its theoretical level of efficiency.

Last, but certainly not least in terms of influencing the accounting profession in a myriad of ways, is the hourly rate. The hourly rate is a direct cousin of the Du Pont Return On Investment formula, and is also a form of cost-plus pricing. But the real ancestor of the hourly rate is the Labour Theory of Value, first developed by Karl Marx in the mid-1800s. This theory was almost immediately shown to be false – in terms of its ability to explain, predict or prescribe – as a method of determining value in a marketplace. My first ACCA booklet, *Burying the Billable Hour,* showed the fallacy of this theory, and offered a better theory: the Subjective Theory of Value. That is, ultimately, the person paying for it, not the seller's internal overhead, desired profit or labour hours, determines the value of anything. Value, like beauty, is in the eye of the beholder.

Again, consider revenue in the Old Practice Equation. Since

professional service firms have such large contribution margins (defined as revenue per person less direct cost per employee), averaging between 50 to 67% – they are not like grocery stores that operate on a 1 to 2% bottom line – the prevailing attitude seems to be when marginal revenue is added to the top line, a larger and larger percentage will flow to the bottom, given that most firm costs are fixed, at least in the short and medium term (in theory, all costs are avoidable in the long run).

Not much thought is given, however, to the profitability of that marginal business. It is one thing to get more business, it is quite another to get better business. The "bigger is better" mentality is an empty promise for most firms. Acquiring more customers is not necessarily better. Growth simply for the sake of growth is the ideology of the cancer cell, not a strategy for a viable, profitable firm.

If market share explained profitability, General Motors, United Airlines, Sears and Philips should be the most profitable companies in their respective industries. Yet they have all turned in mediocre profitability records. Growth in profitability usually precedes market share, not vice versa.

SUMMARY AND CONCLUSIONS

I have exposed the flaws of the traditional Practice Equation. Although the discussion above is not meant to be comprehensive, it nevertheless sets forth a compelling case against the traditional paradigm. With the growth in the labour pool of accountants decreasing, with the technology curve flattening and utilisation rates stuck between 62 to 95% from the dawn of time – not to mention the focus on efficiency compromising the profession's innovation and effectiveness – the items of leverage appear to be disappearing.

But are they really, or are we not looking at the right things to leverage? In other words, is there a better theory for the professional service firm? I believe there is, and my task in the remainder of this booklet is to prove this new theory's superiority over the old one, and even have you adopt it as your own.

The New Theory

Professionals tend to get so absorbed by the technical aspects and enveloped in the arcane knowledge of what they do, it rarely occurs to them to stop and think about why they are as successful as they are. Interestingly, if someone outside of our walls were to study the Old Practice Equation from the previous chapter, that outsider would gain the impression that professionals are successful because they have learned how to leverage people very efficiently, and they have trained their customers into believing they are purchasing their time. This is a profound misunderstanding of exactly what makes professionals successful, and it has focused the profession on attempting to leverage precisely those things that do not explain its success.

WHY ARE PROFESSIONALS SUCCESSFUL?

Professionals are not successful because they sell hours, because no customer buys hours. This is a very simple concept, but a profound one nonetheless. For approximately two generations the profession has genetically encoded its members with the core belief that they only sell time. But customers don't buy time – they mostly buy results, expectations, good feelings, hope, dreams, a preferred vision of the future, and solutions to problems. No customer seems to care how long it took the manufacturer to produce their car. The notion that all professionals have to offer the customers they are privileged to serve is their time is not only preposterous, it is humiliating and not worthy of a noble calling.

In the final analysis, professionals are successful because they help people achieve their objectives. Mostly, this is a human endeavour and cannot be measured in a satisfaction survey or on a timesheet. Helping customers achieve objectives is done through leveraging your firm's Intellectual Capital, not by mindlessly piling people into a pyramid and trying to leverage hours, which are fixed anyway.

The old theory is no longer relevant to the Critical Success Factors in accounting firms. Buckminster Fuller (designer, cosmologist, philosopher, mathematician and architect) once said, "You can't change anything by fighting or resisting it. You change something by making it

obsolete through superior methods." It is time to replace the Old Practice Equation described in the previous chapter with this new model:

Profitability = Intellectual Capital x Price x Effectiveness

Let us briefly explore each component in the above equation and then illustrate why it is a better theory for explaining the success of firms operating in today's marketplace realities. We start with *profitability*, rather than *revenue*, because we are not interested in growth merely for the sake of growth. As many companies around the world have learned – some the hard way, such as the airlines, retailers and car manufacturers – market share is not the "open sesame" to more profitability. We are interested in finding the right customer, at the right price, consistent with our niche, vision and mission, even if that means frequently turning away customers. I have coined a corollary to Gresham's law (bad money drives out good) from monetary economics, affectionately known as Baker's law: *bad customers drive out good ones*.

Adopting this belief means you need to become much more selective about who you do business with, even though marginal business may be "profitable" according to the conventional practice equation. Accepting customers who are not a good fit for your firm – either because of their personality or the nature of the work involved – has many deleterious effects, such as negatively affecting team member morale and committing fixed capacity to customers who do not value your offerings. This is precisely why the New Practice Equation focuses on *profitability*, not simply top line revenue.

Your firm's ability to create wealth outside of itself ultimately depends on your ability to create and leverage *Intellectual Capital (IC)*. There are many definitions of IC depending on which authority in the field you read. For our purposes, IC is comprised of three primary components:

1. *Human Capital (HC)* – these are your team members and

Our theories determine what we measure. It is theory which decides what we can observe
– Albert Einstein

associates. As one firm leader said, "this is the capital that leaves in the elevator at night". The important thing to remember about HC is that it cannot be owned, only contracted, since it is completely volitional. In fact, I consider professionals to be knowledge workers who own the means of your firm's production, and knowledge workers will invest their HC in those firms that pay a decent return on investment, both economic and psychological. In the final analysis, your people are not assets (they deserve more respect than a copier machine and computer), they are not resources to be harvested from the land like timber when you run out; ultimately, they are *volunteers* and it is totally up to them whether or not they get back into the elevator the following morning.

2 *Structural Capital* – this is everything that remains in your firm once the HC has stepped into the elevator, such as databases, customer lists, systems, procedures, intranets, manuals, files, technology, checklists, and all of the explicit knowledge tools you utilise in order to produce results for your customers.

3 *Social Capital* – this includes your *customers*, the main reason a business exists. It also includes your suppliers, vendors, networks, referral sources, alumni and reputation. Of the three types of IC, this is perhaps the most overlooked and least leveraged, and yet it is highly valued by customers.

This is not a new theory, created during the dot.com revolution. In fact, IC has nothing at all to do with technology per se. Intellectual capital has always been the chief driver of wealth creation. Wealth does not exist in tangible resources – such as timber, land, real estate, oil and so forth – but in ideas and their creative expression. Oil was completely useless – in fact, if you were a farmer it was an absolute nuisance – until man invented the combustion engine.

Professional service firms have few tangible assets; certainly their balance sheets do not measure the most important factor in generating wealth – that is, IC. Yet it is this factor, more than any other, that is the *means* that produces the *ends* which customers purchase, and the fact is that most of it – human capital – exists in a form that cannot be owned, controlled or managed. Professional firms need to understand the profound importance of intellectual capital in order to focus on the right characteristics to leverage, so that they are able to create wealth for their customers.

Next, consider *Price*, which is perhaps the most complex component of the four Ps of marketing. Price is your firm's only opportunity to *capture* the value you create through your value proposition. If you think of the four Ps of marketing as a farmer might, *Product* is your crop, be it wheat, corn, fruit and so forth, or some combination thereof. *Place* is the land where you plant your crop, and *Promotion* is the fertilising, irrigation and watering of your crop. *Price* is where you reap what you sow; it is the harvest. However, unlike farmers who are for the most part – and there are exceptions – *price takers*, professionals are *price makers*, since there is no fixed price for intellectual capital.

Businesses have prices – not hourly rates – and since professional service firms are subject to the same laws of economics and consumer psychology, it is time they recognise that they need to set prices up-front, not quote hourly rates. You would not fly on an airline that attempted to charge you £4 per minute; why do we believe the customers of accountants would not like to know the price of our services *before* they purchase? This is what I call *pricing on purpose*.

Finally, in the New Practice Equation, *effectiveness* takes precedence over *efficiency*. A business does not exist to be efficient; it exists to create wealth for its customers. An obsessive compulsion to increase efficiency (doing things right) reduces the

firm's effectiveness at doing the right things.

It is not that efficiency is bad per se; it is that it has been pursued at the expense of nearly everything else. There is no such thing as a free statistic. To add insult to injury, the efficiency measures that do exist in the professional service firm—billable hours, realisation rates, utilisation—are all *lagging* indicators that measure efforts and activities, not *leading* indicators that measure results and define success the same way the customer does.

SUMMARY AND CONCLUSIONS

I have argued that the Old Practice Equation is not worthy of our noble profession, that it leverages the wrong things and doesn't explain the elements that comprise our success. The New Practice Equation does all of these things and is a worthy paradigm for a proud profession.

Professional firms are intellectual capital organisations, and it is time for them to begin acting as if they understood this fact, rather than trying to constantly enhance efficiency by treating their human capital as if they had no mind of their own, redolent of the days of Frederick Taylor's time-and-motion studies. Humans are not simply machines that exist to bill hours, and the Old Practice Equation keeps us mired in this mentality. I believe we can – indeed, must – do better than the opportunities presented by an antiquated model.

SECTION 3

Measuring What Counts

In the 16th century a new word appeared in English dictionaries – *Pantometry*, which means counting everything. Ever since, man has been obsessed with counting things, from people and sheep, to the amount of tobacco imported and the number of McDonald's hamburgers served. Being able to count and measure is one of the traits separating man from animals.

Today, we have all heard the famous saying – often referred to as the McKinsey Maxim, named after the famous consulting firm – "What you can measure you can manage". This has become such a cliché in the business world that it is either specious or meaningless. It is specious because companies have always counted and measured things, ever since the Italian Fra Luca Pacioli brought double-entry bookkeeping to the world in 1494, and it is meaningless because it does not tell us what ought to be measured. Measurement for measurement's sake is senseless, as quality pioneer Philip Crosby understood when he uttered, "Building a better scale doesn't change your weight".

The problem for the pantometrists is the same one that faces businesspeople today – what should be measured? Blindly relying on measurements can obscure important realities. The ultimate problem with numbers and measurements is what they *don't* tell us, and how they provide a false sense of security – and control – that we know everything that is going on. In fact, one could put forth an argument – running counter to the McKinsey Maxim – that the most important things in life cannot be measured. How do you measure happiness and contentment? How do you measure love, joy, respect or trust? How do you measure the success of your marriage?

Since intellectual capital is the chief factor in wealth creation, the costs that exist in the tangible items of software and silicon – or the paper and binding of this booklet – are a tiny fraction of the value they provide. This is precisely why the cost-plus pricing mentality is less significant in an economy predominantly driven by human capital. Human beings do

Things that matter most
Must never be at the mercy of things that matter least
– Johann Wolfgang von Goethe

not lend themselves to easy measurements. Perhaps we need a corollary to the McKinsey Maxim: "What is really important cannot be measured", what author David Boyle calls the *McKinsey Fallacy*.

Yet this corollary to the McKinsey Maxim will no doubt be met with tremendous resistance. It goes against the very grain of the MBA and accountant mindset – the modern-day pantometrists– who are taught that everything needs to be quantified and counted. The Russian novelist and social critic Alexander Solzhenitsyn once said, "It is a very dangerous thing to speak against the fashion of the times." But I am going to do it anyway.

THE GOSPEL OF EFFICIENCY

The most famous preacher of the Efficiency Gospel was Frederick Winslow Taylor, who observed endless ways to make labourers' work more rational, quantifiable and scientific, writing about the "science of shoveling" and the "law of heavy labouring," topics that today would most likely make for lacklustre book sales, but in Taylor's time ushered in a new era of management thinking.

Taylor became an industrial engineer, testing his time-and-motion theories on the factory floor among his co-workers at the Midvale Steel Company in Philadelphia. He took all the romance out of work; instead of a "noble skill" it was subdivided into a series of simple motions. All of the other aspects of human beings – creativity, initiative, innovativeness and the like – were to be done somewhere else in the organisation, usually the province of upper management, who did the "thinking" while the workers did the "doing". It was Taylor, after all, who replaced the phrase "working harder" with "working smarter".

FREDERICK TAYLOR ENTERS THE PROFESSIONS

Taylor's search for the "one best way" to use labour and material effectively and control productivity (not so much to monitor financial costs) swept all levels of the world's economic and social institutions. The manifestation of Taylor's theories in the professional service firm was the timesheet.

Along with the Du Pont Return On Investment (ROI) formula, legal firms in the United States began using timesheets as early as 1945 as a way to monitor the costs and desired net income from each project. Although the timesheet was originally adopted as a *cost accounting* procedure, it was quickly transmogrified into a tool to measure the *productivity* of the professional and then, ultimately, for *pricing* the professional's services.

Before we challenge the effectiveness of timesheets at measuring productivity and as a cost accounting tool, let us examine how the economics profession was getting into the counting and measuring act.

ECONOMISTS POSIT THEORIES

In the United States Simon Kuznets (1901–1985), a Russian-born economist and Harvard professor, invented the Gross National Product (now commonly known as the Gross Domestic Product) in the early 1940s. Once economists began to measure the economic performance of a national economy, the next logical step was to begin to *forecast* the performance of the economy. In order to do this, economists had to develop a plethora of economic indicators in order to measure where the economy was heading, by looking at where it had been.

Economic indicators provide a snapshot of the economy's health. In the same way that a doctor checks your vital signs, an economist might check the vital signs of the economy by looking at Gross Domestic Product (GDP), the Consumer Price Index (CPI) or the unemployment rate. Unlike management accountants and auditors, who tend to focus on *lagging* indicators – such as a business's financial reports – economists developed not only lagging indicators, but also leading and coincident indicators.

- *Leading indicators* anticipate the direction in which the economy is headed.
- *Coincident indicators* provide information about the current status of the economy.
- *Lagging indicators* change months after a downturn or upturn in the economy.

Why is it that when I buy a pair of hands, I always get a human being as well?
– Henry Ford

This is not to claim that economists can *predict* the future; far from it – some claim the leading indicators failed to predict *any* of the last three American recessions. There is a tremendous amount of history that supports the observation that no one can predict the future.

What the indicators do teach us is how to develop a theory about where the economy is heading. Recall from Chapter 1 that a theory should be able to explain, predict or prescribe certain outcomes or behaviours. Economic indicators are just that – they are theories, testable in the real world to see how well they accomplish those three goals. If the theories are falsified, then they are revised and tested again. It is a much easier task to develop a set of indicators for a business than for an entire economy.

Yet when one examines the major indicators in the business world, and especially the ones focused on by accountants, they are financial indicators such as the balance sheet, income statement and statement of cash flows. These are examples of *lagging* indicators, as they report on where the business has been. This may or may not be useful in determining where the business is headed. Real-time financial statements would rise to the level of *coincident* indicators, since they would track present performance. But what every business should develop is a set of *leading* indicators that would enable it to get a sense of what direction the business is heading in.

ACCOUNTING IS NOT A THEORY

Developing leading indicators requires evolving a set of falsifiable theories the business can test to determine the relationship between those indicators and future financial performance. The accounting profession has simply not taken a lead in this area, largely because *accounting is not a theory*. It is simply a set of guidelines, rules and procedures for measuring financial items such as assets, liabilities, revenues and expenses, grounded by postulates such as relevance, reliability and materiality.

Try this thought experiment. You are the CEO of Continental

Airlines; what leading indicators would you want to look at on a daily – or even hourly or shorter – basis to determine whether or not Continental was fulfilling its mission of flying passengers around the world profitably? It is relatively easy to develop *lagging* indicators, such as profit, revenue per passenger mile, cost per passenger mile, frequent flyer miles earned, and so on. But those are *lagging* indicators, and all of the employees would not be able to influence those results on a day-to-day, or hour-by-hour, basis. How would the baggage handler's behaviour change as a result of learning last month's load factor?

One could certainly develop *coincident* indicators, by tracking all of the lagging indicators mentioned above in real time, and no doubt the airlines do this internally to some extent. Yet that still does not necessarily help the flight crews, baggage handlers or caterers fulfil the goals and objectives of the airline. What are needed are leading indicators that have some *predictive* power – in other words, that anticipate the financial results of Continental. In his book *From Worst to First: Behind the Scenes of Continental's Remarkable Comeback*, Gordon Bethune details how he was able to turn around the failed airline – which had filed for bankruptcy twice in the preceding decade – between February 1994 and 1997, turning it into one of the best and most profitable airlines in the sky. It is a remarkable story, and it illustrates the importance of utilising leading Key Performance Indicators (KPIs) in order to focus the entire organisation on its purpose and mission. Bethune basically tracked three *leading* KPIs:

- On time arrival
- Lost luggage
- Customer complaints

Continental ranked dead last for all of these indicators, which are also measured by the US Department of Transportation. Bethune analysed the problems – and there were many – and discovered the culture of the airline was focused on driving down cost per available seat mile (the standard measure of cost in the airline industry). It cut costs at every opportunity, by packing the planes with more seats, cutting down the food and

drink portions, paying people poorly, and so forth. It believed its mission was to cut costs, but as Bethune constantly pointed out, "We aren't in business to save money – we are in business to put out a good product. … you can make a pizza so cheap nobody wants to eat it. And you can make an airline so cheap nobody wants to fly it" (Bethune, 1998: 123, 50).

A leading indicator, by definition, should measure success the same way the customer does. None of the above indicators would show up on a financial statement, but as the airlines have learned over the years – by testing the theory – they have a predictive correlation with profits. Any indicator that can be taken from a financial statement is most likely a lagging – or at best coincident – indicator, since most leading indicators are non-financial in nature. The other important point about the above three indicators is that every employee of Continental can influence the outcome of each of them, from the baggage handlers and flight crews to the gate agents and reservation operators. It is worth quoting Bethune at length on this vital point:

Don't forget, Continental got what it seemed to want at the time: By saying that cost was the thing that defined its success, Continental's management got everybody to focus on cost. That turned out to be the wrong thing to focus on, though, and they just couldn't get that through their heads. It was what they focused on, it was what they measured, and they simply believed that somehow it would lead to success. That's why, even before the organisation almost gave up the ghost, even when it was still trying as hard as it could, Continental just couldn't find the key to success – because the key didn't reside in cost, and cost was the main thing Continental focused on. (Ibid. 233)

When we're looking for goals for an entire company, we make sure our employees know what we're going for: to get the planes on time, not to aim for a certain return on investment. Goals such as certain equity or debt ratios or interest percentages work fine for the accountants, just as striving to repair a specific number of engines

or reduce the number of seconds before the phone gets answered are goals set for particular departments. But when it concerns the whole company, we need a companywide goal – something that employees can immediately identify. (Ibid. 208)

This is one of the most common problems in businesses. Businesses fail because they want the right things but measure the wrong things – or they measure the right things in the wrong way, so they get the wrong results. Remember? Define success the way your customers define it. (Ibid. 233)

SUMMARY AND CONCLUSIONS

Obviously, the KPIs for the airline industry will evolve over time, since they deal with customer expectations, which are dynamic and not static. Since these KPIs are an actual theory, they must constantly be tested and falsified, and new ones developed to reflect changing market conditions. These KPIs are not only critical for internal management, but they are also becoming information that outside investors and other third parties are interested in in order to assess the health and direction of the business.

To make the task even more challenging, no two businesses will use exactly the same KPIs, although certain standards can be established for an industry, such as the Triple Crown Criteria discussed above for the airlines. Dell Computers, for instance, has developed a customer dashboard that measures three critical success factors for its business: order fulfillment, product performance and service support.

These Critical Success Factors are sometimes referred to as a dashboard because they serve the same purpose as the dashboard in a car: they inform the driver of the key measurements that you want to constantly monitor and are essential to keeping the car moving forward – fuel level, MPH, RPMs, temperature, oil pressure, and so forth. Let us now examine KPIs for an accounting firm.

Key Performance Indicators for the Accounting Firm

The point of the Continental Airlines example in the last chapter is important and goes to the heart of what a professional service firm should measure. Who would suggest that customers of professional service firms define success by how many hours are logged on a timesheet? Is this the right metric to track? What, exactly, does it measure? And why do firms everywhere devote such an enormous amount of time to completing, tracking and printing out reports based upon billable hours?

Let me be clear: timesheets are a *lagging* indicator. They in no way measure the success of a professional in the same manner that a customer does. Before we can measure, we must first understand. Since it is important to recall how customers define the success – and failure – of their accountant, let us re-examine why we lose customers, which I discussed in *Burying the Billable Hour* but want to reproduce here in order to look at these factors from a different perspective – that of KPI development.

According to August J. Aquila and Allan D. Koltin, in their article "How to Lose Clients Without Really Trying", the top seven reasons why people leave their accountant are:

1. **"My accountant just doesn't treat me right."** [Two-thirds of the responses]
2. They ignore them.
3. They fail to cooperate.
4. They let partner contact lapse.
5. They do not keep clients informed.
6. They assume clients are technicians.
7. They use clients as a training ground [for new team members].
   (Aquila and Koltin, 1992: 67-70)

And why people select accountants:

- Interpersonal skills.
- Aggressiveness.
- Interest in the customer.
- Ability to explain procedures in terms the customer can understand.
- Willingness to give advice.
- Perceived honesty.
  (Winston, 1995: 170)

If a professional service firm wanted to develop leading KPIs, shouldn't it study the above factors to determine how it can create KPIs that would either discourage – or encourage – the above behaviour? This requires modelling a theory of factors important to measure and reward.

Fortunately, we have been able to conduct hundreds of workshops on this very issue, and have had professionals brainstorm to come up with KPIs for a professional service firm. Some of these are much better than others, yet they are a superior alternative to timesheets.

It is important to note that there is ample evidence that from *three* to *eight* KPIs should be enough for any business in order to have predictive capability. I wanted to provide enough so that you can at least begin to think in this direction and perhaps develop even better ones for your particular firm. The KPIs are divided between firm-wide and individual team-member KPIs:

Firm-wide KPIs – Velocity

- Turnaround time

Firm-wide KPIs – Financial

- Revenue per person
- Innovation sales
- Net income percentage and profit per partner

Firm-wide KPIs – Pricing

- Percentage of Fixed Price Agreements (FPAs) rejected
- Average difference between initial FPA price and final price
- Percentage of FPAs accepted above the firm's minimum price

Firm-wide KPIs – Customer

- Customer loyalty
- Share of customer wallet
- Value gap
- Customer referrals

Team-member KPIs

- Marginal contribution to firm revenue
- Customer feedback
- Effective listening and communication skills
- Risk taking, innovation and creativity
- Personal development
- Personal marketing plan
- Number of customer contacts per week

I'd rather be vaguely right than precisely wrong
– John Maynard Keynes

It is emphatically *not* suggested that you adopt all of the eighteen KPIs shown here. *Do not boil the ocean*. If you try to measure too many KPIs, you end up knowing nothing, and you have replaced the timesheet with something even more burdensome.

SELECTING THE RIGHT KPIS FOR YOUR FIRM

When choosing your firm's KPIs, do not over-intellectualise the process. You are testing a theory, which will greatly influence what you are measuring and observing. You are looking for KPIs that will measure and reward results over activities, output over input, performance over methodology, responsibilities over procedures, and effectiveness over efficiency. Timesheets measure efforts. But no customer buys *efforts*, they buy results, so we must align our metrics with the desired behaviour.

Let us examine each of the firm-wide and team-member KPIs listed above, and explain their logic, the results they are trying to measure and the behaviour they are trying to encourage.

Turnaround time. Michael Dell likes to refer to the time lag between a customer placing an order for a computer and the company assembling and shipping the finished product as *velocity*. Accounting firms should also be diligent about tracking when each project comes in, establishing a desired completion date and measuring the percentage of on-time delivery. This prevents procrastination, missed deadlines, and projects lingering in the firm while the customer is kept in the dark.

Imagine installing 360-degree webcams everywhere in your firm. Now your customers could log on to your secure website, type in their names and passwords, and the appropriate web camera would find their files and give them a real-time picture of it, probably lying on a partner's floor or side table awaiting review. Would this change the way work moved through your firm? Would this hold the firm accountable for results, not merely efforts? FedEx and UPS do exactly this, and in fact some of the larger law firms utilise intranets that provide their customers with real-time access to

the work being performed on their behalf. Even some day-care facilities have installed webcams so that parents can watch their child(ren) over the Internet while at work. This one metric would go a long way to solving most of the reasons customers defect (not kept informed, feel ignored, and so on).

It is an interesting question whether or not the firm should communicate to the customer a deadline. I have encountered firms that do, and they swear by this policy and say it has improved customer service and communication dramatically. Obviously, the date has to be extended in some circumstances if the customer has not provided all of the information, but it is hard to argue with the results these firms have achieved by informing the customer of the date they can expect their work to be completed.

If that makes you too nervous, a good interim step is to simply set an *internal* deadline and hold the team members accountable for their percentage of on-time completions (better still, have the team decide on the deadline). Turnaround time can be tracked at the firm-wide level, as well as the team-member level. If a particular team member is missing deadlines, it is a good indication that they have been given too much work, do not have adequate training to do what has been assigned, are unclear on the assignment responsibilities, or are simply not up to the job. Whatever it is, the turnaround time provides a leading indicator to firm executives to intervene and correct any problems. The timesheet does not provide this advantage, because once they are analysed the problems are history.

In fact, if you had to be condemned to only *one* KPI for a firm, it should be the turnaround time. It will bring to light – quickly – a lot of the reasons why customers become dissatisfied with their professionals. Every firm that has replaced timesheets with KPIs has implemented the turnaround-time KPI.

Revenue per person. This is a financial KPI and is simply gross firm revenue divided by the number of full-time equivalent team members in the firm (either

There ain't no rules around here! We're trying to accomplish something!
– Thomas Edison

professionals, or the whole team, depending on what type of statistics you are comparing against). This result is then benchmarked against other firms to see how the firm compares to the competition. Although this is a lagging indicator, it can be used to formulate specific growth and revenue goals for the firm's future (hint: any KPI that can be obtained from a financial statement is usually a *lagging* – or if the information is timely enough, *coincident* – indicator).

The natural tendency to divide the revenue per person one more time by the number of each person's billable hours is superfluous. What, exactly, does that say about the firm? Do most firms do it simply because everyone else does? Is not revenue per person just as adequate a comparison? Why break this number down further, especially since no customer buys hours?

Innovation sales. This metric measures revenue from services introduced in recent years, and also the firm's innovation in offering additional services to its customers. It is an essential measurement to determine the life-time value of the firm to the customer, rather than the value of the customer to the firm. For example, Hewlett-Packard wants 50% of its revenue from products that did not exist two years ago. Intel achieves 100% of its revenues from products developed within the last three years. 3M targets 30% from products that did not exist four years ago. Firms spend an enormous amount of resources measuring billable hours and realisation rates, but very few measure innovation sales and make them a key component of their strategic vision.

Net income percentage and profit per partner. Another set of lagging indicators, but useful benchmarks to compare to the competition. Again, we are not just interested in the absolute percentage and profit, but also in the change. Why is it increasing or decreasing? Is the firm making adequate investments in its intellectual capital for the future, or is it consuming all of its seed corn on partner drawings and wages?

Percentage of Fixed Price Agreements (FPAs) rejected. In order to change the firm's culture to one that prices on purpose, this KPI can be used to measure your rate of success – and failure – in implementing the Value Pricing paradigm. The percentage of FPAs rejected is a way to track the firm's success rate in getting customers to enter into a long-term relationship with the firm. Do not fall into the trap of believing the optimal percentage to be 100% – that is a sign you are taking on the wrong type of customer, or not pricing your work in accordance with value. For more information on FPAs and Value Pricing, see *Burying the Billable Hour*.

Average difference between initial FPA price and final price. Another metric to determine pricing for value, and the firm's ability to understand, communicate, convince and capture the value the firm is delivering to the customer. If this gap is too large, it could be a sign the firm is not doing an adequate job qualifying the customer, or determining exactly what the customer needs. It could also signal the firm is not getting enough customer involvement into the design and terms of the FPA.

Percentage of FPAs accepted above the firm's minimum price. This KPI measures the firm's ability to cross-sell more services than simply the core bundle included in the firm's minimum price. In order to do that, the team member negotiating the FPA has to communicate with the customer and understand not only their needs and expectations, but also their hopes, desires, dreams and preferred vision of the future, since these latter wants will compel the customer's willingness to purchase more services.

Customer loyalty. According to studies, fewer than 20% of corporate leaders rigorously track customer retention. For professional service firms, who derive anywhere from 80 to 95% of their revenue from existing customers, this is an enormous omission. Also, when you consider it costs an average of four to eleven times more to *acquire* a customer than to *retain* one, this metric must become part of the firm's value system.

Share of customer wallet. This changes the firm's focus from *market* share and revenue growth to *better* growth and profitability by increasing the percentage the firm derives from each customer's budget for professional services. In order to increase this share over time, the firm must be up-front with all customers that share of wallet is an important part of their long-term relationship. Unless you have a strategic reason for doing so, the firm should not allow its customers to distribute its work among many firms. You should make it part of the expectation with each customer that you want the lion's share of their work over the long term. This ensures a deeper relationship, increased loyalty, premium prices, higher switching costs and greater profitability.

Value gap. This measurement attempts to display the gap between how much the firm could be yielding from its customers and how much it actually is. It is an excellent way to reward cross-selling additional services, increase the life-time value of the firm to each customer, and gain a larger percentage of the customer's wallet.

Customer referrals. Because word-of-mouth is the most effective way to acquire the right kind of customers, referrals from existing customers are a leading indicator that the firm is delighting its existing customers. Also, if the firm's leaders are interested in promoting rainmaking activities at all levels within the firm – and rewarding them commensurately – customer referrals can also demonstrate that the firm is asking its existing customers for contacts they believe could derive the same benefits from doing business with the firm as they do.

Below are individual team-member KPIs. Obviously some of the firm-wide KPIs – such as turnaround time and the pricing KPIs – can be tracked on an individual basis. We are attempting to develop measurements that will shape team-member behaviours in ways that customers value. If we are what we measure, it is time we measured what we want to be. You will notice some of these KPIs are "fuzzy", "subjective" and considered to be "soft measures" by some of the critics who prefer "hard" and "objective" measures

(even if they measure things not important to the customer, such as billable hours). It is as if these critics would rather be totally accurate about the *wrong* question than approximately correct about the *right* question.

Marginal contribution to firm revenue. This is not taking the team-member's book of business or, worse, hours multiplied by rate, but instead it measures the *marginal* contribution they make to the firm's revenue. How many new customers have they acquired? Have they cross-sold any of the firm's services to existing customers? Have they negotiated any FPAs or Change Orders? What price did they realise? Firms claim they want team members to develop an entrepreneurial mindset, but rarely do they measure and reward such behaviour, preferring instead to hold junior team members to stringent billable hour quotas. But one does not develop marketing and rainmaking skills simply by putting in time. It requires resources, education and a firm that holds people accountable for their share of the firm's growth. Not everyone is cut out to be a rainmaker, but every team member can spot Change Orders or cross-sell additional services to existing customers.

Customer feedback. What are the customers saying – good and bad – about the team member? Would you trade some efficiency for a team member who was absolutely loved by your customers? How does the firm solicit feedback from its customers on team-member performance? Does the firm reward team members for delivering outstanding customer service or going above and beyond the call of duty for a customer? Are these stories shared with the rest of the firm so that they can become part of its culture?

Effective listening and communication skills. If reading and writing go together, so too do speaking and listening. Yet is anyone really ever taught to listen? It is well known that speaking and listening are harder to teach than reading and writing, and if we lament the low level of reading and writing being taught in schools, just think how much lower speaking and listening skills must be.

Risk taking, innovation and creativity. Another soft measure, but critical skills for any professional. How often do they take risks or innovate new ways of doing things for customers or the firm? Do they engage in creative thinking when approaching their work? Most firms say they want their people to "think out of the box", but when you look at what they measure and reward there is an enormous gap between what they say and what they do. Wouldn't it be better if innovation and creativity were not viewed as separate from the rest of the business, but rather as an integral part of it? Shouldn't firms work to make innovation ordinary?

This is precisely why 3M implemented the "15% rule" – which encourages technical people to spend up to 15% of their time on projects of their own choosing and initiative. I am met with staring ovations when I suggest professional service firms adopt a similar policy. But who can deny that 3M is one of the most successful companies in terms of profitability and innovation? As Ikujiro Nonaka says in The Knowledge-Creating Company: "Allow employees time to pursue harebrained schemes or just sit around chatting, and you may come up with a market-changing idea; force them to account for every minute of their day, and you will be stuck with routine products."

Personal development. What inspires the team member? Why did they enter the profession in the first place? What is their preferred vision of the future? How is the firm helping – or hindering – their professional development? These are all vital areas if you wish to maintain your human capital investors, who are ultimately volunteers.

Personal marketing plan. Many progressive firms have each team member – at all levels – develop a marketing plan. This may include measuring the number of customer meetings and lunches, joining professional organisations, giving speeches or seminars, writing articles, or revenue goals for cross-selling and new customers.

Number of customer contacts per week. Since two-thirds of

customers defect from accounting firms because of perceived indifference, why not encourage all of the firm's team members to meet regularly with the customers they serve? This is not to say that the first-year team member should lunch with the CEO of your customer, but they could develop a relationship with someone at an equivalent level inside the customer's business. This keeps the firm visible and in front of the customer, will lead to more services and a higher wallet share, develop the communication and listening skills of the team, and increase customer loyalty.

The firms that have got rid of their timesheets and replaced them with some (usually between three and eight) of the KPIs above have also implemented this change in a very rational manner—that is, they involved the team members in the change. Although it is widely believed people do not like change, I believe there is a difference between change *imposed* and change *adopted*. People don't mind change, but they mind *being* changed.

Let the team members decide which KPIs they want to be held accountable for. These are smart, bright, motivated and professional people who want to do an outstanding job not only for the customers and the firm, but also for themselves. They know what the key drivers of success are. The debate about organisational control is not whether or not it is needed – it certainly is – but about how it is best achieved. Imposing controls such as billable hours, which do not have a palpable relationship with customer success, might cause obedience and the minimum level of effort to obtain the standards, but it will not drive firm excellence.

All of the firms that have let the team decide on the KPIs discovered – most of the time to their pleasant surprise – that the team members chose KPIs that were tougher on themselves than the partners would have been. People who select their own goals are usually more demanding of themselves than when those goals are selected for them.

Social controls are far more effective than financial controls at

influencing your team member's behaviour. This explains why most professional firms that have trashed timesheets tend to hold frequent meetings – both on marketing and work-in-progress – at which everyone is held accountable for the selected KPIs. If you know your peers are holding you responsible and answerable for your activities, you are more likely to act in a manner consistent with the wishes of the group.

SUMMARY AND CONCLUSIONS

Jim Casey, founder of UPS in 1907, said in 1947: "A man's worth to an organisation can be measured by the amount of supervision he requires." Isn't it time professional service firms recognise that they are dealing with *knowledge workers* and not Taylor's factory workers? Knowledge work is not subject to the same rhythms and cadences as an assembly line; it is an iterative process of the mind, and the traditional time-and-motion studies are out of place in the modern firm. It is time for professional service firms to remove the *Sword of Damocles* – the timesheet – hanging over the heads of their professionals and unleash them from a theory no longer applicable to the intellectual capital economy. To adapt a phrase from the last lines in Karl Marx's *The Communist Manifesto*: "Accountants of the world unite! You have nothing to lose but your timesheets."

SECTION 5

Refuting the Efficiency and Cost Accounting Defence for Timesheets

Professionals are the ultimate knowledge workers, and knowledge is not defined so much by *quantity* as by *quality*. As I discussed in *Burying the Billable Hour*, it is also not defined by its *costs*. It is defined by its *results*. It may be possible in a widget factory to work harder, but in a knowledge factory working smarter is the only option. In knowledge work, the traditional tools of measurement have been replaced by *judgement*, and there is a difference between a measurement and a judgement – a measurement only requires a stick, a judgement requires knowledge.

Frederick Taylor did not attempt to measure the productivity and efficiency of knowledge workers because there were not very many in his day. He did not focus attention on how to train the worker to do the job better next time, because he developed systems and procedures that removed the need for them to use their imagination. He substituted rules for thinking. It took approximately 50 years before companies began to learn that this made their organisations complacent and stupid – not the traits you want in a car factory, let alone among professionals. Knowledge work can only be designed by the knowledge worker, not *for* them. In a factory, the worker *serves* the system; in a knowledge environment, the system should *serve* the worker.

Productivity measurements for knowledge work are in their infancy; we do not have a modern day Frederick Taylor who has done pioneering research in the field, except, perhaps, for Peter Drucker. Here is what Drucker has to say about knowledge-worker productivity in his book *Management Challenges for the 21st Century*:

> Work on the productivity of the knowledge worker has barely begun. In terms of actual work on knowledge worker productivity we are, in the year 2000, roughly where we were in the year 1900, a century ago, in terms of the productivity of the manual worker. But we already know infinitely more about the productivity of the knowledge worker than we did then about that of the manual worker. We even know a good many of the answers. But we also know the challenges to which we do not yet know the answers, and on which we need to go to work. (Drucker, 1999: 142)

Drucker believes the main focus of the knowledge worker needs to be

Was Einstein "on budget" for his research?
Who knows? Or cares?
– Tom Peters

on the task to be done – with all other distractions eliminated as far as possible – and this is defined by the worker him – or herself.
Whenever I meet with firms, I ask the following questions of the team members and learn a great deal about the organisation:

- What is your task?
- What should it be?
- What should you be expected to contribute?
- How fair are those expectations?
- What hinders you in doing your job and should be eliminated?
- How could *you* make the greatest *contribution* with your strengths, your way of performing, your values, to what needs to be done?
- What *results* have to be achieved to make a difference?
- What progress are you making in your career?
- How is the firm helping you to achieve your professional goals and aspirations?
- What does the firm do right and what should it continue doing?
- What are the firm's weaknesses and what should it stop doing?
- What critical things should the firm start doing?

These are excellent questions for firm leaders to ask the team members periodically. Between the KPIs from Chapter 4 and these questions, the firm will be able to focus its resources and attention on external opportunities, rather than on internal bureaucratic procedures, rules and systems that probably do not add much value to the customer experience.

So many firm leaders seem frightened at the thought of removing timesheets; they feel as if they are relinquishing total control over their team. Worse, they believe that the suggestion to get rid of the timesheet is giving the team members total freedom, and will create anarchy in the firm. But I am not suggesting freedom for people "to do their own thing"; that is not freedom, it is *licence*. With KPIs, you *are* holding people accountable for the *results* they achieve, hardly a prescription for anarchy and chaos. When firm leaders feel they need to tightly control a knowledge worker, they have made a hiring mistake.

To reiterate, the three major defences of the timesheet are:

1 Pricing tool
2 Productivity and efficiency tool
3 Cost accounting, or Activity Based Costing (ABC), tool

I have refuted the first two of these defences, and now will focus on the third.

REFUTING THE COST ACCOUNTING DEFENCE FOR TIMESHEETS

This chapter has put the timesheet on trial for its life. The cost-accounting defence of timesheets is perhaps the strongest of the three major defences put forth – but it is not impervious from prosecution. Let us recall how the *standard hourly rate* in accounting firms is calculated:

$$\textbf{Hourly Rate} = \frac{\textbf{Overhead + Desired Net Income}}{\textbf{Expected Billable Hours}}$$

The first fact to note is that the above is not cost accounting, it is *profit forecasting*. There is no cost accounting that allocates desired profit – or a return on investment – among its costs. That is an opportunity cost concept, and while economists may use that theory, cost accountants do not. Once you remove the desired net income from the above equation, it becomes apparent in the first order that the hourly rate would drop by one-third to one-half, or perhaps even more, depending on the net income percentage of the firm. Given this reduction, it becomes apparent in the second order that it is very difficult to actually *lose* money in a professional service firm on any customer or project. Hence, the more relevant question firms need to be asking is not "Did we make money on this customer?" – chances are extremely high you did – but rather "Did we *optimize* the profit from this customer?" The above equation – or cost accounting or ABC – cannot answer that second question.

This is not to say losses do not happen, but they are more the result of pricing errors and scope creep than of too much overhead being allocated to the job. As was pointed out in *Burying the Billable Hour*, the price drives the cost, and if the firm loses money on any one customer, it probably priced – or forecast its internal costs – incorrectly. Despite the argument, most firms are not using timesheets for cost accounting purposes anyway; they use them to price. And since pricing mistakes and lost opportunities do not show up on cost accounting or realisation reports, the firm gains no new

knowledge for how to price better in the future. Firms can increase profitability much more with better pricing than with accurate cost accounting.

Engage in this thought experiment: it is day one of your fiscal – or calendar – year. Your firm for the next year is going to have the exact same customers, for whom you will do the exact same work, at the exact price as last year, and with the same cost structure as last year. If you adopted Fixed Price Agreements – there would be no Change Orders since you are not going to be selling additional work – for all of those customers and set them up on payment terms, would you need timesheets in order to know you are profitable? The answer is no.

Expand the experiment. For every new customer, or every Change Order on an existing customer, you price it utilising the philosophy given in *Burying the Billable Hour*, pricing on purpose, up-front and for profitability. You enhance your firm's value proposition, you offer payment terms and reduce the need to send out invoices, offer a service and price guarantee, bundle your services, and so forth, is there any doubt in your mind that you will be able to price at a higher level of profitability than the billable hour? Your income statement will show your profitability. Yes, it is a *lagging* indicator, but so are timesheets. Your selected KPIs will become your *leading* indicators and will correlate with firm profitability.

SUMMARY AND CONCLUSIONS

When you reward people for billable hours, you get billable hours, even if those hours logged on the timesheet are outright lies or are worthless in terms of creating results for the customer. You also create an incentive measurement that will verify C. Northcote Parkison's law: "Work expands to fill the time available." Any of the team-member KPIs outlined in Chapter 4 would do a superior job in determining the worth of an associate than simply looking at billable hours.

Andrew Carnegie's favourite saying was: "Watch the costs and the profits will take care of themselves." In the accounting firm, I would replace that maxim with: "Watch your price and your leading KPIs, and the profits will take care of themselves."

SECTION 6

Not Last Words

Peter Drucker suggests that for a business to be truly innovative it must not only do *new* things, it must stop doing *old* things. It is not possible to create tomorrow unless one first gets rid of yesterday. The human body has an automatic mechanism to discharge waste, but the corporate body does not – that requires leadership and vision. It requires every policy, procedure, service and activity to be put on trial for its life, every two to three years, by asking the following questions: "If we didn't do this already, would we go into it the way we are now? And if the answer is no, then the question is, What would we do?" (Drucker, 2002: 71).

Knowing what you now know about the deleterious effects of pricing by the hour, and using timesheets as a lagging indicator of firm performance, is it not time to abandon these procedures and activities? The physicist Max Planck once said, "Science progresses funeral by funeral." I do not think a profession would progress by shooting its oldest members. It is too simple to say people do not like to change—people love change if it brings hope of a better future. It is time for us to change what we measure in the accounting firm of the future.

No one is able to predict the future, and only a fool tries. But we can influence the future based upon the decisions and choices we make. The world is not controlled by the ever-swinging pendulum of history, or some outside fate. We create the future by the actions we take today. The Berlin Wall did not fall because of inclement weather – it was *pushed*.

Removing timesheets requires leadership and a vision. It requires knowing you are doing the right things, not just doing things right. It is focusing the firm on the external results it creates for the customer and simultaneously building the type of firm people are proud to be a part of and contribute to. It requires a sense of dignity and high self-esteem that you are worth every penny you charge, and you will only work with those customers whom you like and respect and who reciprocate those feelings. It requires an attitude of

When somebody persuades me that I am wrong, I change my mind.
What do you do?
– John Maynard Keynes

experimentation, and not simply doing things because that is the way it has always been done. It requires less measurement and more trust.

On his deathbed in a shabby Dublin rooming house, Oscar Wilde cocked an eye at the horrible wallpaper and said, “One of us has got to go.” These were purportedly his last words. Fortunately, these are not my last words on this topic and, make no mistake, the timesheet has got to go.

I offer this theory in the spirit of a scientific hypothesis, and realise it will be subject to criticism, misunderstanding, rejection, exploration of alternatives and, after a while, clarification, grudging acceptance and finally incorporation as part of the conventional wisdom. Then I hope it will be supplanted by a better theory. I only hope to live long enough to see this process unfold.

A Firm With No Timesheets – Profile

We were frightened of trashing our timesheets. As a general practice working for owner-managed businesses, everyone in our practice of ten professionals had grown up with them; it was what people in practice did. Over the years we had developed very good patter explaining how time-cost billing worked, why it was best and – we were very good at this – why fixed prices were bad. I had often told other accountants the single best investment we had made was our time and fees software. We even persuaded certain clients that they needed to record time, otherwise how could they know what the profitable jobs were, and who was and wasn't pulling their weight?

So when first introduced to Ron Baker in March 2000, initially by reading his book *Professional's Guide to Value Pricing*, now in its fourth edition, and shortly afterwards hearing him speak at an event, I was deeply unsettled. He was very persuasive and made sense as he talked and described a world of fixed prices, guarantees and – horror of horrors – no timesheets. I read his book again and had the opportunity to discuss (argue, really) many of the points with him over the next couple of years (he is indubitably the world's best replier to e-mails).

We didn't see why we had to adopt everything he advocated. He seemed to be right about fixing prices in advance. We had long noticed clients' resentment to the blank cheque approach of professional pricing, and started to introduce fixed prices and adapted his example Fixed Price Agreement (FPA). However, we still had timesheets and so could track the success of this experiment. It took us time to even try FPAs, initially just using them on new clients or on one-off assignments. But once we committed to having them firm-wide, we had all but a handful of clients on them within a year. Some clients were somewhat suspicious of FPAs, partly as a result of our training them as to the benefits of time-cost billing. The overwhelming majority welcomed fixed prices for agreed assignments – and turnaround times. "About time, too" was the single most common reaction when we told them we were going to fix all these things in advance.

We had been using FPAs for around 18 months before we decided to discard timesheets. We had some successes but several failures – or losses – on jobs with FPAs. Being accountants and never wanting to take a loss on anything, we, of course, scrutinised the losses. We found three causes:

- Outrageous optimism/myopia on our part.
- Not holding clients to what they said they would do.
- Scope creep, being of two types:
  - Misunderstanding the client expectations of what we were to do and then being made to do it; and
  - Blithely doing more than we contracted to perform.

Of course, the way we recognised our losses (especially the blithe ones) was by looking at our time records and wondering how on earth so much cost was on a job. The big revelation (“epiphany” in Baker-speak) was our abject disappointment that one particular “good job”, a £25,000 management advisory, training and accounts job, made a £2,000 loss.

Our post-mortem analysis here showed that wilful scope creep (“this is such a profitable job, I’ll just do this one more thing”) poured time on to the job needlessly. This extra work did add value to the client, but we did not capture any of the value created by utilising “Extra Work Orders”, our name for Baker’s Change Orders. But even that did not cause the loss, it just stopped us making a profit. The root problem was that a qualified manager did work that a junior could and should have done. (This may never happen in your firm, but sometimes we mis-schedule, have insufficient resources of the right type available, etc.) Thirty or forty hours were recorded on this job at £96 (don’t ask me why £96!) per hour that should have been less. Fact is, we do not actually pay our managers £96 per hour. The whole “loss” was spurious, just as Baker argues, because it included a “Desired Net Income” factor. We made money on the job – of course we did – but the timesheets led us to believe otherwise.

Holding on to timesheets after introducing FPAs had led us to recognise scope creep – albeit after the fact – and to be attentive to clients' expectations and their obligations to provide us with information. But it finally dawned on us that all of those things should be dealt with *before* the work was done. Timesheets were a crutch, but one that was holding us back.

We understood we should price independently of timesheets. What surprised us was that timesheets did not help us with our profit forecasting or profit recognition. Maybe we were too analytical about this, but once FPAs were in place firm-wide we realised just how inadequate a measure of value timesheets were.

They were also inadequate measures of costs. Accountancy firms have fixed costs. Our task is to consider how to allocate the resources bought by those fixed costs. The introduction of FPAs taught us how to discuss value with clients for a given outcome. We recognised that it was our task to design the cost structure to meet the price – the opposite of the "blank cheque" approach of hitherto.

The last possible reason for holding on to timesheets (odd that we so desperately wanted to hold on to them: nature abhors a vacuum?) was for work-in-progress valuation. Timesheets and time recording had given us something to fix on as the amount of value created in a given period, be it a day or a year. They gave a way of assessing work-in-progress at the month end, which we then adjusted for known write-downs (never write-ups, of course; timesheets don't help capture the extra value you create).

We realised that we had to talk with our team about what work was going to be done, by whom, and when we could expect to complete it. Otherwise how could we be sure when to recognise profit? We went so far as to suggest that if we wanted to make life easy for ourselves, wouldn't it be best if we could start and finish any given assignment within a calendar month, thus assisting profit recognition? This, serendipitously, gives clients exactly what they want:

predictable and (compared with the past) quicker turnaround times. So our firm decided to track the following KPIs:

- Value *expected* to be created in the month;
- Total contracts WIP at start and end of month;
- Average turnaround time of jobs.

We were severely tempted to do more, but resisted. Now we do the timesheets in *advance*: "XYZ company audit to be finished this month? OK, let's put the resources on it so by month end it is 100% complete." Of course the more we do this, the more we recognise our work for clients as being the fulfilment of contracts, for which we require certain resources at certain times.

We learned from experience and mistakes somewhat slowly, but we are now so confident that we can plan our work and capacity sufficiently in advance, that we could abandon timesheets. In effect, we complete the timesheet *before* we do the work, and then use the turnaround time KPI to track – on a real-time and leading basis – our firm's velocity. Thus from 1 July 2002 we became a firm of accountants not using timesheets for pricing, nor for project or team evaluation (not that we ever did, but we always thought we could).

We are now in a position where "no timesheets" attracts clients and prospective recruits (think about it!), and the partners, team members and bank manager love it. Our clients welcomed fixed prices so much that we arranged the payment terms so that we are paid almost entirely in advance. We now have negative lock up (20% – 73 days – of our annual income is prepaid) and at the start of the month the team agrees which jobs will be completed in the month and thus what income earned.

I know that what you've read in this booklet sounds unsettling, even scary. I've been there, gone through it, and have now emerged on the other side. I had the benefit of Ron Baker constantly berating me for holding on to the antiquated timesheet, and we had some major arguments over this issue. Once he developed the KPIs presented in this booklet, we

decided to take the leap of faith and abandon timesheets.

You now have the same opportunity. I have yet to meet an accountant who likes completing their timesheet. And since no customer buys time, and does not measure the success of their accountant based on time, why do we all continue to hold on to a practice that is not relevant to our success—and injurious to our relationships with our customers? I commend Ron Baker and his ideas to you. He has helped our firm with his insights, logic and passion. We could not be sure, in advance, that we were right to abandon timesheets, so to some extent we took a leap of faith. Not a very big leap, because we could always bring them back, but it was uncomfortable abandoning something everyone else was doing. Now we scoff at timesheet-padding scandals, we tell clients and referral sources that we don't do timesheets, and we certainly tell recruitment agents and potential recruits.

We love not having timesheets and will never look back!

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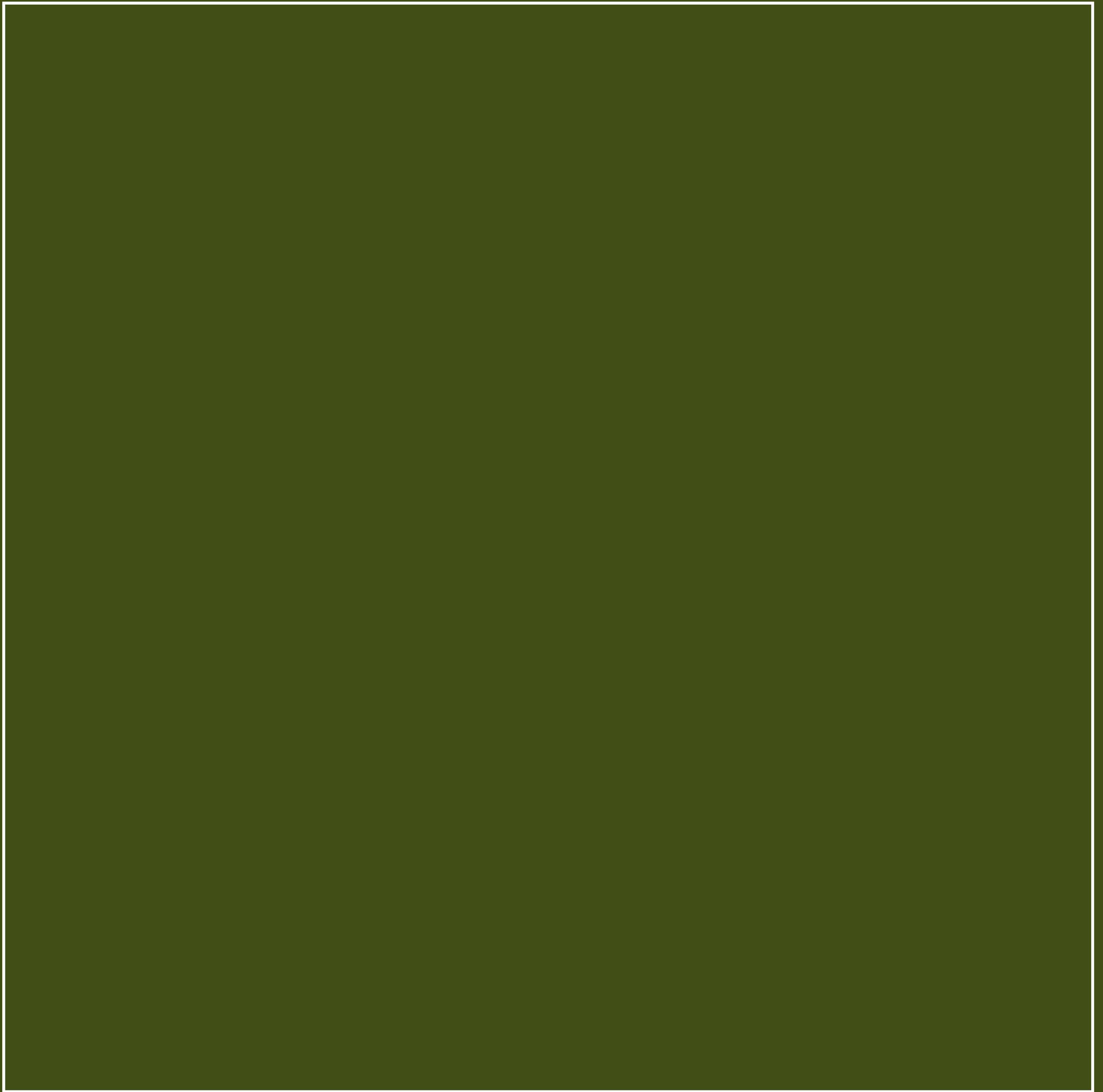

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