It’s About Time

by David Elam

Many A&WMA members are employed by consulting firms; others are employed by industry or regulatory agencies and may hire consultants or transition into careers in consulting. Given the importance of consulting in the environment, health, and safety (EH&S) project management field, it is appropriate to address issues that are unique to project managers in the consulting field. The goal of my next several columns is to help members of the EH&S community better understand the financial aspects of consulting firm operations and management. Accordingly, these columns will provide information that helps professionals advance their careers if they are in consulting, better manage their projects if they hire consultants, and equip those who are considering consulting careers with insights that will improve their prospects for success should they make a transition to consulting.
Consultants sell solutions by allocating professional and technical time to the investigation, understanding, and resolution of a client's specific problem or need. Although there are several different compensation models, consulting firms generate their revenue by charging for the time that is spent developing solutions. There are 52 40-hour work weeks in a calendar year, resulting in 2,080 available work hours if overtime, vacation, and holidays are not considered. In the course of a work week, consultants will divide their time between project and non-project work. Non-project work includes, but is not limited to, management of the firm and staff, administrative tasks, performance reviews, career planning, training, and business development. Effort spent on project work is typically referred to as “direct labor” and effort spent on non-project work is typically referred to as “indirect labor.” Direct labor generates revenue for the firm. Indirect labor does not generate revenue for the firm, but is expected to produce value for the firm in other ways.

As we’ll examine in more detail in the next column, the management of direct and indirect labor is critically important to a consulting firm and one of the primary metrics the firm will use to track performance. Thus, individual consulting firm employees will have direct labor goals that vary with their roles. Technical professionals actively involved in project work may have very high direct labor goals. On the other hand, individuals involved in the management of the firm or business development may have minimal or no direct labor goals.

Consulting firms can establish direct labor goals for employees in different ways. Some firms may simply assign a direct labor goal in hours (e.g., 36 hours per week or 1,872 hours per year). Other firms may assign a chargeability, billability, or utilization goal. These goals, in their simplest form and expressed in percentages, are calculated by dividing the direct labor hours by the total hours worked and multiplying the result by 100. In the case of employees working 36 direct hours in a 40-hour work week, their chargeability, billability, or utilization would be 90 percent. Consulting firms typically monitor direct labor weekly, which can often be a source of stress for employees and their managers, particularly if there is a lull in project work.

The value of direct labor is easy to understand. It represents a client’s financial investment in a solution to a problem or an effort to satisfy a need. With respect to the consulting firm, direct labor produces the revenue that sustains the firm. Direct labor is good. But a firm cannot survive on direct labor alone.

The value of indirect labor is a bit more difficult to understand, perhaps in part, due to its association with “utilization.” Over the years, many colleagues have indicated that they feel “utilization” is synonymous with “value” or “productivity.” When employees do not meet their utilization goals, some may feel they are viewed as valueless or nonproductive. However, this perception is far from the case. Managed correctly, indirect labor is an investment in the firm. Thus, indirect labor represents the firm’s highest level of investment. Accordingly, employees should charge indirect labor hours to the firm with the same spirit and dedication that they would when they post direct labor hours to project work. Success of both the firm and employee are achieved when indirect labor is invested in staff development, thought leadership, productivity improvement, and business development. Employees who understand the consulting revenue model and the value of indirect labor will work closely with their supervisors to ensure that their indirect labor is aligned with the growth objectives of the firm.

Employees who do not have direct labor goals or who have reduced direct labor goals are evaluated in other ways. Management is responsible for the financial performance of the firm, administrative staff is responsible for the proper and timely completion of administrative duties, and business development staff is responsible for selling work. Successful firms will use indirect labor to create, sustain, and advance an environment that enables employees with elevated direct labor goals to achieve them. Thus, a firm will build a team of employees with varying direct labor goals to work synergistically to create a viable and sustainable business.

Consulting firms incur costs beyond employee salaries. Costs that are allocable to projects such as car rental, airline tickets, meals, or field supplies, are direct costs. Costs that are not allocable to projects such as rent, utilities, benefits, or marketing, are indirect costs. Consulting firms track and manage direct and indirect costs closely for the same reasons that they track and manage direct and indirect labor.

Direct and indirect labor and expenses are both critical components of the business model for a successful EH&S consulting firm. In the next column, we’ll explore how direct and indirect labor and expenses work together to establish the firm’s billing rate for its employees.