Why Service Businesses Must Track Employee Utilization Rates

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Manufacturers make or create products to sell to customers, but service businesses sell customers something a little less tangible. While manufacturers keep careful track of their product inventory, service businesses need to track a different kind of inventory: the *time* employees spend working that can be billed to clients.

This measurement of time is known as the employee utilization rate, and it's absolutely critical that service businesses track and strive to improve this key performance indicator. What you want to determine is the total number of hours billed to clients compared to the number of hours employees work. The higher this number, the higher your employee utilization rate — and the higher your company's efficiency in generating billable hours.

Higher Utilization Rate = Higher Revenue

Employee utilization is a key measure of both corporate and individual employee productivity and efficiency. Increases in the utilization rate usually translate into increases in company revenue. Tracking the utilization rate can also alert you to slippages in productivity so you can take action quickly. There are two methods for calculating your employee utilization rate:

1. Divide the total number of billable hours by a fixed number, such as 40 hours per week. For example, if your employee worked 55 hours and you were able to bill 45 hours last week, the utilization rate would be 112% (45/40).

2. Divide the total number of billable hours by the total number of hours worked by the employee during a given period of time. So again, if your employees worked a total of 55 hours last week and you were able to bill clients for 45 hours of work, the utilization rate would be 82% (45/55).

The difference between the two methods is the denominator. The numerator is always the total billable hours. In the first method, the denominator is a fixed number or 40 hours per week. The total hours or 55 hours worked by the employee is not part of the formula. In the second method, the denominator is a variable number, and it is based on total number of hours worked by the employee or 55 hours.

Tracking, monitoring and measuring utilization rates can help your company address a number of different business challenges:

- High employee turnover rates (especially of top performers) and over- or under-worked employees.
- Dissatisfied employees due to unrealistic estimates of deliverables or project completion dates.
- The inability to manage customer expectations.
- Poor decision making, especially during economic downturns.

It's important to remember that improving your utilization rate is not about working more *total* hours — it's about working more hours that can be *billed* to your clients. Or in other words, it's about working *smarter* rather than *longer*. Also remember that striving for 100% employee utilization probably isn't realistic: There are always going to be tasks employees have to perform that cannot be billed to your clients, including customer service duties and administrative tasks such as billing, recordkeeping and HR functions.

You can gauge your utilization rates both corporately and at the individual employee level in order to measure different areas of your company's performance. At the corporate level, monitoring and measuring utilization rates will tell you how efficient and productive your entire workforce or a particular department is. Using this data, you can determine whether steps should be taken to improve overall productivity and what these steps should be.

At the employee level, utilization rates will give you a good idea of the efficiency and productivity of each of your team members. This way, you can easily identify employees who may need some help or additional training to increase their productivity, as well as "star" employees whom you can reward and incentivize to be even more productive and profitable. If layoffs are ever required, tracking utilization rates will give you hard data you can use to determine which employees are the least efficient, productive and profitable and thus probably the ones who should be let go first.

Your company can realize a number of benefits by properly using employee utilization rate data. Monitoring and measuring this data can:

- Help support decisions regarding pricing increases or decreases and contribute to customer, segment and company-wide profitability analysis.
- Improve business planning, especially with regard to resource management.
- Boost revenue by increasing billable hours.
- Help employees see how their individual goals (like increasing their utilization rate) tie directly into corporate goals (like increasing profitability).
- Help identify workflow inefficiencies and steps that can be taken to correct them.

An outsourced CFO services provider can help you measure and monitor your utilization rate and put the data to use. This includes implementing an appropriate timesheet system for tracking employees' time, defining the appropriate variables for measuring utilization and productivity, benchmarking your company's utilization rates against your competitors and peers, and determining appropriate goals for your utilization rates.

Concluding Thoughts

It's important for service businesses to monitor the time employees spend working that can be billed to clients — a measurement that's known as the employee utilization rate. The higher the employee utilization rate, the more efficient a company is in generating billable hours and increasing revenue and profitability. Therefore, it's critical that service businesses track and strive to improve this key performance indicator. An outsourced CFO can provide valuable assistance in your utilization rate analysis efforts.

About CFO Edge

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