EXTRACT

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STRATEGIC PLANNING PROGRAMME

MAY 2015

Part 2: New business models

BASED ON QUANTITATIVE MARKET ANALYSIS FROM MULTINATIONAL ORGANISATIONS

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Contents

Methodology

This report is based on quantitative research. We conducted an extensive survey in December 2014 – January 2015 with senior users and buyers of consulting services.

Survey

We surveyed just over 2,600 senior users and buyers of consulting services in 14 major consulting markets in North America, Europe, the Middle East and Asia Pacific. 56% of respondents work in organisations with more than 1,000 employees (the percentage is higher in mature markets where large corporations are more numerous). Respondents are distributed across operations, general management, sales and marketing, IT, finance and HR. They represent nine sectors: energy and resources; financial services; healthcare; manufacturing; pharma and biotech; the public sector; retail; the services sector (including transportation and construction); and technology, media and telecoms.

The increased scale and scope of our survey creates potential problems in comparing this year's data with last year's. Our experience is that there's not a lot of variation in the way relatively large organisations use consultants, but there are some cases where our sample has had an impact and we highlight these.

The role of this report in our series

This is the second in a series of six reports we will be publishing during the course of 2015 which will use a combination of feedback from clients and consulting firms to analyse the underlying trends shaping the consulting industry over the next 12 months.

The publications in this series are:

SPP1: Forecasts for 2015

This report analyses the prospects for growth in the global consulting market as a whole. The first section looks at the conditions for growth for the energy and resources, financial services, manufacturing, healthcare, retail, services, technology/media/telecoms and public sectors. Section 2 considers how clients' needs are impacting demand for strategy, operational improvement, HR, technology and financial management/risk consulting.

Our concluding section provides forecasts for global consulting demand by sector and service, and analyses the implications for consulting firms.

SPP2: New business models

Is the consulting industry on the cusp of disruption? Most of the firms we speak to think so. So do the multitude of start-ups in the last year that claim to specialise, not in a particular sector or service, but in an innovative way of delivering consulting services. But consulting remains the quintessential 'people business' – and people change far more slowly than technology.

This report examines new business models from two perspectives. On the supply side, the associate model is now well-established, but technology is changing the way consulting firms win work and allocate resources. Changes to the demand side have been few and far between – yet this may be the real driver of disruption.

SPP3: Risk and regulation

Regulatory-driven work has been one of the key sources of growth in mature consulting markets, but there are early signs that demand has peaked and that familiarity may even be breeding a degree of contempt. Risk consulting, though, appears to be at the start of unprecedented expansion and diversification, embracing everything from cyber security (perhaps today's hottest topic) to preventing reputational damage.

This report will explore the size and future shape for the risk and regulation consulting market, comparing clients' views with the response of consulting firms.

SPP4: Trends in procurement

For the sixth year running, Source will be analysing how attitudes to buying consulting services are evolving in one key stakeholder group, procurement professionals. Past reports have highlighted the need for procurement teams to act more as business partners, providing more informed and expert advice. They've also analysed the prevalence of preferred supplier lists, the factors procurement people take into account when short-listing consulting firms, and pricing. Further detail about this year's report will be made available in due course.

SPP5: Planning for growth in 2016

Our third annual market attractiveness index, which assesses each geographical market for the next 12 months in terms of things like: the rate of growth in the market, how easy it is to find and retain talent, how much revenue the average consultant can expect to generate, and the propensity amongst clients to use consultants.

SPP6: The interface between technology and management consulting

Digital is changing consulting, breaking down the traditional boundaries between services. Can you develop a business strategy without considering the opportunities new technology may bring to change operating models? Is strategy technology-enabled, or is technology business-led? How clients answer these questions will determine which types of firms they'll use in the future. How consulting firms respond will determine their success or failure.

This report will look at just how porous the boundary is between technology and management consulting and examine the different opportunities and threats this creates for consulting firms.

Definitions of sectors and services

Sectors	Sub-sectors
Energy and resources	Includes utilities
Financial services	Includes banking, insurance, investment and capital markets
Manufacturing	Includes construction
Pharma and biotech	
Private and public healthcare	
Public sector	Includes federal/central and state/regional/local government, state-owned organisations and education
Retail	
Services	Includes business and consumer services, real estate, professional services, transportation
Technology, media and telecoms	

Services	Sub-services
Financial management and risk	Responding to regulation
	Finance function
	Budgeting/financial planning process
	IT risk
	Operational risk
	Financial risk
	Programme risk
HR and change management	HR strategy and effectiveness
	Benefits, compensation and pensions
	Change management
	Internal communications
	Organisational design and culture
	Stakeholder management
	Team effectiveness and collaboration
	Leadership and governance
	Performance management
	Talent management/training and development
Operational improvement	Business continuity and recovery
	Knowledge management
	Lean and six sigma
	Property and estate management
	Quality and performance management
	Supply chain management
	Cost-cutting
	Innovation
	M&A integration
	Managing quality
	Post-M&A integration
	Process design and re-engineering

Services	Sub-services
	Procurement/purchasing
	Research and development
	Benchmarking
	Distribution strategy
	Environmental, sustainability and CSR
	Operational review
Strategy	Business and financial modelling
	Corporate re-structuring
	Corporate recovery and turnaround
	Corporate strategy
	Market analysis and strategy
	Market research
	Policy formulation
	Strategic sourcing/ offshoring strategy
	Due diligence and valuation
	Infrastructure/asset financing and management, PFI
	Mergers and acquisitions
	Customer service
	New product development
	Branding
	Marketing and channel management
	Customer relationship management
	Pricing
	Sales force effectiveness
	Category management
	Sales and distribution planning
Technology	ERP consulting
	IT training
	Application of new technology
	Hardware/software selection
	IT design and build
	IT strategy, planning and review
	IT testing and integration
	Management information and business intelligence
	Technology and security risk services
	Hardware/software and systems implementation
	Requirements definition
	Web and internet consulting
	Project and programme management (eg where consulting firm has been engaged to run a specific project which it is otherwise not involved in)

Section 1: Introduction

String theory for consultants

Our business model has changed in many ways over the last 20 years. The consulting business model has stayed the same: if the industry is going to keep pace with our needs, it needs to reinvent itself.

COO, services sector, US

That, in a nutshell, is what this report is about.

No one would argue that there isn't mounting pressure for change. From a client's point of view – and the COO quoted above is typical of many – the pyramid structure of a consulting firm, modelled originally on the way law firms work, is wholly unsuited to a world in which large-scale transformation projects stretch across organisations, continents, and years. By spreading the input of the most senior and experienced consultants across a range of projects by supplementing their time with that of junior, less-experienced consultants, conventional consulting also fails to deliver the depth of specialist expertise clients (who themselves are increasingly likely to be former consultants) are demanding. That unsatisfactory organisational model relies on time-related pricing mechanisms either explicitly (through traditional time and material billing) or implicitly (via fixed price and even risk-reward contracts that are still calculated on this basis) – and that sits uncomfortably with clients who think that, at least in theory, it should be possible to fund consulting projects out of the savings made or the new revenue generated. Even where the fees seem reasonable, clients are querying the value added, particularly with regard to sustainable change: consultants come and go, but what do they leave behind? Do they support success or create dependency?

And it's not just clients who are complaining. The same pyramid model that frustrates them is also a source of grief to the people who run it. Most firms run at fairly stable levels of utilisation (though the actual rate varies from firm to firm, based on a whole variety of factors). Small increases can yield high levels of profitability, but equally small decreases can result in quite dramatic losses. Running a consulting firm can feel more like flying a fighter jet than a 747 – which isn't ideal when the economic environment is capable of delivering some fairly hefty bumps. Outside of a handful of high-growth markets, the consulting industry is only just recovering from a financial crisis that saw fee rates fall by around 15% on average. It's now also seriously short of good people and is being forced to pay over the odds for those who might otherwise be tempted by the glamour and stock options a technology company can offer. The need to provide cost-effective services has forced firms to industrialise, to offshore, and to sell more aggressively – none of which endear them to their most senior and potentially valuable clients. Like their clients, the challenge for consulting firms is finding ways to grow that don't involve ramping up costs to unsustainably high levels – and in the consulting industry, that all comes down to how to make more money from the people you have (rather than simply recruiting more people).

All of this is coming to a head at the moment because of a new factor: the bifurcation of the consulting industry into two distinct parts.

Imagine, if you will, the consulting industry as a piece of string. At one end, there's what we could term low-cost consulting – the delivery of a familiar service. Price matters here because these are essentially commodity services: many firms are seen to be capable of delivering them, and there's little difference between what they offer, so the opportunity for substitution is high. For consulting firms working in this space, the key to success is being able to deliver a reasonably high-quality, dependable service for a low and predictable cost. At the other end of our piece of string is high-value consulting: this is less familiar territory for clients, and the work typically involves multiple stakeholders in different parts of their organisation. Because the outcome is less certain (it's the 'unknown unknowns' of Rumsfeldian philosophy), you can't standardise the process, and success depends instead on multidisciplinary teams working together. It's a more cerebral activity, too: this is almost classic management consulting in which smart and informed people have to analyse data (and increasingly this is 'big' data) and facilitate discussions with their equally smart and informed clients.

Both models are viable. Indeed, before you run off after the high-value prize, it's worth bearing in mind that the low-cost market is by far the bigger of the two, having been the major source of growth for the consulting industry for the better part of a decade. But what you won't see so much at the low-cost end is growth. Today, when we speak to clients, we get a strong sense that their attention, investment, and even their emotional focus is being directed towards the high-value end, driven by a combination of technology, consumer, and macro-economic changes. This uncertainty, coupled with huge pressure to find new sources of growth, appears to be the enduring legacy of the financial crisis.

As the string stretches towards breaking point

Some would argue that this is nothing new, and it's true that there's always been an element of polarisation in the consulting industry – commoditisation has long snapped at the heels of short-lived innovation. But we'd argue that there are four significant differences that suggest a substantial shift is in the works.

The speed with which these two markets are moving apart: One of the first questions we ask the clients we interview is to describe how they use consulting services. Whether they're a CIO, CFO, CMO, COO, CHRO, or any other member of the illustrious C-suite, they increasingly preface their comments with the phrase, 'We use consultants in two ways…' Though they may not articulate the difference between these two ways as low-cost versus high-value, we inevitably find that's essentially what they're talking about. We further find that clients don't want to buy these two types of consulting from a single firm – in fact, the greater the distance clients see between the two markets, the more likely they are to think that a firm working in one market can't be credible in another. "If Firm X is good at delivering regulatory compliance and remediation services, then we wouldn't tend to use them for more strategic advice around regulatory issues," they'll say. And CIOs, CMOs, CHROs, etc will all say the same about their areas. So the two markets could potentially become mutually exclusive.

The nature of the split between low-cost and high-value: We shouldn't confuse high-value with strategy or advice, any more than we should associate low-cost with technology or implementation. The high-value market combines the unfamiliar/uncertain end of every consulting discipline, while the low-value covers the familiar and the predictable. Thus, there are some parts of technology consulting that unquestionably fall into the low-cost end (updating parts of your ERP system, for instance), while others – and the prime example here is digitisation, because organisations are still trying to work out what it means for them and how best to exploit the opportunities it brings – fall into the high-value end. Even strategy, traditionally put at the far end of the spectrum away from technology, has its low-cost and high-value parts; so does HR, support around the finance function, and so on. Digital involves implementation as well as advice, so that distinction doesn't hold either. All this accounts for the unprecedented level of fluidity we see when it comes to segmentation. Some geographies, it's true, take a fairly conservative approach and associate technology projects with technology firms, strategy projects with strategy firms, and so on. But in many of the larger, more mature consulting markets, we're likely to see a clearer, and mutually exclusive, distinction between low-cost and high-value work – and, by extension, firms.

The challenge posed by the fast growth in high-value consulting services: Many firms – most, you could argue – have spent the last ten years trying to deliver what clients want in terms of lower costs. They've cut their cloth to suit their clients' price point, offshoring where possible and using methodologies and tools to reduce their reliance on think-on-their-feet partners. But the explosion of interest around digital, for instance (and this is the prime example of the high-value end of technology consulting), is changing the rules of engagement: having an army of business analysts based in a cheap, offshore location isn't going to help you win this type of work, but being able to deploy onsite a small team of industry experts may well. Being able to respond to this quite sudden shift in the market isn't going to be easy for firms whose entire strategic trajectory for the last ten years has taken them in the opposite direction.

People-less growth: The key constraint of the traditional consulting model is that growth and profitability are unavoidably tied to the number of chargeable staff you have. That's fine when the market is growing inexorably and when there's a plentiful supply of the right kind of people – and if the last five years have taught us anything, it's that neither of those can now be taken for granted. Consulting firms therefore need ways to find sources of revenue that are independent of the numbers of people they have. It's easier to see that being possible at the low-cost end of the spectrum – people can be replaced with software, for instance – but that's not where the growth is in the market. At the high-value end, the traditional rules of consulting apply – face-time with clients, experienced consultants, investment in thinking and tools – all of which remain stubbornly dependent on people.

With all four of these factors at play in the market, we really shouldn't be too surprised about the extent to which almost every conversation we have with the management teams of consulting firms, and every presentation we're asked to do, ends up focusing on business models. Can a single firm deliver both high-value and low-cost services? Does it have to choose? If you're one firm trying to bridge both markets, how do you manage the transition from one model to the other? There are also the immediate, practical issues: how should we charge for our services? Is there an alternative to the traditional pyramid structure when it comes to service delivery?

The purpose of this report is to explore these questions, largely by reference to what clients are looking for and/or feel comfortable with, although we'll also look at some of the different models being espoused by firms. Because even the term 'business model' can mean many different things to different people, we've chosen in Section 2 to focus on four strategic areas:

- Pricing: how does a firm charges for its services?
- Delivery: how does a firm work with its clients?
- Integration: do clients want one firm to do everything?
- Client-involvement: are clients stand-off or hands on?

In every case, though, the challenge will be how to use these four strategies to bridge the gap between the low-cost and high-value consulting markets. Firms that can't find the right strategy –and Section 3 looks at how these four strategies are likely to play – will increasingly find their activities confined to just one end of the piece of string.

STRATEGIC PLANNING PROGRAMME

How the *Strategic Planning Programme* can help you

- **Deepens your understanding of the major trends shaping the consulting industry**
- **Helps you to identify what clients want from consulting firms in relation to major trends**
- **Helps you in your business planning activities**
- **Helps you to identify opportunities and threats in the market, and to develop strategies in response to them**

Our Strategic Planning Programme helps you to develop your strategy. It looks at the consulting market from a global perspective, picking out the trends that matter wherever you are and drawing extensively on our research with clients. In 2015 it splits into six parts, honing in – in parts 2, 3 and 5 – on the themes we're hearing most firms and most clients talking about at the moment.

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About Source

Source Information Services Limited (Source) is a leading provider of information about the market for management consulting. Set up in 2007 with offices in London and Dubai, Source serves both consulting firms and their clients with expert analysis, research and reporting. We draw not only on our extensive in-house experience, but also on the breadth of our relationships with both suppliers and buyers. All of our work is underpinned by our core values of intelligence, integrity, efficiency and transparency.

Source was founded by Fiona Czerniawska and Joy Burnford. Fiona is one of the world's leading experts on the consulting industry. She has written numerous books on the industry including: *The Intelligent Client* and The Economist books, *Business Consulting: A Guide to How it Works and How to Make it Work* and *Buying Professional Services*. Joy Burnford was Marketing and Operations Director at the UK Management Consultancies Association between 2003 and 2010, and prior to that worked for PA Consulting Group and has extensive experience of marketing consulting services.

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