March 2022

EXTRACT

Pricing: Your biggest barrier to change?

Emerging Trends Programme

SOURCE GLOBAL RESEARCH

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Introduction

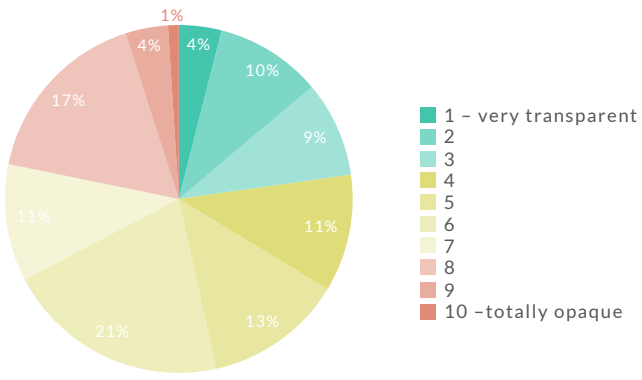
Pricing is one of the most complex issues in what is already a highly complicated industry. No surprise then, that it's a huge bone of contention between buyers and suppliers.

When we pick something off the shelf of a supermarket, we know what we're paying and what we're paying for. If the price is too high (as it may increasingly be in these days of high inflation) we may decide to either not buy the item or to switch to a cheaper item from a different shelf. But consulting isn't like that. Like goods in a shop, individual consultants have their price—almost all firms work on the basis of salary, level of utilisation, and a gross margin expected from project work. Despite the variety of payment models available—a point we'll be coming back to in this report—most projects are still priced based on the cost of inputs. But, unlike items in a supermarket, the pricing of consulting projects is also dynamic; responsive not simply to the composition of the team and the nature and duration of the work involved, but also a client's likely budget, the extent to which the work is seen as a precursor to larger projects, and the urgency and risk of the project.

Moreover, pricing in consulting depends on opaqueness: How a firm prices people and projects can give it an advantage in the marketplace, so standard rate cards are closely guarded commercial secrets. The professionalisation of the procurement function has resulted in many large organisations negotiating consistent terms with a small number of key suppliers, but the focus is mostly on the rates for individuals, which doesn't help when it comes to evaluating large projects and can even become an obstacle to change. Only 23% of end-clients would say that consulting firms are transparent when it comes to explaining their prices.

Figure 1

How do you rate consulting firms in general when it comes to the clarity with which they explain their prices?



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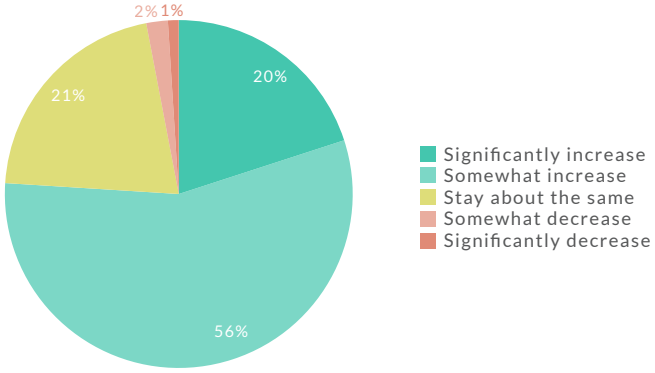
Part 1: What's changed post-crisis, so far as the pricing of consulting services is concerned?

Please note that all the data in Parts 1-5 of the report comes from end-users of consulting services. We look at the procurement function separately, in Part 6.

Consulting firms can expect to be busier than ever over the next few years. Three-quarters of those we surveyed for this report expect to draw on more consulting support over the next three years than they currently do—a figure which tallies with what we've seen in our other recent research.

Figure 3

How do you anticipate your organisation's use of consultants will change over the next three years?



And that's because clients themselves are busy too. The overriding reason we're hearing for this increased use of consultants is that clients have more to do and lack the capacity—and often the skills—to get it done themselves. In research we carried out in the autumn of 2021, 31% of clients said a higher volume of work was the number one reason for using more consulting support; 23% said it was because they're dealing with unfamiliar issues.

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Part 2: What determines the prices end-clients are willing to pay for consulting work?

We've developed a framework, based on past research, which looks at the professional services buying cycle from the client perspective. Seen from this vantage point, the buying cycle breaks down into three distinct stages:

1. During the **prioritisation** stage, clients are working out which, of the many business issues they have, they're going to focus on. At this stage, the client does not yet know how to allocate their limited resources between their organisation's many competing needs. They are trying to establish which need to be addressed through dedicated projects and, which can be parcelled up and addressed through pre-existing programmes of work. Fifty-five percent of possible projects never get beyond this stage: They're abandoned by clients in favour of other initiatives.
2. Once a client knows what their priorities are, they move into a period of **conceptualisation**. This is the point where the scope and broad parameters of the project begin to crystallise in a client's mind. Vague aims evolve into something more actionable. Clients need to decide what's involved, and whether they have the capacity and/or capability to do the work themselves (40% of all possible projects are done in-house). Then, and only then, can projects move into the buying phase.
3. For the 5% of projects where clients recognise that they need external support, the third and final phase focuses on the **choice** of which firm to hire. For projects that do make it all the way through the cycle, the final price the client is willing to pay is a product of the thinking they have done at each stage of the cycle.

At each decision point, ideas that could have evolved into consulting engagements will drop out of the process, either because the client decided that they weren't a high-enough priority, or because they realised that they could deliver them using internal resources or by folding them into existing activity.

We've used the data clients provided about a specific, recent project in order to paint a picture of what actually happens to prices during the buying process.

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Part 3: What impact do different payment models have on the prices clients are prepared to pay?

In the third part of this report, we introduce another ingredient to the complex cocktail of pricing: payment models.

Although the way in which a client pays for a project certainly affects the price, it's not a wildly exciting variable. Clients' overall willingness to use different payment models changes only very slowly, despite much discussion of experimentation within the industry. Fifteen years ago, in some of our earliest research, we found that payment choices were split reasonably evenly between three models: traditional time and materials (T&M), fixed price, and performance- (or outcomes-) based. However, this headline division was also misleading: Although around a third of clients said they used an outcomes-based approach, only a tiny proportion of the fees were actually at risk—less than 2% of all consulting fees, in our estimate. In other words, when clients and consulting firms talk about outcomes-based payment, they usually mean fixed price or T&M contracts that have a small performance-based component.

Everything changes, everything stays the same

During the 2008 financial crisis, crashing demand for consulting work in some areas resulted in a sudden and dramatic increase in true performance-based pricing, with the majority of fees being tied to results achieved.

The shift, however, was short-lived. The complexity of calculating the performance element, a more benign economic environment, and resentment at having to pay more for what they considered to be a standard service, meant that clients were keen to revert to fixed price and T&M contracts, even while consulting firms continued to extol the virtues of outcomes-based pricing.

The result, prior to the pandemic, was a stand-off, with both sides saying they'd be interested in pursuing performance-related pricing in theory, while simultaneously complaining about the practical difficulties in doing so.

When we asked clients in this survey how they'd paid for the recent projects they'd been involved in, the picture, at first glance, isn't all that different. But there were some small, albeit important, changes. The use of T&M payment terms was slightly higher, growing at the expense of outcomes-based models. The issue here is one of uncertainty: The pandemic wasn't a "traditional" crisis, so clients had no precedents or data to base decisions on. Bringing in consultants was a risk: Would they be able to do the work? Was the work being done the right work? Adding uncertainty into the fee structure would only have made matters worse. The same message comes across in our interviews with clients: They've become more conservative and risk-averse where pricing is concerned as a consequence of the crisis.

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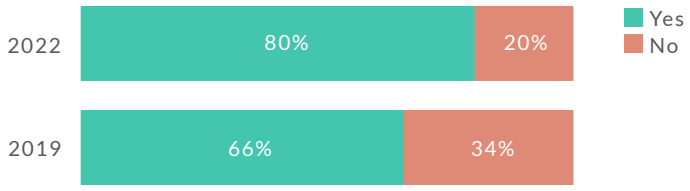
Part 4: What difference does a discount make?

Discounting is not a new or rare phenomenon in this—or any—industry. After all, everyone likes to feel they've got a good deal, and clients are just the same. Our 2019 survey showed that, in 66% of cases, clients had been offered a discount by consulting firms—testament to their nature as part of a fairly widespread practice. And it's only become more popular: that figure has jumped up to 80% in our 2022 survey.

The increase in the prevalence of discounting is most likely a legacy of what happened during the crisis. Clients became accustomed to receiving hefty price reductions; and for consulting firms grappling with the challenges of selling work remotely, a discount was probably one of the easier ways to clinch a deal. But, however prevalent a strategy discounting may be, we need to ascertain to what extent it's actually giving firms an edge over their competition.

Figure 23

Did the firm offer you a discount on the total cost of this project?



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Part 5: To what extent is the global skills shortage influencing clients' attitudes to the price of consulting services?

In Part 1 of this report, we identified the critical role played by expertise in determining the price of consulting services: Clients told us they'd be happy to pay more to secure the specialist skills they need.

Add a well-documented global skills shortage into the mix and it seems as though it should be fairly clear what will happen next. We'd expect the current shortage of skills to boost the prices that clients are willing to pay for consulting support—and yet, the reality turns out to be much more complex.

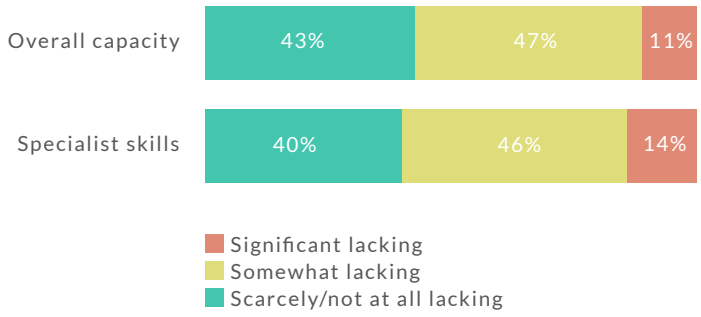
Clients' views on the skills shortage depend on where they sit in the organisation

At a superficial level, clients are reasonably sanguine when it comes to the impact of "the great resignation" on both the overall capacity of their organisations to get things done, and the in-house availability of specialist skills. Twenty-one percent of clients say that their overall capacity has improved since 2019, and 34% of clients say that they have better access to specialist skills.

But appearances can be deceptive. Despite the perception that the situation has improved, 57% of organisations say they are either "somewhat lacking" or "significantly lacking" capacity to get things done and 60% say they are lacking specific specialist skills. This suggests that, while the media picked up on the issues during the late stages of the pandemic, labour shortages may have been an issue for organisations for much longer. Ironically, greater post-crisis flexibility around where people work may have actually relieved some of the pressure.

Figure 28

To what extent does your own organisation lack the skills and/or capacity it needs?



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Part 6: How different is the procurement function from the rest of clients' business?

In addition to our survey of end-clients, which we've referred to extensively in the preceding sections of this report, we gathered responses from 50 procurement managers specialising in consulting expenditure.

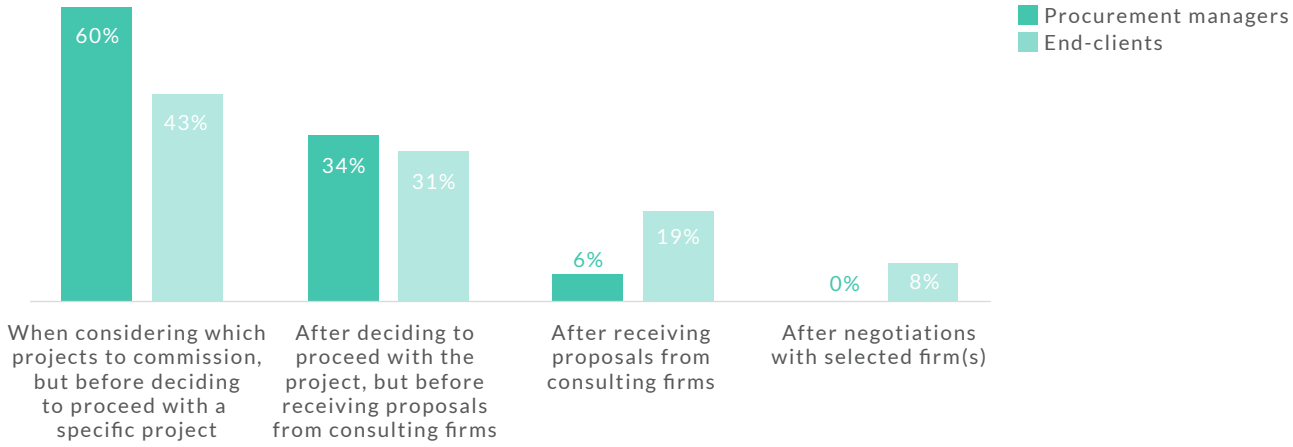
The stories the procurement specialists told us about a recent project differed from those of the end-clients in several illuminating ways.

It's mostly about the money

The differences between procurement managers and colleagues across their organisations begin at the very start of the buying cycle. For the sample of projects we looked at, procurement managers were far more likely to have made their "first reasonable estimate" about a project's likely cost before speaking to any suppliers: That was the case for 94% of them, compared to 74% of end-clients.

Figure 33

When did you make your "first reasonable estimate" of the price of a project? Comparing procurement people's responses with end-clients' responses



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Full methodology

Survey sample

All of our respondents worked in private sector organisations with 1,000 or more employees; held a "head of department" position or more senior position; and had been directly involved in buying and managing consulting projects. Ninety-two percent had personally taken the decision to bring in consultants, and the remaining 8% had sat on project steering groups.

We have included the breakdown of the survey sample below, splitting the numbers by those respondents that work in procurement, and those that work in other functional areas across the business. We have 50 respondents from procurement functions and 101 respondents from other functions. Those working in other functions are referred to as "end-clients" throughout the report, and Section 6 examines the views of those in procurement functions alone.

Figure 37

Sector

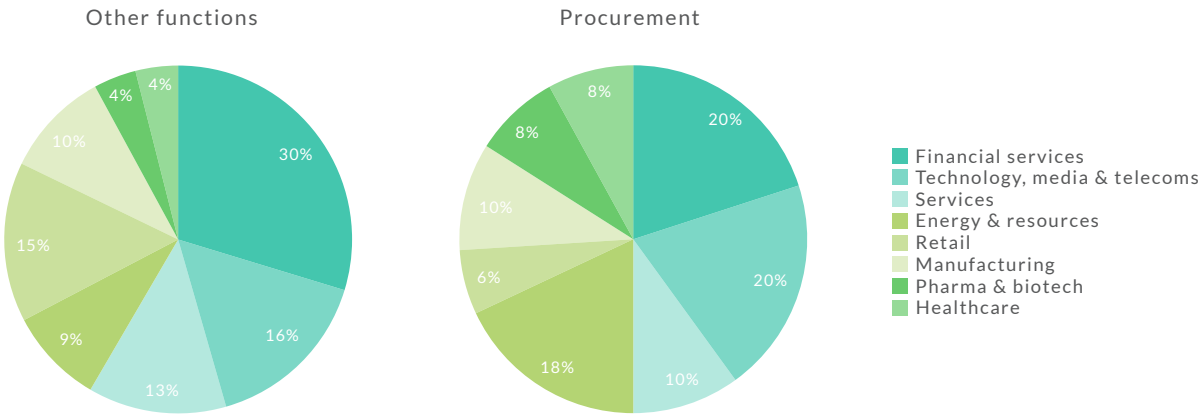

Figure 38

Headcount

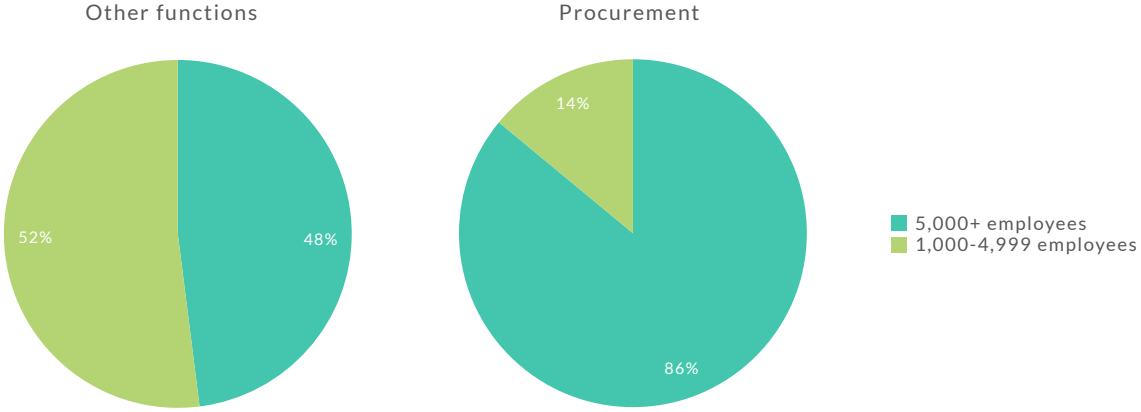

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Figure 39

Responsibility level

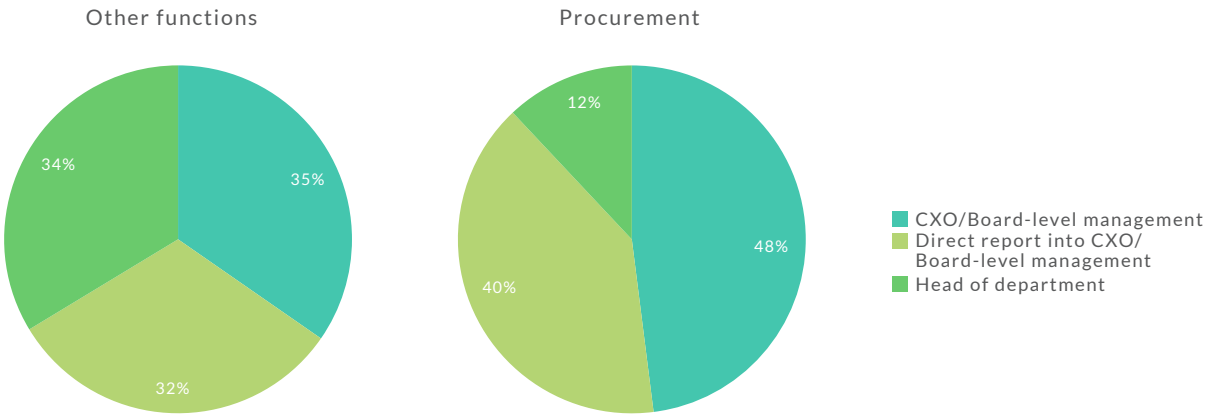
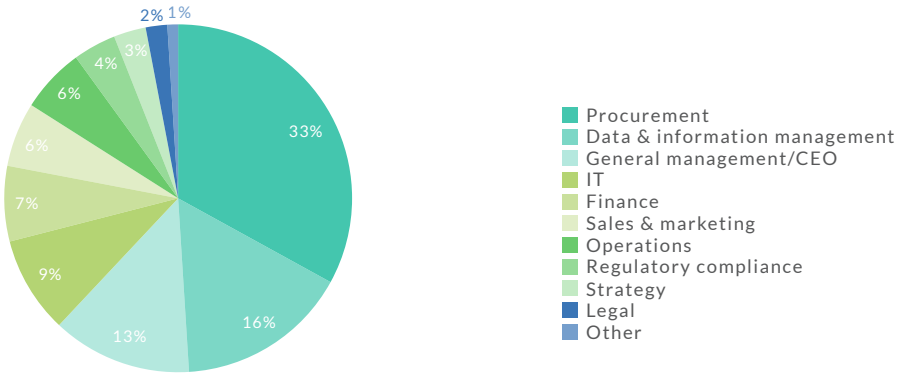


Figure 40

Functional area



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The anatomy of consulting projects in 2022

To help us understand not just how these respondents think about the pricing of professional services in general, but also how they put these thoughts into practice in real cases, we asked them a number of questions specifically referring to the most recent mid-sized or larger project which they had been involved in commissioning ($100,000 or more).

Where this report mentions a sample of consulting projects, these are the ones that are being referred to.

Taken in aggregate, however, this data gives us a sense of the profile of large and mid-sized consulting work being commissioned today:

- **Project size**—10% of projects were worth more than $5m, and 29% were worth between $1.1m and $5m. However, the bulk of them were worth between $500,000 and $1m.
- **Incumbent advantage**—96% of projects were awarded to firms with which the client had already had an existing relationship, a graphic illustration of why the biggest firms in consulting grow the quickest.
- **Final-choice firm**—40% of the projects were won by either Accenture or Deloitte.

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Meet our experts

Fiona Czerniawska

A Co-Founder and Managing Director of Source, Fiona is one of the world's leading commentators on the management consulting industry. Since founding Source in 2008, she has been bringing this expertise to bear on our clients' most pressing strategic projects and business issues. Fiona has published a dozen books on consulting topics, including two for The Economist: Business Consulting: A Guide to How it Works and How to Make it Work and Buying Professional Services.

She has more than 20 years' experience as a management consultant, working primarily in the areas of marketing and strategy. She was previously in charge of strategic planning for EY in the UK and has worked in the consulting practice of PwC. Fiona also has a PhD in 17th century French art and lives in hope that it will be of practical use in business someday.

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Alice is a Writer and Analyst. She works across the company to contribute to our Market Trends and Emerging Trends reports, as well as supporting bespoke projects and authoring other industry-focused content. Prior to joining Source, Alice worked as a freelance writer and editor.

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About us

We analyse and examine how change drives the way organisations use professional services, and the implications that might have for professional services firms.

Derived from data, years of experience, and sophisticated proprietary research, we use our team's extensive knowledge of the industry to provide actionable and clear conclusions on the best course of action for professional services firms around the world. Our insights not only provide interesting reading, but they have underpinned some of the biggest strategic investment decisions made by firms around the world.

So, how can we help you?

SOURCE GLOBAL RESEARCH

How we can help you

In addition to our reports, we also provide custom advice and evidence-based consulting services to the world's biggest and most successful professional services firms, helping them to better understand their markets and the challenges and opportunities they face. Underpinned by original research, interviews with your clients, extensive surveys of buyers of professional services, and our wealth of data and experience, our work is designed to help you fully understand the markets in which your firm operate, and want to operate.

Among other things, our offerings include:

- Market entry strategy
- Competitor profiling and research
- Access to our MegaModel, tailored to your definition of the market

For more information about any of these, or our other work, please visit our website or get in touch.

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