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PPI Mini Presentation

SPPI for Business and Management Consultancy Activities in Germany

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1. Industry Output

1.1 Description of the Sector (ISIC 7414 / NACE 74.14)

This sector is divided into business / management consulting and public relations consulting. **Business and management consulting** includes consulting, support and instruction of enterprises, organisation and public services. While the wide range of management consulting is in the field of organisation, management, marketing, controlling, accounting etc., personnel management consulting provides support in all matters of human resources such as search and selection of specialised staff and executives or consulting in personnel development.

Public relations consulting puts its focus on consulting a company on its outward presentation to public such as customers, press, in the broadest sense on the corporate image or to the enterprise itself (in house, its products etc). Activity fields are mostly public relations, corporate design, promotion but also communication concepts.

In Germany the total turnover of ISIC 74.14 amounts to approximately 15 Billion Euros. The market for management consulting is dominated by few large market players with a turnover per company of above 100 million EURO. These companies play a decisive role on a global base and cover all important activity fields of a management consultant. Small and medium sized enterprises of management consulting services are very often specialised either in particular branches as financial or management consulting or in specific consulting topics such as controlling or value based management.

In Germany there is the Federal Association of German Management Consultants (BDU) whose task is to increase the performance standard of consulting companies, to implement quality standards by means of professional regulations and principles, to positively influence the economic and legal framework conditions of the consulting sector and finally to support the demand for management consultancy.

1.2 Classification Aspects

NACE 74.14 contains business and management consultancy activities and public relations services. In Germany the market share for business and management consultancy activities is approximately 93 % and for public relations services 7 % respectively.

The German market of **management consultants** according to a branch analysis¹ offers a variety of services which are usually divided into four fields: Classic management consulting in strategy (market share of 24.5 %) and organisation (35.5 %), IT consulting (28.5 %) and human resources consulting (11.5 %).

While strategy consulting deals with strategic and policy on enterprise philosophy, organisation consulting contains all projects which analyse potential improvements of employed processes of enterprises. The field of IT consulting is engaged in services of analysis, selection and implementation of systems for hardware and software.

¹ Study of the Federal Association of German Management Consultants (BDU): "Figures and facts of consultants in Germany for 2004"

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The core business for human resources is consulting for the search and selection of specialised staff and executives. Consulting in human resources development and outplacement is therefore another activity field.

Quite contrary to other countries in Germany it is not a common practice to differentiate in branches such as in financial management consulting, marketing management consulting or production management consulting as in practice there are overlaps between these activities.

An accurate differentiation of IT services and management consulting services is becoming more and more difficult. On one hand the increasing relevance of IT services as a supporting tool of management consulting, on the other hand IT companies that widen their range of services about services in organisational or strategic topics. This development makes it difficult to draw a clear line between management consulting and IT consulting. There will be less IT relevant projects in the future but more management consulting projects with integrated aspects of IT services. The FSO Germany is going to follow the way of the Association of German Management Consultants (BDU) to include enterprises whose main focus is on management consulting projects including IT services. In Germany there are large subsidiary companies of globally active IT firms which are to be integrated in the sample.

Because of the small importance of public relations consultants in the German market the FSO plans to neglect this target group in a first step of the pilot study.

2. Index Methodology

The following remarks are preliminary as the FSO – on behalf of Eurostat – is presently conducting a pilot study on ISIC 74.14. After finalising consultations with associations and companies, specifications in more detail will be made.

2.1 Price Mechanisms

It has to be made a strict distinction between price mechanism which gives an overview over market structure and processes, i.e. how the prices are set by the market participants on the one hand and the price methods which give an overview over the statistical methods how the prices are analysed and integrated in the SPPI on the other hand (see the draft SPPI manual of the OECD/EUROSTAT Task Force).

Prices in the management consulting sector are not legally regulated as –for Germany – e.g. in the case of legal services or tax consultancy but run according to free price negotiations between the client and consulting company.

Firstly an overview is given over the price mechanisms which are strongly related to the activity fields of the consulting companies:

The billing of both **consulting in strategy** and **consulting in organisation** have three different price types: Consultants charge a bill for their clients either on

- a time basis,
- a project basis or
- a value basis.

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- The prices for strategy and organisation consulting services could be time-based. Experts estimate that 90 % of all cases are priced as daily rates, only 10 % as hourly rates. Charge-out rates, at least in middle-sized to bigger companies (according to turnover figures), could be differentiated between professional levels (such as partner, project leader, senior and junior consultant and back office) and activity fields (such as strategy and organisation consulting services). Because of the high level of experience and qualification for consulting in strategy the FSO Germany supposes that charge-out rates for this activity field are higher than for consulting in organisation.
- Probably the most important prices are project-based in the form of a fixed-rate process with fees agreed to when the proposal is accepted. Here the rate depends on the complexity of the project, on the fact if the client is a new or old client or on the client's annual turnover with the consultant company – in the broadest sense it is a matter of negotiation. For unexpected and uncontrollable problems sometimes there is included a risk coefficient. Bigger companies could have a greater frequency of project-based pricing than smaller companies which could be more disposed in time based pricing.
- Value-based pricing is a risk-sharing approach in which a consultant agrees to solve a problem that either saves money or increases revenue, for a fee (percentage fee) based on the size of the benefits that accrue to the client. Both client and consultant have shied away from value-based pricing. It appears as if neither side wants to be in a position of not knowing what the eventual price of a project will be.

In some cases the price mechanism is a mixture between fixed rate and success fee. In this case a part of the price depends on achievement of objectives.

The price mechanism for **IT consulting** is either a time-based pricing or a project-based pricing (see description above). While large IT projects are often calculated by a fixed price the smaller ones are calculated by charge-out rates.

The price mechanism in the field of **personnel consulting** could be differentiated on one hand in the activity field of search and selection of staff and on the other hand in consulting in human resources development and outplacement. While the prices for human resources development services are normally formed by daily rates depending on professional level, outplacement consulting is priced as a fixed amount per case. In case of outplacement consulting of an individual a percentage of the salary is used, in case of outplacement consulting for a group of employee a daily rate is charged.

In collaboration with the clients the personnel consultant for search and selection of staff² arranged very often a fixed fee which is a percentage of the new candidate's expected salary. Nearly 90 % of all contracts are paid by progress of the contract i.e. 1st rate is paid by commissioning, 2nd rate by presentation of candidates and 3rd rate after closing the employment contract. Only 8 % of all contracts are fixed by success fees. The fee for the Top 20 of personnel consultant enterprises is based on a minimum level, which is named in the contract. The average of this fee range between 14.750 EUR and 26.000 EUR depending on the size of the personnel consultant enterprise.

² Study of the Federal Association of German Management Consultants (BDU): "Personnel consulting in Germany for 2004"

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It is supposed that price adjustments generally take place in the beginning of a year than during the year; furthermore experts estimate that 25 % of all contracts are with new clients.

Another important price component for billing of management consulting services is **expenses** for travelling etc., which are approximately between 10 and 15 % of contract value.

The FSO Germany is going to check these facts by questionnaire.

2.2 Main Pricing Methods Used

Here the statistical approaches are listed how the SPPI for management consulting services could be constructed from the given price types.

As mentioned the most important approaches are the fixed rate and the charge-out rate method. Slightly less important, but relevant in the area of human resource consulting, is the model pricing approach.

- Time-based method (charge-out rates)
Charge-out rates as average hourly rates or average daily-rates, differentiated by professional level such as partner, project leader, senior and junior consultant and back office and by activity fields as strategy, organisation, IT and human resources consulting services shall be inquired by questionnaire.
 However, in cases of project-based pricing with fixed rates a more differentiated approach is indicated. List prices often do not reflect the actual price development. Therefore in the current pilot survey it has to be proved, if it is possible to receive data about the ratio of realised and implied revenue or about average realised hourly rates for the different professional level and for the activity fields of the consulting companies.
- Model pricing method
In case of personnel consulting the price is calculated as a percentage fee of the salary. As these cases are inhomogeneous over time the FSO Germany is going to build up representative cases, so called model pricing cases. Desk research by analysing the FSO in-house statistic "salaries and wages" and contacts with the associations will support to construct model cases. A service whose specifications are held constant will be described by the FSO which can either be fully fictitious or based on a contract signed in the past.
While a current inquiry of the percentage rate by the consultant companies is planned, the FSO has to find an adequate reference indicator - maybe the index of average gross earnings - in order to describe the development of the values of claim over time. This is a similar approach as it was chosen for tax consultancy and (partly) for legal services in Germany.

In the same way a model pricing approach is indicated in case of high relevance of expenses.

3. Sampling and Weights

3.1 Sampling

Base of the sample is the FSO business register, covering companies of all kinds of industry sectors throughout Germany including data such as turnover, number of employees etc.. Data for management consulting companies differ between the FSO business register and statistical information provided by the association. It is therefore recommended to contact the branch association of management consultants for more specific information and to update the business register by branch information where appropriate.

In Germany insight into the structure of the management consultancy sector is given by the "Lünendonk list" which contains a review of the top management consultant companies. Furthermore there is a German ranking of big companies in business innovation or rather transformation partner who are focused on service from one hand as a mix to be made up of management consulting and IT consulting, realisation and business process management.

Bigger companies regarding their turnover can be followed up in the internet.

In Germany 97 % of management consulting companies with a yearly turnover up to 2 Mio EUR gain 35 % of the market share, while 3 % of the companies with a yearly turnover above 2 Mio EUR have 65 % of overall turnover. On this fact FSO Germany puts its focus to collect mainly data from enterprises with turnover above 2 Mio EUR.

A random stratified sampling according to turnover is considered to be the most adequate method for the set-up of inquiries. However, companies with turnover figures of above 10 million EURO usually represent the dominant market players and are integrated as price drivers in a total sample.

3.2 Weights (Data Collection)

The methodological approach consists of two phases: the development of a weighting pattern – phase 1 and the installation of the current price observation – phase 2.

After the initial consultations it is planned to start with phase 1: the development of a weighting pattern at the end of August 2005. The questionnaires contain elements such as company figures – overall turnover of the company, number of employees – and questions about the company's activity fields weighted in terms of turnover and their specific terms of payment such as charge-out rate, fixed rate, by commission or per case. Furthermore questions about the percentage of new clients, the time of price changes and the expenses are foreseen.

The questionnaire for current price observation (phase 2) is in preparation. A pilot survey shall start in October 2005. FSO Germany plans to implement different questionnaires depending on the activity fields, on the different price types and maybe on the turnover of the respondent.

4. Issues in Maintaining Constant Quality

Productivity progress is a factor which influences the service and product quality so that the assumption of stable quality features over time is not realistic. This means that also an index for productivity profit should be calculated and integrated in the price index. For IT related activities in management consultancy this seems particularly important. However, scientific papers have shown that the measurement of technological/productivity progress is rather difficult. It is not growing proportionally and appears unexpected and erratically over time. The productivity profit in the target groups' sectors is probably exclusively calculated by a reduction of working time on the same subject or by a shift of staff levels during the project process.

5. Results and Price Measurement Challenges

5.1 Expected Results

At the moment the project to construct producer price indices for business and management consultancy activities is still in pilot phase. It started in 2005 and is supposed to end in the beginning of 2006. So the German producer price indices will be published regularly from 2007 on (base year 2006). The project takes place on behalf of EUROSTAT and is considered as European objective. It is the aim to publish the SPPI on a quarterly basis though it is not considered that price changes occur more often than once a year.

5.2 Price Measurement Challenges

In Germany one of the main challenges is to get a sufficient response from the questionnaire. So far the legal basis of the survey, the draft amendment for the REGULATION (EC) OF THE EUROPEAN PARLIAMENT AND THE COUNCIL amending the short-term statistics Council Regulation 1165/98 (STS), has only provided room for inquiries on a voluntary basis.

In the consultations of the past months companies proved to be rather reserved towards information on their pricing behaviour.

As the amendment of STS regulation was adopted in July, the FSO now hopes to receive better results and feedback from the respondents. The new legal base implies compulsory inquiries for the respondent.

Open questions to be discussed:

- How do other countries treat companies which offer IT related activities, but put their focus on consulting in organisational or strategic topics?
- The FSO Germany wants to include expenses for travelling etc. in the index calculation (using price indices for travelling, hotels, restaurants). What about the other countries?
- Another question to be solved concerns handling of new contracts. Do other countries observe different prices for contracts with old and new clients?
- What about the experience of other countries in observing realised charge-out rates? Are the respondents willing to provide this information?
- The demand of management consulting services with integrated aspects of IT services depend much more of economic propensity to invest than other consulting

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- fields. The weighting of this activity field could oscillate on a high level. Do other countries include this fact in their index calculation?
- Do other countries integrate productivity progress figures into their producer price indices?
 - Get other countries in touch with the “Kennedy information”, a report which reveals details about fees, utilisation and other key metrics such as length of engagement and billing methods in the consulting profession?