

**21ST meeting of the
VOORBURG GROUP**

2006-

Wiesbaden, Germany

The French SPPI on business
and management consultancy

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1/ the "Business and management consultancy activities" branch is made up of two relatively different sub-branches: management consulting, on the one hand, and on the other public-relations consulting. The respective shares of each are approximately 90%/10% (see memo 'The French SPPI on business and management consultancy' by B. Buisson for the 20th meeting of the Voorburg Group in Helsinki in 2005).

Within **management consulting**, the activities are fairly scattered and there is no overall homogeneous vision of the profession as to the exact content of the various sub-branches. The profession includes under it strategic consulting, financial management consulting, CRM (customer relations management) consulting, Human-resources management consulting, and supply-chain management consulting.

The profession makes a distinction between

- organisational consulting, which can cover various areas within the client company (the purchasing sphere, the production sphere, etc.)
- strategic consulting
- human-resources consulting
- information systems consulting (linked with IT)
- operations or industrial-process consulting.

Outplacement and coaching activities, which are not within the scope of Business and management consultancy activities, are sometimes considered by companies as management consulting. Management consulting firms also segment according to the client's economic activity, making such distinctions as that between public and private sectors, and sometimes between industry, service, banking/insurance, etc. The levels of competency required are not always identical, with the banking sector having the reputation of being more demanding than other sectors.

Public relations services work to improve the image and the positioning of the company, both internally and externally. The contacts necessary for performing the tasks involved are many and varied – with the media, professional organisations, Public Authorities, etc.

Since some companies don't fall into the above classifications, it was necessary to name a new modality, "**Other types of consulting**" (quality control, preparation and implementation of projects for clients, cost control, etc.)

A consulting project comprises phases of recommendation, accompaniment of implementation, and – more and more frequently – the implementation itself. This means that the frontier with other types of activities is fairly fuzzy, in particular where IT service firms are concerned. The separation from IT consulting is clear when the work is handled by two different legal entities (as in the case of the GFI group, with GFI Consulting and GFI IT services); but it is much less clear when that is not the case. More and more, consulting tends to be one component of a broader set of services sold as a package. The end result is often a report made up of recommendations that the client company must endeavour to put into practice. The output is often intangible.

Large companies have difficulty making the distinction between what is IT consulting and what is management consulting, since the two activities are fairly intertwined. That is true, for example, of two of the biggest companies in the field (Accenture, formerly Andersen Consulting, and CapGemini Ernst & Young), within which the two activities exist side by side.

A difficulty inherent in the branch is that of making the distinction between management consulting and IT consulting.

2/ pricing unit of measure:

the management consulting service aims at giving a particular response to a specific case. This output is consequently unique, which is the main difficulty of this industry.

3/ market conditions and constraints:

3.1 size of industry

The Business and management consultancy activities sector in France represents 13,000 million € for 42,000 companies employing 113,200 persons. There are many freelance employees, which leads to a situation in which the sector employs twice as many non-salaried employees as other business and production services. Other characteristics: high remunerations (50% more than business and production services companies), 50% women.

3.2 special conditions and restrictions

Clients' purchasing departments are becoming tougher and are a limiting factor on prices. This is what companies call the "boomerang effect" – they have taught client companies how to negotiate prices, and now they are suffering the consequences themselves. The sector suffered from the effects of the Enron affair (2001-2002).

The activity is cyclical. There was Y2K, then the implementation of ERP, then the adoption of the euro, and now firms are again in a period of activity with BPO (Business Process Outsourcing) and hope to get involved in the process of transformation of public services and government administration. Outsourcing, as part of what is often referred to as "change management" or "change accompaniment," is prepared for and sometimes implemented directly by the consulting firms when they have the tools necessary for doing so.

The market can be described in several ways:

The size of the firm **Very large firms** work for major accounts: they are referenced with the major clients who use this type of consulting, and who prefer to limit the number of suppliers. This is the industrial level of consulting. Often the firms handle both consulting and implementation, since they have the resources (sister companies or subsidiaries) to do so. These companies employ many junior consultants, who stay on for a short time only. The turnover is high. The boundary line with IT consulting is difficult to draw.

medium-size firms do consulting but don't handle implementation. Many of these firms are bought out by "integrators" who thus extend the range of their activities. Firms disappear and/or are absorbed.

small firms who do niche consulting. The experts are highly specialized, but there is strong competition from freelancers. There are many start-ups in this sector.

Qualifications pyramids are theoretically stable, but can vary with market conditions and as a function of pressure from major accounts to reduce costs. Under such circumstances, one way of reducing costs is to hire junior consultants, and sometimes to fire senior ones. The relation between the qualifications pyramid and the price of services is nevertheless very close.

Even Accenture, one of the biggest firms in this industry, provided us only with an RDR for the whole firm.

Prices are less volatile than in the IT sector.

3.3 record keeping practices

the 80 firms of the sample receive the questionnaire with the fine description of the questions (the number of items depend of the protocol decided between the firm and the statistic office. For this industry, from one item to 10).

This protocol was defined when a ingenior-surveyor visited the firm when we first visited it

The rhythm of inquiry is quartely, as for all industries (except accounting), and for this industry too. The firms can respond on paper, or on a specific INSEE website. When we detect strange or unusual variations in the collected price, we make a phone call at the firm to make sure there is no mistake or no quality variation which could affect the index.

Though this inquiry is obligatory, we never went until litigation, which would be at least, quite possible.

4/ standard classification:

NACE rev 1.1 (2000) code 74.14 "Business and management consultancy" activities includes provision of advice, guidance or operational assistance to businesses and the public service:

- public relations and communication
- design of accounting systems, cost-accounting programmes, budgetary control procedures
- advice and help to businesses and public services in planning, organization, efficiency and control, management information, etc.
- management consultancy such as by agronomists and agricultural economists to farms, etc

CPC 1.1 (Central Product Classification-2002) and **CPA** (Statistical Classification of Products of All Economic Activities-2002) distinguish following services:

ISIC	NACE	CPC	CPA 2002	
<u>3.1</u> <u>7414</u>	<u>1.1</u> 74.14	<u>1.1</u> <u>82191</u>	74.11.17 Other legal advisory and information services (arbitration and conciliation services)	
	Business and management consultancy activities	<u>83111</u>	74.14.11 General management consulting services	x
		<u>83112</u>	74.14.12 Financial management consulting services (except corporate tax)	
		<u>83113</u>	74.14.14 Human resources management consulting services	x
		<u>83114</u>	74.14.13 Marketing management consulting services	x
		<u>83115</u>	74.14.15 Production management consulting services	x
		<u>83119</u>	74.14.17 Other management consulting services	x
		<u>83121</u>	74.14.16 Public relations services	x
-	-	<u>83129</u>	74.14.17 Other management consulting services	
		<u>83190</u>	74.14.21 Project management services other than for construction	
			74.14.22 Other management-related services n.e.c.	
74.15		-	74.15.10 Management holdings services	

Remarks:

The Statistical Classification of Products by Activity in the European Economic Community (CPA 2002) for Activity 74.14 deviates from the corresponding ISIC product classification on two points: It excludes legal advice and representation and services provided by holding companies. Holding companies are not currently dealt with by the price index calculation departments.

1/ holding companies: Some serious methodological problems will doubtless have to be solved before dealing with the calculation of a price index concerning the activity of holding companies: What is the service provided? Who is the purchaser, what measurements to use, is there a market price, what is the price of a holding company's services? For the moment France remains on the sidelines regarding this type of issue.

2/ financial consulting: Consulting in financial matters includes consulting regarding mergers and acquisitions. In this area, partners are essentially commercial banks, for consulting (example: the Arcelor-Mittal merger, an estimated 300 million dollars in consulting fees for the commercial banks who took part), and law firms for drawing up the documents. However, the French statistics system does not have a structural sectoral study in the banking sector. The share of financial institutions in turnover where consulting is concerned is imperfect, which disrupts the financial consulting sub-index (not published in France due to insufficient coverage of the activity.) Link to be made with measurement of output.

3/ According to **draft of NACE rev2**, main modification should be the inclusion of 'lobbying activities', 'fish stock management' and the exclusion of management consultancy by agronomists and agricultural economists to farms'.

7/ pricing methods

As was pointed out explicitly last year by several speakers, Business and management consultancy activities is an area where the percentage of intellectual work is preponderant.

A/ Pricing mechanisms

The main pricing method is the **fixed price**: the consulting firm works out its fee based on the qualifications necessary for the work requested and the remuneration paid for that qualification, on the number of persons needed for the work and on the number of days of work. The product of these three factors determines the fee that will be negotiated with the client. This is a classical price estimation calculation based on costs and a target profit margin.

Certain companies may include a risk coefficient to protect themselves against the uncertain nature of projects (this risk coefficient can depend on the reputation of the client company, its business sector, and its promptness in paying its bills – it being taken for granted, for example, that the public sector has the reputation of paying late, resulting in inclusion of a risk coefficient.)

Where referencing is used (although that applies to only the 5 -10 largest firms in the market), rates are predetermined and discounts for the volumes purchased are already known, and therefore there is theoretically no need for negotiation.

Invoicing **on a time-spent basis** is not very common, being used in only 10% of cases. This is often done with consulting at a high level provided to the directorial team, when time overruns are not a discriminating factor (example: communication during crisis periods). The service then amounts to provision of staff, and the situation is a comfortable one for the consulting firm, which need not worry about excess time spent that would eat into its profit margin, as would be the case with fixed prices.

Success fee pricing (invoicing based on share of results) also exists and is developing. This is most often seen with the industrial clientele, the success of a consulting mission being measured by improvements in productivity. There has to be a very precise agreement between the provider and the client as to the means of measurement of improvements to production processes. In the service sector (IT, banking, insurance, etc.) the contribution of success fees is more uncertain. The "purchasing" departments in large companies can also function in this manner, and in this case the success fee is based on the reduction in costs. This type of invoicing is nevertheless not very common (according to the companies, approximately 5%).

In the case of crisis management, **retainers** are sometimes used: the cost can be high, but it ensures the client of rapid and immediate reaction by the consultancy in case of a sudden need for communication or support.

B/ pricing methods

The choice of pricing method is based on a mechanism with several levels:

1/ first the **industry and professional organizations** are met with to identify the mode of operation of the profession and attempt to understand how prices are determined. In France an industry organisation (GSSEC) represents the firms in four branches: management consulting, public relations, recruiting consulting and marketing studies/opinion surveys. These contacts provide an understanding of the way companies segment their activity, which is essential for identifying the services provided by the companies in the branches. This is the first stage in making the link between the official classification and the collection classification.

Meetings with this organisation resulted in identifying the three methods of setting prices: fixed price based on working time, contract pricing, and fixed price with success fees.

In management consulting, the industry organisation represents 62 companies, corresponding to 50% of the market.

2/ second, **test visits to companies** these are made to companies that are significant in the branch. These meetings, with the administrative and financial directors, often associated with pure practitioners or technicians experienced in contact with the clientele, refine our perception of the services provided by the firm, as perceived by the firm itself (standard classification vs. collection

classification - that of the real world), the methods of setting prices and possible solutions for price monitoring.

The collection classification for management consulting which the companies understand and under which they can classify themselves is the following:

- strategy consulting** (general management consulting services)
- financial management consulting**
- sales management consulting** (CRM)
- human resources management consulting**
- production management consulting services**(including supply chain consulting)
- Other management consulting services (miscellaneous)

The client's economic sector is not specified.

This collection classification make it possible both to break down the company's turnover in detail, but also to anticipate the calculation of detailed indices by product. Therefore it must be understood by the company while at the same time not being too far from the official classification of activities and products so that pertinent sub-indices can be calculated.

It was found that the most appropriate means of measuring price was "**pricing based on working time**," a method which was adopted during the visits to companies.

3/ the **personalized visits to companies** by the engineers-surveyors, which allow these pricing methods to be tested against reality.

After visits to the 81 companies in the sampling, the pricing methods noted are as follows:

pricing method	number of prices surveyed	weight in index
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pricing based on working time	274	93.60%
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Working time is the basic concept used in pricing

percentage fee	1	3.60%
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contract pricing	5	2.70%
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data type in the survey	weight in index	
input prices	3.20%	The firm knows the cost of its own staff, sometimes calculating based on qualification and the gross margin calculated for the firm. Often firms know the cost of their staffs in detail only in annual terms, but are able to provide a quarterly margin rate.
unit values	90.50%	The RDR (realised daily rate) is very often known and calculated by the firm. This is either an RDR per qualification ("realised daily rate per grade of worker" - 53%), or an RDR for all qualifications taken together (32%), or sometimes a turnover per person occupied, corrected for the activity rate (5.5%)
percentage fee	3.60%	A percentage of the savings made following the consulting services provided by the management consulting firm (rare)
real transaction price	2.70%	In case of consulting provided annually on a retainer basis (rare)
target of measurement		In 94% of cases, the "hourly or daily charge-out rate"

8/ quality adjustment methodology

1/ The **RDR for all qualifications** taken together clearly poses the question of the stability of the qualifications pyramid. In periods of economic recovery, many juniors are hired and the pyramid is pulled out of shape. That is what has been happening since 2004. The RDR tends to drop, which is not the case with RDR per qualification.

2/ Is it possible to **validate** the firms' **calculation of the RDR**? Stability of the RDR for all qualifications for many foreseeable quarters prompts one to question the quality of the calculations made by the company. There is no doubt that what we are actually dealing with in this case are list prices in disguise. It is unquestionably easier to supply the target RDR than to calculate it quarterly. Especially since the problem of evaluation of the turnover to be taken into account arises: invoiced turnover, turnover on advancement of work, or turnover collected. It is not at all certain that all companies use the same method for calculating this RDR. For many companies, the visit by INSEE's engineer-surveyor initiates calculation of an RDR, an exercise in which they clearly do not have much experience.

RDRs often show significant variations, and efforts are made to correct for them. The solution chosen was that of substituting gliding-average data series for the raw series). This was done for 16 companies out of a sampling of 81 companies.

3/ Another recurring problem is that of **productivity** – one for which there is currently no solution. Increases in productivity can have an effect on wages (the employee is more efficient, which results in an increase in wages), on margin (if price and wages remain constant, the immediate effect is an increase in the firm's margin) or on the client (if the hourly prices do not change, the work will be done in less time, and thus with a decrease in the price charged for identical work, provided that the rapidity of the work is not taken into account as a criterion for determining the price. Almost any other combination of effects is also possible, which is a good indication of the difficulty of the problem.

PPI quality assessment framework tool:

Points	Category and Questions	Score
	1. Shipment Price (Weight = .10)	
	<i>Select a. or b.</i>	
0	a. Price represents order pricing, actual price at shipment may well be different.	
100	b. Price represents the completion of service or a proxy measure for the completed transaction.	100
	2. Representative of current period production (Weight = .10)	
	<i>Select a. or b.</i>	
50	a. Emergence of new product lines or critical new product features has not occurred since the index reference period or since sample augmentation last done.	50
0	b. Emergence of new product lines or critical new product features has occurred since the index reference period or since sample augmentation last done.	0
	<i>Select c. or d.</i>	
50	c. Product substitution usually occurs when an item becomes obsolete or, if model pricing applies, the models are regularly updated to reflect changes.	50
0	d. Product substitution usually does not occur when an item becomes obsolete or, if model pricing applies, the models are not regularly updated to reflect changes.	
	3. Transaction price (Weight = .25)	
	<i>Select the one most prevalent in the industry</i>	
100	a. The price is the real transaction price or a list price that can always be assumed to be equal to the transaction price.	
50	b. The price is a list price not equal to the transaction price.	
100	c. The price is a unit value for a homogeneous group of products.	
50	d. The price is a unit value for a non-homogeneous group of products.	50
75	e. The price is a model price.	
50	f. The price is constructed from input cost plus profit and overhead mark-up.	
	4. Output price (Weight = .25)	
	<i>Select the one most prevalent in the industry</i>	
100	a. Recorded price reflects an actual transaction or average of actual transactions.	
75	b. Recorded price reflects a model transaction incorporating the pricing of all features found in an actual transaction.	
50	c. Recorded price reflects a model transaction incorporating the pricing of only some of the features found in an actual transaction.	
50	d. Recorded price reflects some components of a transaction.	50
50	e. Recorded price reflects input costs plus overhead and profit margins incorporating the pricing of all features found in an actual transaction.	
25	f. Recorded price reflects input costs plus overhead and profit margins incorporating the pricing of some of the features found in an actual transaction.	
0	g. Recorded price reflects charge out rates for fixed labour inputs not directly tied to a specific quantity of output.	0
	5. Timely measure (Weight = .10)	
	<i>Select a. or b.</i>	
50	a. Pricing data reflect the service provision in the current period and are not lagged.	
0	b. Pricing data are lagged.	0

	<i>Select c., d., or e.</i>	
50	c. Pricing data reflect an average over the entire period.	50
40	d. Pricing data reflect an average of multiple measurements over a portion of the period.	
25	e. Pricing data reflect a single point in time.	
	6. Constant quality maintained (Weight = .20)	
	<i>Select a. or b.</i>	
100	a. Rapid changes to product specification are not expected or, if they are, a good method to explicitly quality adjust is in use.	100
0	b. Rapid changes to product specification are expected and no explicit quality adjustment method is in use.	
	Total =	
	Type A point range = over 90	
	Type B point range = 70 to 90	70
	Type C point range = less than 70	

Explanations:

1 shipment price

The price used in the branch is a fixed price: theoretically it should not change. If there are overruns in the amount of time spent on the services provided – if the length of the project was underestimated, for example –, the consulting firm bears the burden.

2 representative of current period production

The services provided change regularly, and the qualifications required for responding to tender calls for consulting vary.

The duration of the consulting services is extremely variable. Durations of from 3 to 6 months are often seen.

3 transaction price

The price calculated corresponds to an average amount invoiced for a given qualification. The number of qualifications given varies from 1 (for all staff) to 7 or 8. The use of **subcontracting** can disconnect the selling price one is attempting to measure from the RDR measured (are freelancers whose services are engaged for a specific operation taken into account in calculating the RDR, or are these costs included in the firms' costs as intermediate consumption? Are these staff costs or are they additional costs?)

4 output price

The RDR per qualification is actually not directly linked to a quantity of work – a concept that is very difficult to measure when the work in question is intellectual work which can take various forms. The result of the work – that is, the effect on production processes – or the accompaniment of change is difficult to quantify.

5 timely measure

The service provision can cover a period of up to six months in normal configurations. It is not certain that this duration is taken into consideration in calculating the RDR. There is also uncertainty as to whether the turnover used in calculating the RDR actually corresponds to the advancement of the work, which generates significant variations in the RDR per qualification. In a significant number of cases (16 companies out of 80, it is necessary to use gliding averages to offset the uncertainty as to the proper consideration of turnover and of work duration by the firms.

6 constant quality maintained

Technologies and products have an inertia of several years, since the sector is not subject to disruption by sudden technological revolutions. The qualifications of the staff employed are not too subject to sudden upheavals, which permits price samplings over fairly long periods. Only changes in the qualification pyramids could have an effect on the index. Firms say that they don't

change very quickly – less quickly than in IT consulting. If new modes of production don't appear, it is preferable to maintain stable staff structures over the duration the index base.

Alternative methods?

Except for a few companies located in consulting niches who invoice on an annual retainer basis or by success fee, the "hourly charge-out rates" method is all but universal in France, perhaps because the "model pricing" method has not met with sufficient interest. The question we might ask, nevertheless, concerns the validity and the quality of the calculation of these RDRs by the firms. The key to guaranteeing that statistics don't stray too far from reality lies in maintaining contacts with the professional representation and collecting its opinion on the general evolution of prices as experienced by the companies in the branch. We should, however, be wary of a certain latent pessimism on the part of the professionals. During the visits to firms, many of them mentioned the drop in prices, but it was not tangibly manifested in their responses. An annual request for companies' opinions as to their feeling regarding price trends over the past year could be a way of validating the indices calculated.

9/ evaluation of comparability with turnover/output measures

An annual survey on french service firms (EAES) is realised every year. So, when beginning to work on a new index, or when we need a periodic review of these indices, it's easy to sample from these results.

For ISIC 3.1 'business and management consultancy' 7414, we know, for the greatest firms, the turnover by products in 8 levels, close to the CPC levels.

A great detail on turnover is also available for all the service industries, so that the sample is done on products.

The supply and use equation is done for whole 7414, with index of 7414 product The effect on growth rate is evident.

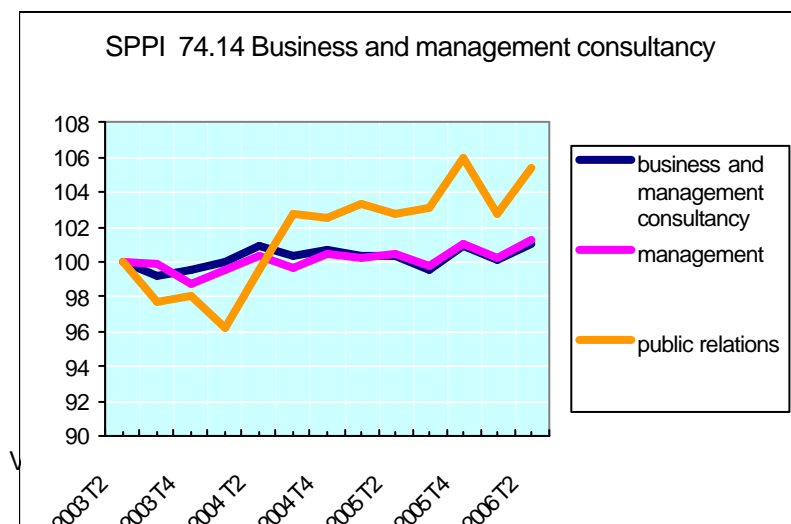
The revision of weights can be done by using the same annual survey.

10/ summary and some results

After 3 years, we have published the PPI for management consulting in january 2006. The professional Association (Syntec Conseil) agreed with the results, which is always a good point. The stability of prices during the period was like an evidence for them. The hourly charge out rate is the main pricing method we are using. We know it's not the good solution to avoid productivity effects, but is there really another one for this industry?

indices disseminated:

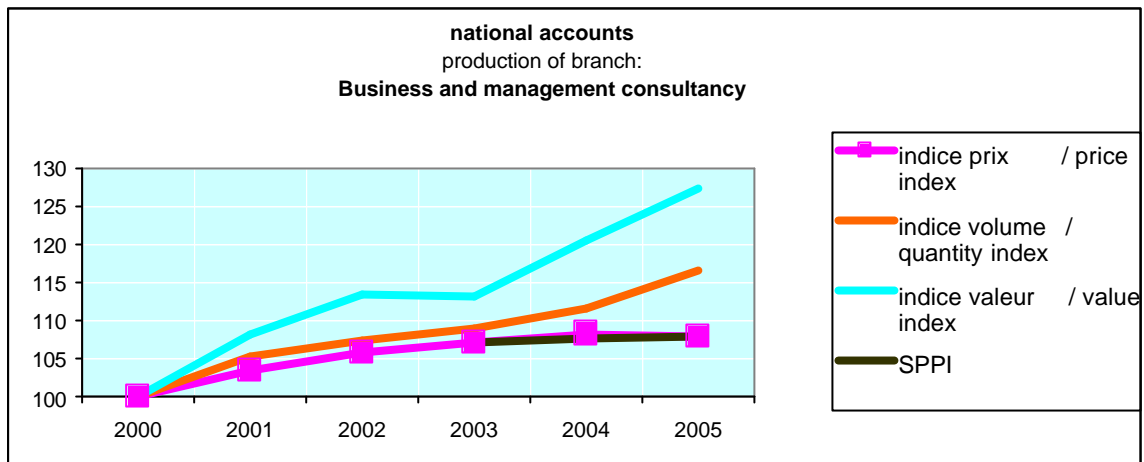
	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2
business and management consultancy	100	99.2	99.5	100	100.9	100.4	100.7	100.3	100.3	99.6	100.9	100.1	101
management	100	99.9	98.8	99.5	100.3	99.7	100.5	100.2	100.5	99.8	101	100.2	101.3
public relations	100	97.7	98	96.2	99.5	102.8	102.5	103.3	102.8	103.1	106	102.8	105.4



The calculated index appears to be in conformity with the information provided during visits to firms and with the sentiment expressed by industry professionals: prices, if not actually being dragged down, are at least forced into stability as a result of the strong pressure exerted by companies'

purchasing departments and of heavy competition at a time when there is no strong demand.

Effect on the national accounts: Since 2003, the base year of the price-index calculations, the national accounts have applied a price index that is closer to the calculated index to production of the product.



2005 temporary

2004 semi-final

2003 final