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SPPI Mini Presentation

**SPPI for Business and
Management Consultancy Activities
in Germany**

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1. Definition of the service being priced

This sector is divided into business / management consulting and public relations consulting. **Business and management consulting** includes consulting, support and instruction of enterprises, organisations and public services. While the wide range of management consulting covers the field of organisation, management, marketing, controlling, accounting etc., personnel management consulting provides support in all matters of human resources.

The European Federation of Management Consultancies Associations describes the management consulting market as follows: "What is more, whilst other markets are well defined, the MC market is, due to its nature, ever changing. There is no cohesive industry; it is too complex for a single, integrated set of rules. Management Consultancy keeps converging with other high value added business services to provide innovative solutions and help companies to be competitive. This is how it should be: Consultants respond to needs; they don't follow a standard process."¹

Public relations consulting put its focus on consulting a company on its outward presentation to the public such as customers and the press. Activity fields are mostly consulting in public relations, corporate design, promotion but also communication concepts.

Because of the relatively small importance of public relations consultants, the FSO plans to neglect this target group in a first step of the work. Since in Germany public relations consulting are closely linked to the advertising market, we hope to find out more about this service during the current development work on SPPI for advertising.

2. Pricing unit of measure

The output of this industry is highly diverse. Management Consulting Services cover a large heterogeneous range of consulting activities; they are client specific and vary depending on the requirements of the client. Most of the consulting services are unique. Thus the output of this industry could be described as unique consulting services, varying in the time engaged for different professional levels of the consultants and their achieved results.

For management consulting services, both the definition of the output and the definition of the value of the product cannot be well-specified particularly with regard to consecutive periods. Because of the lack of classical price-determining factors for consulting services, other characteristics have to be identified instead.

¹ FEACO (Fédération Européenne des Associations de Conseil en Organisation = The European Federation of Management Consultancies Associations), Brussels: www.feaco.org

Having specified a model service in detail a model pricing approach is applied. Here a service – mostly generic sub-activities – whose specifications are held constant will be described which either can be fully fictitious or based on a contract signed in the past.

Focusing more on the provision of the service (input) than on the service itself, time-based pricing methods are applied for SPPI's for unique services. Therefore an implicit assumption is made that the time a consultant for a given professional level spends with a client is the best approximation for price observation.

3. Market conditions and constraints

3.1 Size of industry

In 2004 the worldwide market for management consultancy had a turnover of over 100 billion US \$. About one half of that was generated by Europe based consultancy firms. The UK and Germany are by far the largest markets in Europe, representing respectively 29.3% and 27.3% of the total European market. In third place, France represents 12.2%.²

In 2004 the total turnover of ISIC 7414 / NACE 74.14 in Germany amounted to approximately 16 Billion Euros according to the FSO Service Statistics (Dienstleistungsstatistik).

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 93% and for public relations services 7% respectively according to the FSO Service Statistics.

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 worldwide and cover all important activity fields of management consultancy. Small and medium sized enterprises of management consulting services put their focus mostly on niches of activity, capable of providing services in specific areas, industries and markets.

3.2 Special conditions or restrictions

Two special conditions for developing SPPI for management consultancy in Germany can be pointed out:

- In Germany the Federal Association of German Management Consultants (BDU) was installed with the aim to increase the performance standard of consulting companies, to implement quality standards by means of professional regulations

² Source: FEACO: Survey of the European management consultancy market 2004; www.feaco.org

and principles, to positively influence the economic and legal framework conditions of the consulting sector and finally to support the demand for management consultancy.

For the FSO it was important to seek assistance from the Association both in the sample design process and in the questionnaire design process. The BDU provided splits of the main activity fields of management consultants in Germany and it turned out that in Germany it is not a common practise to differentiate the management consulting sector in branches such as in financial, marketing or production as in practice there are overlaps between these activities. The German market of management consultants is usually divided into four fields:

- Consulting in strategy,
- Consulting in organisation, management and processes,
- IT consulting and
- Human resources consulting.

While strategic consulting deals with strategy 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 management consulting projects with integrated aspects of IT services; software development is expressly excluded. The core business for human resources is consulting in human resources development.

This kind of classification is nearly the same as the one applied by the European Federation of Management Consultancies Associations (FEACO) which segments the management consulting market into five key service lines³:

- Information Technology (IT) Consulting
- Corporate Strategy Services
- Operations-Management
- Human-Resources (HR)-Management
- Outsourcing Services

- o Before drawing a random stratified sample of this market according to turnover, it was the main challenge to fix the universe of the FSO business register. The term "management consulting" invites a lot of enterprises to enrol to NACE 74.14 at the FSO business register. Beside this fact an accurate differentiation of IT services and management consulting services is becoming more and more difficult. On one hand the relevance of IT services as a supporting tool of management consulting is increasing, on the other hand IT companies are widening their range of services to organisational or strategic topics. This development makes it difficult to draw a clear line between management consulting and IT consulting. According to experts 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

³ www.feaco.org

consulting projects including IT services. Both enterprises with main focus on IT services and enterprises which are engaged on software development are excluded from this survey.

The composition of the German market for management consulting companies shows that 36 245 enterprises (99.0%) with a yearly turnover up to 5 Mio EUR gained 52.5% of the market share, while 370 of the companies (1.0%) with a yearly turnover above 5 Mio EUR accounted for 47.5% of the overall turnover⁴. Based on the fact of particular importance of big companies the FSO puts its focus on checking the universe of the FSO business register mainly from enterprises with turnover above 5 Mio EUR.

As the enterprises with the highest turnovers are key figures for the German SPPI for management consulting, all enterprises that achieved an annual turnover of more than 10 million Euros constitute a full-coverage stratum and are matched with the units of the FSO Service Statistic.

3.3 Record keeping practices

The level of organisation at which data items are collected differs from the phases of the survey. Phase I (production of the weighting pattern) needs overall figures that are usually kept at corporate level; in contrast, the pricing records needed for phase II (current price observation) are normally kept at the operational level. In some cases, this includes asking several subsidiaries of the company.

In anticipation of the initiative of the German government to reduce bureaucracy, the FSO established only a small sample of small and medium sized firms chosen to represent these strata. The sample size covers nearly 50 enterprises with a yearly turnover up to 5 Mio EUR and about 100 enterprises with a yearly turnover above 5 Mio EUR.

The presently used concept has the important advantage that respondents are troubled as little as possible. The rhythm of the inquiry is annual⁵ for smaller and middle sized enterprises and quarterly for larger enterprises.

Model pricing is a highly resource-intensive method and is realised only with a few enterprises within Germany.

⁴ according to results of the FSO Service Statistics, 2004

⁵ The rhythm of the inquiry is annual and at the time of price adjustment. By pre-survey it was found out which companies adopt their prices annually and at what point of time.

4. Standard classification structure and detail

... related to the area – does the standard include necessary product detail based on identified price determining characteristics?

In **NACE** Rev. 1.1 (2002) 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.

A nearly identical description is used by **ISIC** (International Standard Industrial Classification of All Economic Activities) Rev. 3.1 (2004) for code 7414 “Business and management consultancy activities”.

In contrast both drafts of ISIC Rev. 4 (Dec 2005) and NACE Ref. 2 (April 2006) give a finer description of code 70.2 Management consultancy activities. The most important changes for the future are the inclusion of ‘lobbying activities’ in these drafts and the exclusion of ‘management consultancy such as by agronomists and agricultural economist to farms’.

The **CPC** (Central Product Classification, Version 1.1, 2002) and the **CPA** (Statistical Classification of Products by Activity in the European Economic Community, Version 2002) divide the group ‘management consulting services’ into the branches:

- General management consulting services
- Financial management consulting services
- Human resources management consulting services
- Marketing management consulting services
- Production management consulting services

As written in chapter 3.2 this kind of differentiation can scarcely be distinguished from each other in practice. Instead in Germany it proved more practical to structure according to functions (activity fields) such as consulting in strategy, in organisation/ management/processes, in IT and in human resources.

Results of the price collection process at the FSO showed that there are different levels of charge-out rates not only for different qualifications levels but also especially for the activity field of strategic consulting services, for the activity field of organisation, management and process consulting services, for IT consulting and for human resource consulting.

This aspect will be rudimentary implemented in **draft CPC, Version 2 (2006)**. The draft shows following structure for class 8311 management consulting and management services:

- 83111 Strategic management consulting services
- 83112 Financial management consulting services
- 83113 Human resources management consulting services
- 83114 Marketing management consulting services
- 83115 Operations management consulting services
- 83116 Supply chain and other management consulting services
- 83117 Business process management services

Here distinctions both in branches (financial, marketing, supply chain) and in functions (strategic, operations and business process) are made which in practise lead to overlapping of management consultancy services.

5. Evaluation of standard vs. definition and market conditions

First experiences of the price collection survey for the German market for management consultancy proved the importance to distinguish between the different functions of consulting services such as strategy, organisation/management/processes, IT and human resources. On the one hand respondents are able to calculate charge-out rates for these activity fields, on the other hand analysis of price determining characteristics shows different levels of charge-out rates not only for different qualification levels but also for the different activity fields.

Against the background of the ever changing markets and consequently further challenges for management consultants, the traditional differentiation of enterprises in branches such as financial, marketing and production could be not suitable for the future. Here the draft CPC (Version 2 - 2006) meets better the requirements of the German management consulting market, but the distinctions of the activity fields in both branches and functions lead to overlapping.

6. National accounts concepts

... and measurement issues for the area related to GDP measurement

German national accounts uses CPA 74.14 "Business and management consultancy services" as most detailed position for price and volume measures. Up to now the price indices from the consumer price statistics for tax advisers' services are used to deflate the output. This is not satisfying. When a price index for management consultancy is available, this will be a big step to improve price and volume measures for this kind of services. The index is appropriate for the main part of the product group CPA 74.14 and will be used to deflate output of the whole product group. The new German price index based on daily fees is comparable to a price index based on hourly fees, which is

accepted as a B method in the Eurostat Handbook on price and volume measures in national accounts. That means, it is a price index, which can be used in case an A method cannot be applied. During the period of development, German price statistics have proved that most appropriate methods for price and volume measures in national accounts for management consultancy, based on actual contract prices or model prices, are not practicable. Therefore German national accounts will get best possible and satisfying price indices for management consultancy in the near future.

7. Pricing method(s)

... and criteria for choosing various pricing methods – depending on record keeping practices and billing practices, there may need to be a hierarchy of methods from actual to best proxy (discuss order and list prices, current or lagged prices, transaction, shipment, etc.) -- Refer to the categories in the PPI Quality Assessment Tool for guidance.

Firstly an overview is given over the price mechanisms in Germany⁶. Consultants charge a bill for their clients either on

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

The prices for management consulting services could be **time-based**, priced as daily rates. Daily rates could be differentiated between professional levels (such as partner, project leader, senior and junior consultant) and activity fields (such as strategy, organisation / management / process organisation, IT and human resources).

Project-based prices could be 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 whether the client is a new or old client or on the client's annual turnover with the consulting company – in the broadest sense it is a matter of negotiation. For unexpected and uncontrollable problems sometimes a risk coefficient is included. Bigger companies have a greater frequency of project-based pricing than smaller companies which are 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. For that reason and

⁶ The methodological approach for calculating SPPIs for management consultancy consists of two phases:
 Phase 1: the production of a weighting pattern in 2005/2006 and
 Phase 2: the development of SPPI, the current price observation (base 2006).

Defining one activity field as one transaction with 4 realised daily rates per enterprise the FSO collects nearly 500 transactions within one survey period.

Evaluation within the PPI Quality Assessment Tool for guidance:

1. Shipment price
To b) The collected prices represent the completion of the management consulting service
2. Representative of current period production
To a) The market for management consultancy is under observation and there haven't been new services since the current base period.
To c) Substitution of new services occurs when this service becomes obsolete.
3. Transaction price
To d) In small and medium-sized enterprises charge-out rates are collected as actual daily rates. The prices in a few middle-sized and many bigger companies are realised daily rates which are calculated as a ratio of income and working days needed for each of the different professional levels. Because of the focus rather on the provision of the service (input) than on the service itself and the uniqueness of the service, the FSO would classify these kinds of prices as unit value for a non-homogeneous group of products.
4. Output price
To d) Realised charge-out rates are neither an actual transaction nor a model transaction. Therefore the FSO would classify pricing data of both charge-out rates and realised charge-out rates as a reflection of some components of a transaction.
5. Timely measure
To a) transaction prices collected as charge-out rates reflect the service provision in the current period and are not lagged.
To b) However mainly price data is collected in form of realised charge-out rates which can only be calculated afterwards and therefore is lagged usually by one quarter of the year.
To c) Referring to the representativeness, the data represent the entire time period
6. Constant quality maintained
To a) The FSO would assess that product changes in the market for management consultancy in Germany occur at a very slow pace.

7.2 Real transaction prices as model transaction

As defined in OECD/Eurostat SPPI Manual, model pricing is only used for clearly specified services in terms of output and not of input.

A standard or generic contract as a model transaction has to be defined. Here a service – mostly generic sub-activities – whose specifications are held constant will be described which either can be fully fictitious or based on a contract signed in the past.

Below the FSO made an attempt to classify its practices according to the structure provided by both the Thesaurus of SPPIs and the PPI quality assessment framework:

Data type in the survey:

- Real transaction prices for the model pricing

Length of delivery and length of the survey period:

Most contracts and model transactions for management consulting services last longer than one survey period due to the nature of the service;

Relation between the moment of delivery and price recording in the index:

The price is recorded before delivery starts

Number of real transactions covered in one piece of price information:

Model pricing is realised only with a few enterprises within Germany (see chapter 10). The questionnaire consists of the description of the model case as one transaction and the evaluation of price adjustments due to price or quality.

Evaluation within the PPI Quality Assessment Tool for guidance:

1. Shipment price
To b) The collected prices represent the completion of the management consulting service
2. Representative of current period production
To a) The market for management consultancy is under observation and there haven't been new services since the current base period.
To c) Being in close contact with the respondent, a regular updating of the models is used, to ensure that they do not become out of date. Therefore substitution of new services occurs when this service becomes obsolete.
3. Transaction price
To e) The price is a model price
4. Output price
To c) The recorded price reflects a model transaction. Because of making only an attempt to take into account usual discounts offered in this industry, the recorded price reflects only some of the features found in an actual transaction.
5. Timely measure
To a) Real transaction prices reflect the service provision in the current period and are not lagged.
To c) Referring to the representativeness, the data represent the entire time period. Furthermore this is assured by regular updating of the model transaction.
6. Constant quality maintained
To a) The FSO would assess that product changes in the market for management consultancy in Germany occur at a very slow pace.

8. Quality adjustment methodology(s)

... depending on the pricing mechanism and item substitution practices

Productivity progress is a factor which influences the service 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. However, scientific papers have shown that the measurement of technological / productivity progress for services is rather difficult. It is not growing proportionally and appears unexpected and erratically over time. The FSO evaluates that productivity changes in the market for management consultancy in Germany occur at a very slow pace.

9. Evaluation of comparability with turnover/output measures

...(including an assessment of the quality of turnover/output data and problems encountered in using classifications systems, especially for product line determination) (The purpose of Headings 8 and 9 is to help ensure that turnover/output and quality adjusted price data are adequate for use and provided in enough detail that major differences are not lost within the aggregates.)

The German Service Statistic has been producing results of turnover figures for management consultancy since 2000. During this period the accuracy of measurement of turnover figures has continuously increased.

While the output of turnover is well defined and surveyed, base of the sample for both the SPPIs and the Service Statistic is the FSO business register which appears as one of the main difficulties (see also Chapter 3.2). For that reason the FSO sections for SPPIs and for Service Statistic are in close contact with each other, a matching of all enterprises above 10 Million EURO turnover being in the sample has been made.

10. Summary

Results of the survey pointed out different levels of charge-out rates not only for different qualification levels but also for the different activity fields. It proved that it should be of importance to distinguish between the different functions of consulting services instead of the different branches.

The Eurostat 'handbook on price and volume measures in national accounts'⁸ defines price collection of actual contract prices for management consultancy services as an A-method. Contract pricing cannot be applied for unique services in case of management consulting. Therefore the FSO uses model pricing and pricing based on working time⁹.

⁸ Edition 2001, Page 107f

⁹ The meaning of "pricing based on working time" results in actual charge-out rates or in realised charge-out rates (see Chapter 7.1)

But both are not able to measure the actual price exactly. While model pricing very often does not reflect the discounts and the contribution of the negotiation process, pricing based on working time sometimes gives no insight into changes of the engaged working time and/or into variances of the professional levels of the engaged staff. Model pricing is a highly resource-intensive method for price collection, because of the need for regularly updating of the models used, assuring their representativeness and their quality as a tool for the observation of the actual price – which all requires a constant dialog of the price-collectors and the respondent, especially in an heterogeneous service like management consulting.

In contrast price-collection based on working time could be managed with fewer resources causes much less burden to respondents. Therefore this approach was integrated as the major German working procedure for calculating SPPIs. The very fact that only at the beginning of the price collection process an intensive contact with the respondents is essential, further price observations are less resource-intensive. The disadvantage of getting lagged realised charge-out rates is limited to one quarter period in collecting price data on quarterly base in particular at large companies.

However the Eurostat 'handbook on price and volume measures in national accounts'¹⁰ classifies both model pricing - if the criteria of measuring "actual prices" are not met – and 'charge-out rates' as a B-method. Still measuring prices based on working time (actual charge-out rates/realised charge-out rates) is assessed by the German National Accounts as the best possible and satisfying price index.

The inclusion of both all market players achieving an annual turnover of more than 10 million Euros and a random stratified sample drawing on enterprises with a yearly turnover up to 10 Mio Euros assures a representative coverage of the market for management consultancy activities. Thus as a way for getting reliable results in connection with an efficient price collection process, the FSO prefers to put its main focus for measuring SPPIs for management consultancy on pricing based on working time.

¹⁰ Edition 2001, Page 24 and 108

11. PPI Quality Assessment Framework

Points	Category and Questions	Score for pricing method ...	
		... based on working time	... as model transaction
	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	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	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.	-	-
	<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	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.	-	75
50	f. The price is constructed from input cost plus profit and overhead mark-up.	-	-

Points	Category and Questions	Score for pricing method ...	
		... based on working time	... as model transaction
	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
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 labor inputs not directly tied to a specific quantity of output.	-	-
	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.	-	50
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	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	100
0	b. Rapid changes to product specification are expected and no explicit quality adjustment method is in use.	-	-
	Total =	70	81,25
	Type A point range = over 90		
	Type B point range = 70 to 90	70	81,25
	Type C point range = less than 70		