

Benchmark Your Way to a Better Bottom Line:

Perspectives on Firm Management
and Key Industry Benchmarks

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About Kennedy Information

Kennedy Information, the leading information source on management consulting since 1970, publishes the newsletters *Consultants News*, *Global IT Services Report*, *Management Consultant International*, plus *Consulting Magazine* and *The Directory of Management Consultants*. The company produces annual conferences for thought leaders in consulting and powers the Web portal ConsultingCentral.com.

Described by *Fortune* magazine as “authoritative” and regularly quoted by *The Wall Street Journal*, *The Financial Times* of London, CNN and other major media outlets, Kennedy Information’s editors and analysts are the world’s foremost experts on the consulting industry. The company is based in Peterborough, New Hampshire, with bureaus in New York, Washington D.C., and London.

Kennedy Information is a subsidiary of The Bureau of National Affairs, which has been the nation’s leading provider of specialized financial and regulatory news and information for professionals in business since 1929.

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In addition to ten years of operating experience, Mr. Smith worked as a management consultant for Towers Perrin, where he led a number of assignments, focusing on strategy and organization across a number of industries.

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Introduction

Benchmark Your Way to a Better Bottom Line:

Perspectives on Firm Management and Key Industry Benchmarks

By Brad Smith, Vice President
Kennedy Information, Inc.

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It's been a tumultuous start of the millennium for the consulting industry. With corporate scandals, world economic downturn, and the constant threat of global political instability, it's no wonder the industry contracted for the first time in the thirty-plus years Kennedy Information has tracked it.

Though consultants have suffered since 2000, the time seems right for an industrywide recovery. But firms shouldn't expect a rising tide to lift all boats. There will be winners and losers in the next few years as the industry expansion picture stabilizes – and the management steps you take today will affect your bottom- and top-line results. Intense competition and increasingly sophisticated clients make effective firm management critical to overall success. Understanding key operating benchmarks will greatly facilitate making the difficult decisions about how best to allocate valuable resources.

In this paper, we break out firm costs into three principal components:

- Human capital, including variable compensation
- Marketing and sales, a cost center critical to keeping the pipeline full
- Other firm costs, including allocations for training, occupancy, and IT.

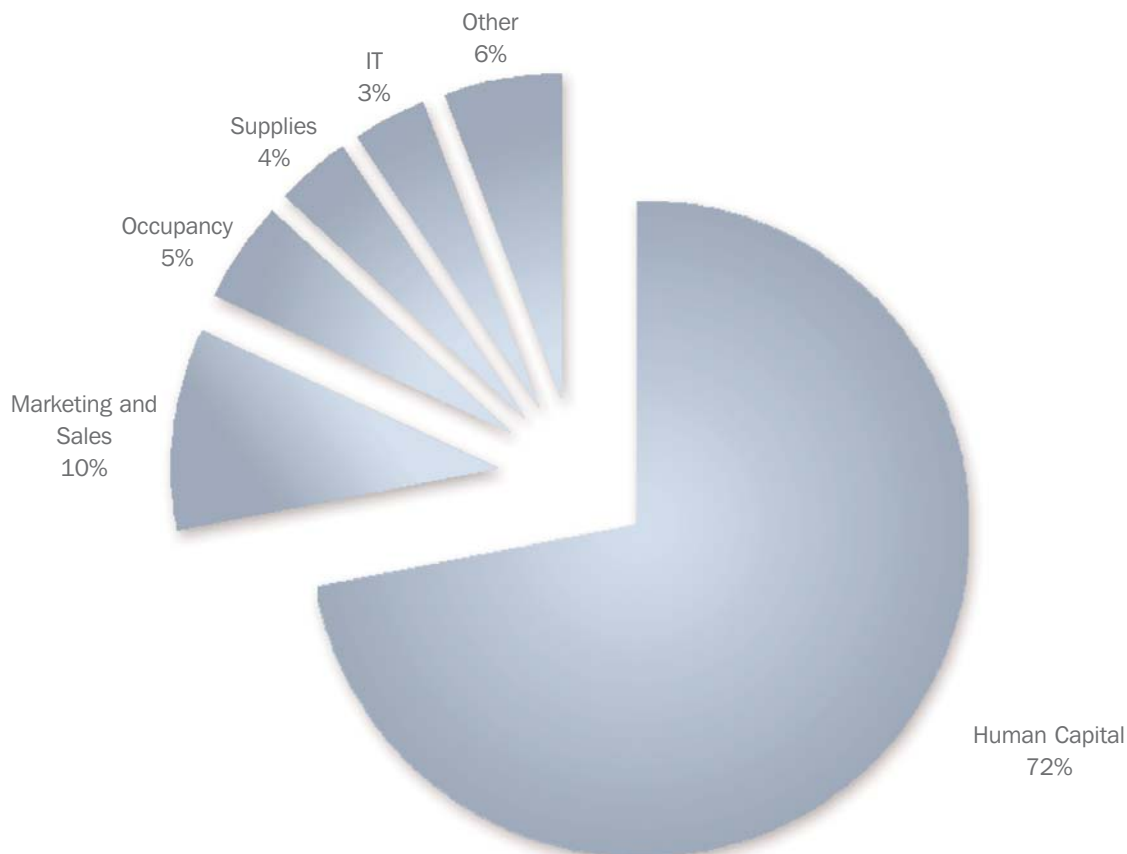
Each is interconnected; a shift in one metric will likely impact one or more of the others. Likewise, trying to affect one measure may influence other measures – either positively or negatively. For instance, decreasing fees may positively impact various sales figures such as win rates and backlog while negatively impacting profit margins and, ultimately, profitability.

The Bottom Line: Managing Firm Costs

Managing firm operating costs has become more important than ever in the last few years. Many firms have laid off staff, reduced marketing budgets, and otherwise cut overhead. Our research shows that small and medium-sized enterprises (SME) have outperformed their larger competitors over the past several years in large part because they were able to manage costs more effectively. SME firms tend to have lower human capital costs, as many experienced consultants are willing to trade away a portion of their large-firm paycheck for more work/life balance at a small firm. Further, large firms tend to rely on thought leadership and brand building to a larger extent, driving up direct marketing costs and lowering utilization among the thought leaders. Lastly, smaller firms have tended to operate more comfortably with lower overhead costs than larger firms.

Figure 1 illustrates the extent to which human capital costs dominate the typical consulting firm's operating budget. Further down the expense list is marketing and sales, the second-largest expense, which averages 10% of operating costs. The balance of expenses is divided among occupancy, supplies, IT, and other costs.

Figure 1. Average Consulting Firm Operating Cost Breakdown



Source: Kennedy Information, Inc.

Though the operating cost breakdown differs among firms, the range of divisions is quite narrow. The two middle quartiles range between 65% and 80% for spending on human capital — proving the point that spending on employees is the most constant and important expense for consulting firms. Marketing and sales budgets vary more widely, with a range of 4% to over 11% (Figure 2).

Figure 2. Quartile Analysis of Operating Cost Allocations

	25th Percentile	Median	75th Percentile
Human Capital	65.0%	74.5%	80.0%
Marketing and Sales	4.0%	8.5%	11.3%
Occupancy	2.0%	5.0%	8.0%
Supplies	1.0%	2.0%	5.0%
IT	1.0%	2.0%	4.0%
Other	0.0%	2.0%	8.0%

Source: Kennedy Information, Inc.

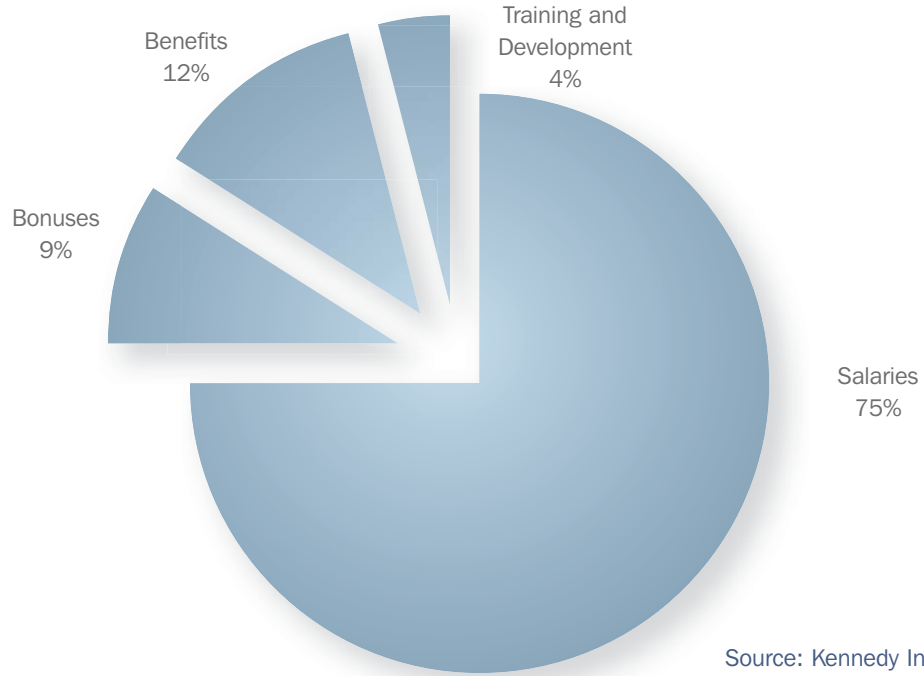
The Big Nut: Human Capital Investment

Since human capital expenditures dominate a firm's operating costs, it's important to look at how these costs break down. Figure 3 provides the average breakdown for human capital spending. Salary and benefits costs make up a larger part of overall compensation than in the past, due to rising health care costs and the cutting of discretionary training and bonus spending.

Key to the way consultants are compensated, there are indications that bonus payouts in 2004 will be higher than bonus payouts in 2003. While only very small increases in base pay are expected, the use of variable pay based on both individual and firm performance will become a larger part of total compensation. There is still a great deal of caution in the consulting market with respect to increasing base pay more substantially; we don't expect to see base pay rise until 2005 and beyond.

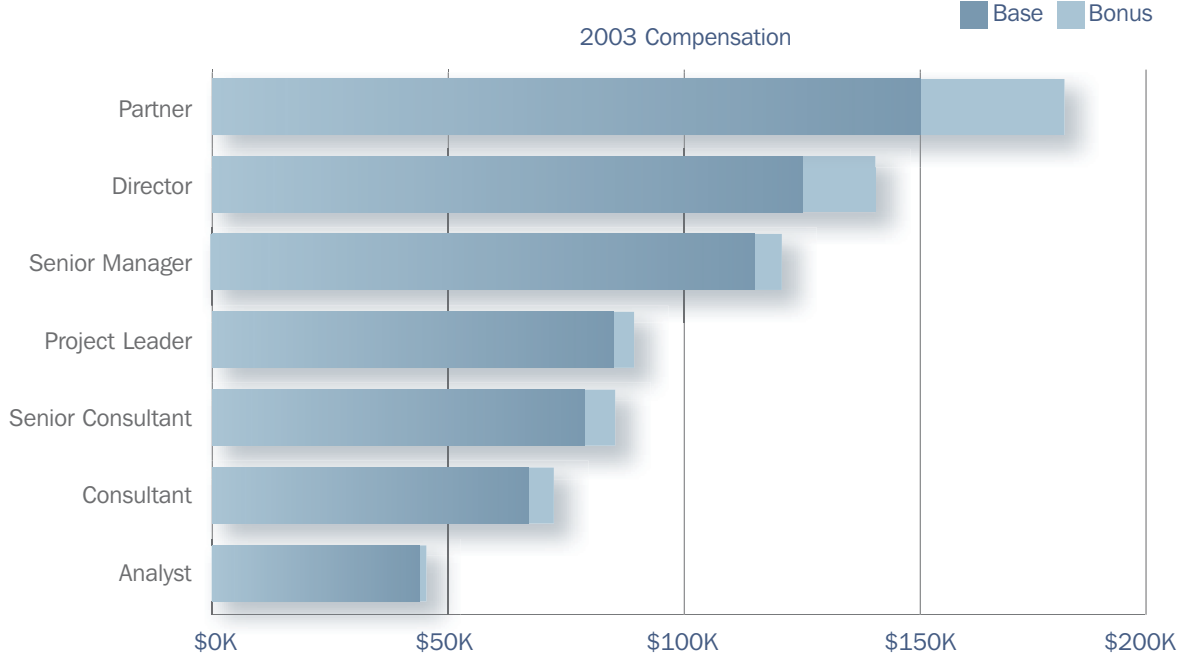
Despite industry revenue declines in 2002 and essentially flat growth in 2003, firms still managed modest salary increases to most employees last year. Small firms (under \$10 million in sales) were less apt than larger firms to provide an increase, whether a "cost of living" type or one based on merit. However, the size of the increase was, on average, higher for employees at small firms than at larger ones. Median salaries for small firm positions are shown in Figure 4.

Figure 3. Average Consulting Firm Human Capital Cost Breakdown



Source: Kennedy Information, Inc.

Figure 4. Median Consulting Salaries by Employee Level, 2002



Source: Kennedy Information, Inc.

Marketing That Works

If your firm is like most, you are always looking for new and better ways to develop business. While you have a range of marketing and sales activities to choose from, some offer more return on investment. Additionally, some types of marketing are better for one goal, while others are more suited to a different objective.

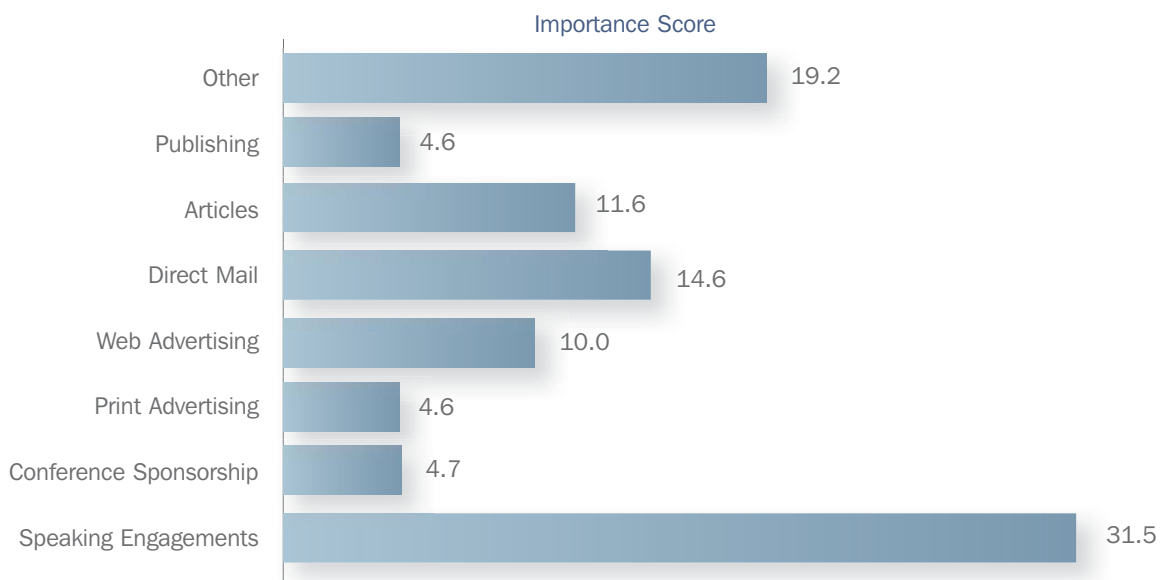
In this complex age of marketing overload, it's imperative to use the right ways to reach clients. And it's equally important to know why certain marketing and sales strategies are right for you. In this section we take an in-depth look at which marketing activities are most important and why. Additionally, we analyze the breakdown of marketing and sales spending for the consulting industry.

Identifying the Most Important Marketing Activities

Since 2000, it has become a buyer's market for consulting services. With longer sales cycles accompanying shorter projects, firms have struggled to keep the pipeline full. Increased competition makes sales wins harder. But increased competition is only part of the story. There is more competition because projects are smaller and clients are more demanding. Because of shrinking discretionary budgets and pressure to make the numbers, clients are requesting smaller projects and ones on which the investment will pay off tangibly.

Since projects have more defined business outcomes and are in general more circumscribed, the opportunities for consultants to walk the halls to drum up new business are drying up. Sales opportunities are being mined in different

Figure 5. Importance Ratings for Consulting Firm Marketing Activities



Note: Firms were asked to allocate 100 points among the above options.

Source: Kennedy Information, Inc.

ways by firms now. “We’ve taken out a layer of middle management in sales completely...[and] we’ve tried to throw more incentives onto our existing consultants to generate sales and new contracts, specifically hoping to penetrate deeper with our existing relationships,” notes one mid-market consulting firm executive.

Many firms are gearing themselves even further to provide expertise in a narrow range of industries or functions. Most of this specialization is occurring at medium-sized or small firms and is a reaction to client needs. Clients are looking for lower delivery costs and faster project cycles from their consultants. Experts require little or no ramp-up time, which allows projects to be shorter and less expensive.

But how do you let clients know about your deeper expertise? Most firms, as indicated by Figure 5, report that speaking engagements (including conferences, proprietary events, forums, seminars, and the like) are far and away the most important marketing activities their firms undertake. Indeed, speaking in-depth about a topic on which one is an expert is a great way to show potential clients the depth of understanding a consultant has of an industry, process, technology, or function. The fine balance a firm has to make is in deciding whether it’s more effective to speak to the diverse needs of potential clients at a large event, or to address the more homogeneous needs of a smaller pool of potential clients attending a targeted event. Both have their pluses and minuses.

Still, other traditional marketing methods can be effective for consulting firms. If a firm has the capital to spend on direct mail, professional sales staff, and advertising, they can be highly effective when strategically combined. For a good example of how this can work, see the case study on page 11 for details.

Which Medium for Which Goal?

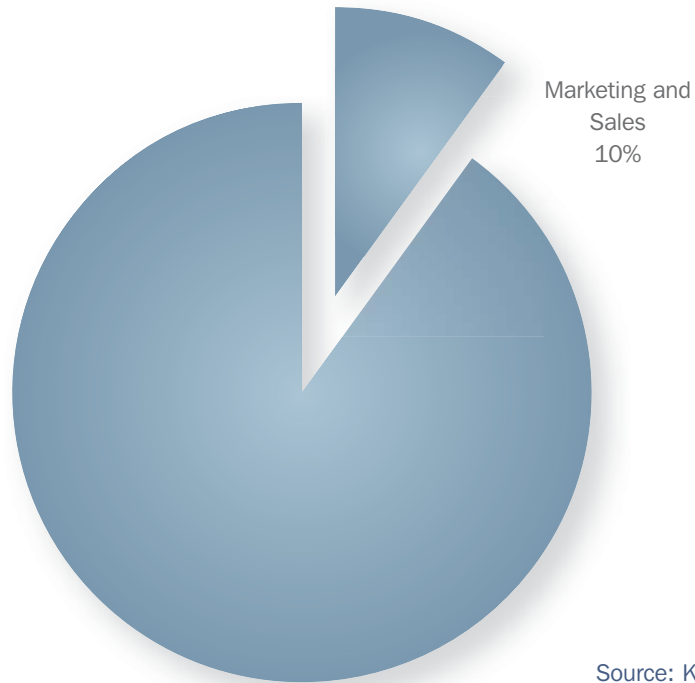
Different marketing and sales activities are best suited to different goals. Speaking engagements are the most common method for building awareness of firm capabilities. Conference sponsorship, print advertising, and articles in third-party publications are the most commonly used marketing tools for brand building.

Figure 6. Reasons Consulting Firms Undertake Marketing Activities

Marketing Reason	Marketing Activity							
	Speaking Engagements	Conference Sponsorship	Print Advertising	Web Advertising	Direct Mail	Articles	Publishing	Other
Don't Do	1%	46%	48%	26%	15%	10%	49%	20%
Brandbuilding	20%	27%	24%	9%	15%	36%	15%	2%
Firm Capabilities	59%	18%	18%	42%	27%	46%	25%	28%
Generate Sales	19%	9%	8%	20%	41%	8%	11%	48%
Other	1%	0%	2%	3%	2%	0%	0%	2%

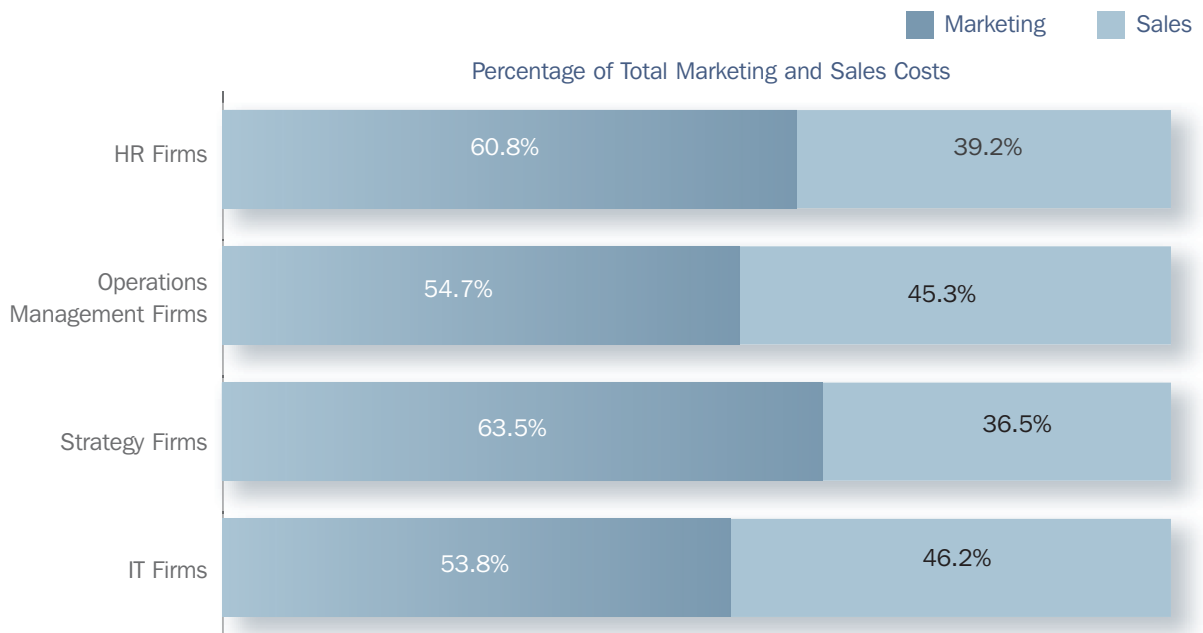
Source: Kennedy Information, Inc.

Figure 7. Percentage of Total Operating Budget Allocated to Marketing and Sales



Source: Kennedy Information, Inc.

Figure 8. Consulting Firm Spending Allocation Between Sales and Marketing Activities



Source: Kennedy Information, Inc.

Marketing and Sales Spending in the Consulting Industry

The marketing budget has taken a hit recently at most consulting firms. As consultants grapple with reining in costs to make lower fees profitable, marketing spending is one of the first casualties. Still, firms reported spending an average of 10% of their total operating budgets (including human capital, marketing, occupancy, IT, supplies, and other costs) on sales and marketing combined (Figure 7). SME firms spend about 11% of their total budgets on marketing and sales.

Strategy firms spend most of their business development dollars on marketing rather than sales. Because of the relationship nature of the strategy consulting business, firms in this space tend not to allocate their business development budgets to specific sales activities. IT firms, on the other hand, devote more money to direct sales efforts, reflecting the more project-driven nature of that sector's business. Figure 8 provides detail on how marketing and sales budgets break out for different kinds of firms.

A Case Study: How One Firm Integrated Sales and Marketing

One boutique sales and marketing consultancy focused on the professional services industry launched an innovative integrated marketing and sales campaign. The elements of the campaign included:

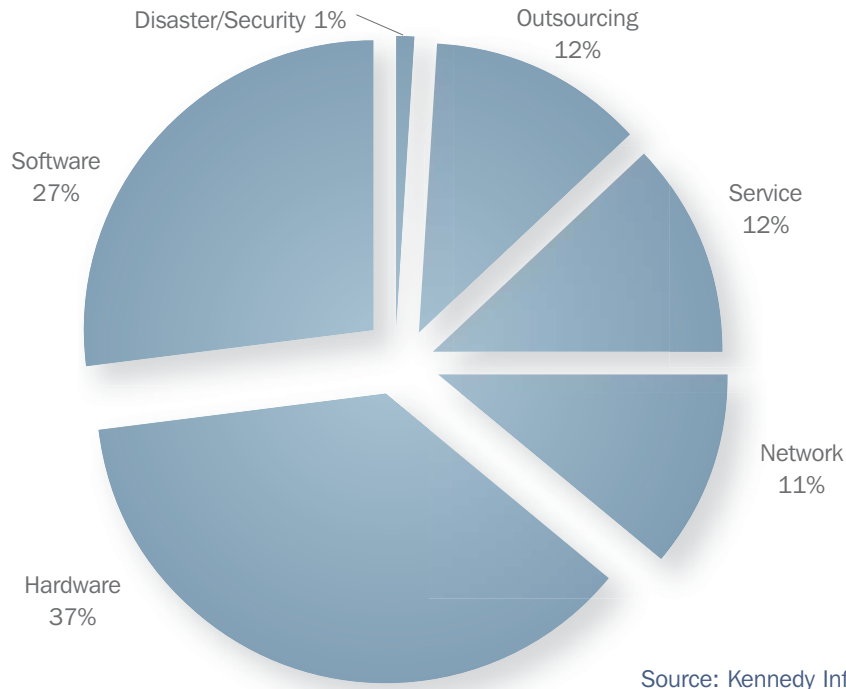
- Brand awareness building postcards mailed monthly to their target database
- Bi-monthly newsletter designed to establish thought leadership on marketing and sales for professional services firms
- A full-page monthly ad in an industry-focused magazine
- Bylined articles in trade publications, audio program on United Airlines, speaking at industry organizations
- Lead generation from a dedicated senior professional who called senior managers in the target database to introduce the firm and schedule meetings

In the first four months of the campaign, the firm didn't see appreciable results. Then the effects of the integrated campaign started to kick in. Prior to launching the campaign, the firm averaged four to five meetings with prospects per month resulting in two to three proposals. At 10 months into the campaign, the firm averaged four to five meetings and two to three proposals per week.

Controlling Those “Other” Costs

Figure 9 captured the distribution of costs for the average consulting firm; the allocations are not materially different for small versus large firms. As we saw, human capital and marketing/sales costs comprise nearly 90% of a small firm's cost structure. However, the remaining expenses — in particular, IT — are some of the most critical investments the firm makes and play a significant role in improving productivity. Below, we benchmark spending on the key IT components to help you understand whether you are allocating resources in line with your peer group. Smaller consulting firms, not surprisingly, tend to spend more on software and hardware than do larger firms.

Figure 9. IT Spending Breakdown for Small Consultancies



Action Items

So, what does all of this mean for the busy firm leader? Below, we offer some closing thoughts.

- Serving customers should always be the first priority of the consultant. However, that can be done only through the effective deployment of smart, motivated professionals. You cannot take your eye off the critical human resource issues of attracting, retaining and motivating employees.
- Avoid the all-too-common swings that consultancies find themselves in: an emphasis on business development leads to new work, but then highly utilized staff don't have time to devote to future business development. And developing and managing staff sometimes is relegated to a distant third, next to selling and executing on client engagements. Work to balance these three requirements: sales, client work, and firm/staff management.
- Consider structuring compensation around greater variable pay based on performance and less on base salary. This leads to greater alignment of activities with goals and reduces risk in weaker revenue periods.
- Know your markets and stay focused. Smaller firms have illustrated the wisdom of this strategy relative to larger generalist firms that grew quickly in the heady days of the late 1990s but have been hit with high overheads, weak marketing messages and staff layoffs since late 2000.
- Continued strategic investments in tools that enhance productivity and collaboration will help the travel-intensive consulting profession thrive in a cost-conscious era. IT outlays should be considered for their returns on investment and not simply as required costs of doing business.

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