CMC-Canada's 2011 Management Consulting Industry Study

Executive summary

The general economic climate has shifted since much of the research was conducted in the summer of 2011. This research report provides a snapshot of opinions at that time – and should be interpreted in that light. The key findings are summarized below and on the following four pages.

Regaining ground: Canada's management consulting market regained momentum in 2010, as strong overall growth more than offset the sudden contraction in 2009.

- Industry revenues rebounded to an estimated $9.2 billion in 2010, fractionally above 2008 levels. In real terms, the revenue change in the two years since CMC-Canada's last industry study translates into 0.6% compound annual growth – in line with real GDP.
- Regionally, the distribution of demand is similar to two years ago. Ontario remains the largest market (44%). Eastern Canada still accounts for an estimated 23%: Quebec (19%) and Atlantic Canada (4%). Collectively, the western provinces generate approximately one-third of industry revenues: British Columbia (12%), Alberta (14%), Saskatchewan (2%), Manitoba (3%) and the Territories (1%).
- Among the major service lines, information technology continues to be the largest source of consulting revenues, almost equaling all others combined.

Uneven speed of recovery: The extent and timing of the turnaround varied by firm.

- Larger, diversified firms were resilient and recovered quickly: 83% of firms with 100+ full-time professionals posted year-over-year revenue increases in 2010. In some cases, M&A supplemented organic growth.
- Consultancies with limited diversification (in services and client base) varied widely in performance. Sole practitioners illustrate the point: 51% posted higher revenue versus 2009 – including 21% that enjoyed more than 20% growth – while 29% declined, including 16% that dropped over 20%.

Sectoral shifts in demand: The not-for-profit sector was hit hardest, shrinking to just 5% of the market (down from 12%, two years ago). The public and private sectors remained almost evenly split (49% vs. 45% share, respectively).

- Within the public sector, federal spending accounted for a smaller market share (16%, down from 23% two years ago), while the municipal share held steady (9%). Provincial and territorial governments, the dominant segment, accounted for two-thirds of the public sector consulting market (66%), including health care. One notable change was a doubling in the share of spending by *other public sector*[1] <#_ftn1> institutions (10%, up from 5%).
- In the private sector, banks and insurance companies helped drive demand. Together, two client industries – *financial services* and *technology, telecommunications and media* – accounted for more than half the total corporate spending on management consulting in 2010.

Mid-year optimism for current year: Consultants seem generally upbeat about the industry's immediate prospects: 68% expect higher revenues, while another 23% say revenues will remain steady.

- Optimism is strongest in the Prairies: 79% predict growth – including 29% who expect double-digit increases.
- Larger firms (100+ full-time consultants) are the most bullish: 93% expect at least moderate market growth this year – and most aim to outperform.

Accelerated turnover: With the market recovery in 2010, 35% of larger firms (100+ full-time consultants)

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experienced more than 10% voluntary turnover. In part, this may be *catch-up* for low turnover in 2009 – but some commentators see double-digit turnover as a new normal amid growing competition for scarce critical skills.

Signs of innovation in fee models: Fixed fees and hourly/daily rates still prevail across all firm sizes and service lines. The most noteworthy shift is a modest uptick in *outcome-based* (*contingent* or *incentive*) fees. At large firms (100+ full-time consultants), 29% use outcome-based models at least *sometimes,* up from just 10% two years ago. However, even now, virtually no one relies on outcome-based fees *most of the time*. Usage is generally confined to performance improvement or cost reduction mandates where measurement may be simpler.

Stability in median target billing rates: Overall, *standard target billable rates*[2] <#_ftn2> have barely moved since the last industry study, although the median target rate for experienced ('level 2') consultants has edged up at the largest firms (100+ full-time consultants).

- The *large firm premium* is greatest at the most senior level. At 'big brand' firms, the target hourly rates range from $600 to over $800 for top-level consultants. For higher revenue firms (over $100 million), the median hourly rate for the *highest level professional* is $617, compared to $264 at mid-tier firms ($1 to $100 million).
- Focusing on the smallest revenue firms (under $250,000) – principally independent practitioners – the median hourly rate is $188, although the range is very broad, from below $100 to over $400.

Discounting remains widespread: Pricing pressure is still intense: the fees actually realized can be substantially lower than the *target standard* rates.

- Bigger firms (100+ full-time consultants) are the most prone to propose fees below their *standard target rates*: 79% discount *sometimes/very often*. Moreover, 27% say discounts of *30% or deeper* are *typical*. Discounting to *increase utilization* is still common, but fee-cutting to *support clients through their tough times* has dropped markedly (29%, down from 48%). The most common reasons for discounting are to *secure high-value contracts*, *win government business* or *protect client relationships*.
- At mid-size firms (10 to 99 full-time consultants), discounting to win *government business* is less common than at larger firms, but otherwise motivations are similar. However, with lower standard fees, mid-size firms have less flexibility and tend to offer shallower discounts, typically less than 15%.
- Although smaller firms (<10 full-time professionals) vary widely in the frequency and depth of fee-cutting, discounting to *support a not-for-profit client or a good cause* (56%) is almost as common as discounting *to secure a high value contract* (59%).

Profitability under pressure: At smaller firms, profitability is wide-ranging, but distributions are similar to the previous study.[3] <#_ftn3> However, larger consultancies see gross margins being squeezed.

- At the largest firms (100+ full-time consultants), only 7% reported gross margins of 50% or more in their most recent fiscal year (vs. 29% for the 2008 fiscal year).
- In general, mid-size firms (10 to 99 full-time consultants) have suffered the most margin compression: just 4% generated gross margins of 50% or more (vs. 20% for the 2008 fiscal year). Moreover, 32% reported gross margins below 20%. *We get squeezed by the small single practitioners with no infrastructure at all and the big firms with lots of resources,* explained one commentator.

Building brand: Most consultancies use formal marketing channels to help build awareness, reinforce brand, demonstrate thought leadership and generate leads.

- Not surprisingly, the largest firms use the broadest marketing mix – and also tend to rate effectiveness more highly. At the other extreme, about 20% of sole practitioners invest no time or resources in formal media.
- In-person presentations at third-party events are commonplace and well-rated. Webinars are less frequent (41% usage) and also perceived as less effective – although large firms have notably better regard for that

medium. Publications and sponsorships are also fairly widespread (64% and 59% usage, respectively).

- Approximately half the firms advertise, but enthusiasm is muted. Even at larger well-resourced firms, only 23% think their advertising is *very/extremely effective*.
- Newer media have relatively low adoption and perceived *effectiveness*: overall, only 44% post blogs and 31% produce podcasts. Among users, fewer than one-in-five rate these media as *very/extremely effective.*

Outlook for the next 24 to 36 months: On balance, consultants are optimistic about the three-year outlook for the domestic market: 65% anticipate growth, surpassing their expectations for the US and abroad.

- Not all provinces are expected to benefit equally: only 25% see higher demand in the Atlantic region and 28% in Quebec, compared to about half in Ontario, Manitoba and British Columbia. Alberta leads the pack, with two-thirds foreseeing growth there.
- In every major service line, the vast majority of consultants predict either market growth or stability over 24 to 36 months. Nevertheless, confidence varies: about half the consultants in IT, operations and HR expect demand to rise, compared to just 36% in marketing.
- Overall, only 38% expect growth in the provincial public sector, while 19% foresee contraction. Predictions are even gloomier at the municipal and federal levels, with pessimists outnumbering optimists. However, big firms are much more sanguine than smaller consultancies.
- Within the private sector, most expect growth or stability in *energy*, *mining* and *financial services*. Opinions are more mixed on other industries, particularly *consumer products, retail distribution* and *manufacturing*.

Achieving ambitions in a maturing market: Most consultancies expect to grow – and in a slow-to-moderately growing market, achieving ambitious growth targets demands outperformance.

- Across all size categories, 73% plan to pursue expansion in existing markets, while a substantial minority expect to venture into new services (41%) or markets (36%).
- *Targeted hiring* is seen as a growth strategy for 85% of large firms (100+ full-time consultants) – signaling that resourcing costs will likely rise in the struggle to attract and retain talent.
- Non-organic strategies also figure prominently: 49% of firms with 100+ full-time consultants expect to grow by merger, acquisition or joint venture in the next two to three years, essentially continuing the brisk M&A activity of 2010 and the first half of 2011.
- Among smaller firms, a minority indicate *no plans* to grow, suggesting that the business is already operating at the desired scale or that the principals plan to scale back or exit within three years.

Challenges and transformative trends: The study highlighted several inter-related trends that are shaping the future of management consulting in Canada, influencing structure, competition and profitability.

- **Talent supply: Opportunity and constraint**: Talent management is seen a growth opportunity, but consulting firms must also address their own critical skill shortages. The battle to attract – and retain – the best people is already underway. Almost inevitably, resourcing costs will rise.
- **Balancing specialization and diversification**: Specialization – by client sector or service offering – is essential for differentiation and to satisfy client demands for deep subject-matter expertise. However, specialists must be nimble enough to adapt and re-invent as conditions change. As the 2009 recession demonstrated, larger, diversified multi-line firms were more resilient and bounced back sooner.
- **Adapting to new rules of engagement**: Government procurement policies are effectively restricting competition to the largest firms. The spread of formal RFP processes by large corporate clients also tends to favour suppliers with brand and scale, while promoting fee-based competition. Over the long term, these shifts in buyer behaviour may promote further industry consolidation.

Protecting reputation and demonstrating value: CMC-Canada has a crucial role in advancing best practices and increasing recognition of the CMC designation – key in the defence against unqualified practitioners, as well as those with more specialized credentials in narrower disciplines, such project management. Demonstrating more directly the return to clients on their investments in management consulting is also critical – a shift that may drive further experimentation with outcome-based fees. In a general sense, CMC-Canada has a key part to play here too, promoting the value of management consulting.

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[1] <#_ftnref1> *Other public sector* institutions include organizations such as crown corporations, post-secondary educational institutions, non-government organizations (NGOs), certain government-funded research agencies, among others.

[2] <#_ftnref2> Consultants were asked the *standard target hourly billable* rates for different levels of professionals in their local offices. Those who did not charge by the hour were requested to calculate an estimated notional hourly rate; for example, by dividing *per diem* fees by 7.5 hours. Smaller firms that did not have the full range of professional levels were able to indicate *not applicable*, as appropriate.

[3] <#_ftnref3> Comparisons of profitability are complicated by the diversity of business and ownership models. As in the previous study, consultants were asked: *What was the % profitability (gross margin) of your firm's consulting business in the most recent fiscal year?* Gross margin was defined as: Gross Margin = (Revenue minus Direct Expenses, i.e., excluding overhead, etc.)/Revenue. This data was analyzed at the firm-level.