

Towards a new time-money ratio

Shaking up the traditional consultancy model brings added value to clients and helps consultancies to secure incomes. Jake Liddell, director of Four Hats Ltd, presents three innovative new approaches.

Consultancy has been around for centuries and the model has changed little in that time. The consultant offers a slice of their time, for which a client pays an agreed rate, with a ratio of 1:1. For larger jobs, clients might negotiate a discount for a block of time, but essentially it's still a 1:1 relationship between time spent and money earned.

This sounds fair; however, there are problems with this model for both clients and consultants. For the client, it is impossible to control how much time, and thus money, is spent on a project. For the consultant, it is very hard to generate a regular, year-round income, and during a recession work can be difficult to find.

The industry needs to develop a model that allows clients to control their expenses while helping consultants to earn a regular income and increase profits.

Time is money

At its most simple, clients are buying a consultant's time, along with his expertise, experience, reputation and methods. Therefore, the consultant is basically selling time. All things being equal, the consultant would like to sell you lots of time – and this is the problem.

Consultants find it very easy to tell their clients: "I have your best interests at heart, and will only do the work you need. I will ensure that my team optimises their involvement to minimise our fees." However, the reality is that consultancies have sales pressures just like any company.

Clients are naturally suspicious about whether they are really getting the bare minimum required to do the job. In fact, there is little in the consulting model to motivate the consultant to work fast or do the absolute minimum.

Once a client starts buying delivery teams from consultancies, costs can rapidly escalate. First, the client hires the big cheese – the person with the experience to project/programme-manage the client's route to victory. Top consultants set themselves a healthy day rate – £1,500 is typical in the market at present.

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The problem really starts when the client begins staffing the project. Behind the lead consultant comes an army of lesser consultants. Each level is a little less experienced than the one before. And once you get to the bottom of the tree, it is a little bit rich to even be calling them consultants – they are typically graduates with a couple of years' experience under their belts.

For the client, a typical £500,000 engagement could instead have been managed to develop better staff while saving £200,000 if only they could find a way to build a trustworthy team in the first place.

Slowing down time

For consultants, it is equally simple: one day's work equals one day's pay. Sales people know that the moment a consultant finishes a project, he needs another job to start immediately. Dead time, or time on the bench as it is known, is just eroding the bottom line. Despair.com has a great Demotivator® on the subject: "Consulting – If you're not a part of the solution, there's good money to be made in prolonging the problem."

It is very tempting for consultants to try to eek out a few more days or weeks from each job if they know there isn't much else in the pipeline. This is clearly not good for the customer, but at the time the alternative can seem worse for the consultant.

Another major problem is the market itself. The market is very price-sensitive, and costs and revenues are tightly linked, fixing the profit that a consultancy can make. If you look at the margins consultancies typically announce in their annual reports, you will find that lower performers might make 3% and higher performers can earn up to around 10%. However, there is not much room to improve these margins within the pure consultancy business.

During periods of high demand, clients are prepared to pay more for a consultant's services. However, when a recession comes along, clients stop buying. If there is no market for the time that consultancies are selling, consultants sit on the bench. Consultancies have expanded to cope with the good times, but now they have too many people.

The simple solution for a consultancy firm is to lay off 20% of its staff. The irony here is that it is more often the unlucky semi-random 20% that happens not to be billing on the day in question rather than the bottom 20% in terms of ability. During the 2001 recession, many companies were hit much harder than 20%, and those without cash reserves went under. This 1:1 ratio of cash to time is precarious during a period when no one can justify buying the time.

The standard business model does make money for those who own the businesses. Yet 5–10% per annum is a hard slog when you consider how carefully costs have to be managed, how unpleasant it is to make people redundant during a recession and the stress of the continual pressure to keep the sales funnel full.

Three routes to a new approach

It is clear that the consultancy profession needs to find a solution to all these issues. One option is to try to break the 1:1 ratio by offering a product service that adds value.

Another way of improving profits during times of higher demand is to increasing the margin on consultancy staff. Is there a way to buck the system, and get away with charging a little more for our people or paying them a little less?

There might also be a way of generating a regular income that requires no sales effort and will continue in a recession. Could we create a model where our costs are automatically lower during periods of inactivity, without having to cut staff?

This is not an easy challenge, but there are a number of innovative companies trying to meet it.

Example 1. Managing contractors

It is becoming increasingly difficult to keep good consultancy staff employed and motivated, and employment market analysts are predicting that 2007 will be just as difficult as 2006 was.

So, rather than hiring employees, consultancy firms looking for a new approach are building a network of highly skilled, carefully vetted contractors. This mitigates the risk of hiring contract staff by allowing clients to gain value from a pre-vetted, loosely connected community.

Curo Resourcing is one company doing this. Karen Field, director and co-founder, says: "My years of managing a technical consultancy team have demonstrated that traditional consultancy is an almost impossible market in which to find the space to innovate. At Curo, our aim is to add value to the freelance market, and that's not just through reformatting CVs. Our goal is to provide a framework for building a connected virtual community; a centre of excellence achieved through the running of social and academic events to disseminate advice and best-practice."

This kind of proposition can be of real value to clients. They can now hire top consultants at a contractor price, which is typically almost half the cost of a big consultancy.

Curo intends to extend this model further. With modern technology solutions, this virtual community can become an extension of the client's own staff pool. In the knowledge that the virtual bench will take up the slack, clients achieve real flexibility to manage staff capacity much closer to the wire, delivering true value to the client and a recurring revenue model for the consultancy.

Example 2. Increasing profits

There is not much room for increasing profits in a traditional consultancy outfit. The simplicity of the model means that there is little scope for earth-shattering efficiency gains.

Consultancies often look to cut costs through reducing such things as training courses, team meetings and non-work activities. However, this is the route to disaster: you need to balance overhead reductions with the consequences on staff morale. Put simply, small cuts just aren't worth the risk.

One way to cut costs could be through in-sourcing. The industry has learnt some painful lessons about how difficult it can be to run projects offshore; however, Mindstream Resourcing is creating an innovative middle ground. It is working with consultancies and software houses in countries such as Estonia, Romania and Latvia, and bringing the experienced staff into the UK to work on projects as part of the project team.

Mindstream manages all the administration from paperwork to finding the staff somewhere to stay. This shields clients from much of the risk that they would otherwise have to take on. Because the typical rates are much lower in the consultants' home countries, there is plenty of space to offer the client exceptionally low rates while still providing a good margin to Mindstream and the supplying consultancy.

This is great for an end client, but could also be leveraged to good effect by existing consultancies. As a consultancy, using such resources as part of a project team could make a project more competitively priced, or the savings could go straight to the bottom line. Either way, it is an interesting model.

Example 3: Regular recession-proof income

FourHats was founded with the sole intention of trying to build an organisation that was reasonably profitable while also offering a stable, long-term and recession-proof model.

FourHats offers design, build and maintenance services for corporate websites. This is typically a project-based, and therefore time-based, market in much the same way as a pure IT consultancy. However, as websites need to be updated on an ongoing basis, we felt there was room for a different approach.

FourHats charges a flat monthly fee with no up-front costs and its clients can rely on the fact that their payments are not going to change.

FourHats clients derive some unique benefits, including:

- Shared technology across the entire client base
- Consistent, regular administration and management processes
- Known, stable costs and revenue every month
- Continual client contact

When a recession hits, although FourHats will not be signing any new clients, it will still have its present clients supplying a regular income. In fact, the only real risk to its income is if its clients go bust.

Improving the ratio for both sides

The consultancy model has a number of major flaws, both for consultancy owners and managers and their clients.

There are numerous possible approaches, but whether any will be successful remains to be seen. Although the three organisations mentioned above are trying some innovative ideas, they are all in their infancy. It will be interesting to watch how they progress. Ultimately, if they are to succeed, they will need to find clients that are prepared to try a different approach.

Those consultancies attempting to innovate their industry stand a good chance of financial success, and there's every chance that their customers will benefit greatly too.