

Global and US Trends in Management Consulting A Kennedy Information Perspective

Summary

There is firm evidence of significant growth in the management consulting industry in 2005 and 2006. In some markets, such as the US, this growth is building on a recovery that has been underway for over a year. In other markets, this growth is part of a much-needed return to a healthy consulting marketplace.

The recovery is due largely to improvements in regional economies, pursuit of globalisation, a return to a growth orientation by the market, and pent-up demand for services that were deferred in recent years. But as clients once again focus on growth, they are also focusing on value. Clients are more mature, and this is reflected in more structured relationships, such as acquiring of services through purchasing departments, and a demand for measurable results from consulting projects.

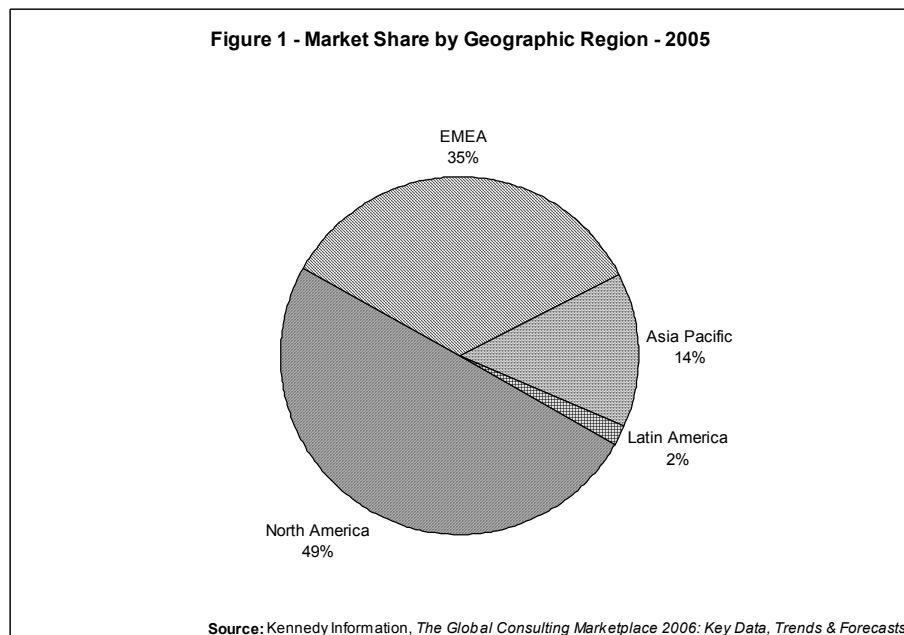
Global Consulting Market Overview

Globally, many of the trends reflect the state of the business in regional markets. Global clients are generally taking their cues from major markets like Europe and the US. They are typically buying industry-leading consulting services and applying the benefits across their businesses.

Emerging markets such as those in Latin America, Eastern Europe, and Asia, are seeing a lot of activity. For some firms, they are low-cost centres from which consulting services are delivered in an effort to reduce costs. Other consultancies approach them as markets with growing client

demand as local companies strive to become more competitive and expand across borders, and as multinationals enter the local markets.

Serving clients in local markets requires that firms have a local presence. As large global consultancies, often headquartered in North America, contemplate entering new markets, they are faced with deciding whether to open local offices, acquire local firms, or enter into alliances. This positions the local consultancies as competitors, acquisition targets, or partners. Under all scenarios, business is likely to get much more interesting.



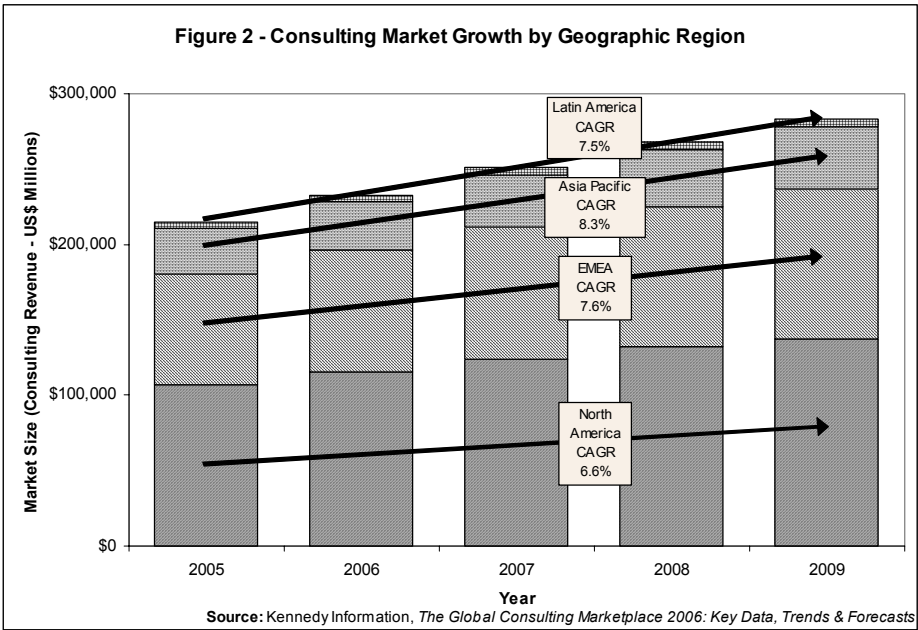
On a global level, the overall consulting market is doing well, although there is a lot of variation among regions, as would be expected. The general improvement across markets is being helped by the fact that an increasing number of consulting clients are multinational companies. Their consulting needs often span multiple markets, so projects are less affected by local business conditions.

This benefit, however, is not universally realised, so there are still many markets in which the demand for consulting is being limited by political uncertainty, stagnant economies, and unfavourable regulatory environments.

During 2005 the global consulting market experienced an 8.5% growth in revenue. A similar increase is expected in 2006. This compares favourably with the 1.4% growth rate in 2004.

Over the five-year period from 2005 through 2009, consulting in the Asia Pacific region is expected to experience the highest growth rate. On a percentage basis, growth is expected to be about equal in both the Latin America and EMEA (Europe, Middle East, and Africa) markets. However, in Latin America the growth will be on a much smaller base. The slowest growth, although a healthy CAGR of 6.6%, is expected in North America, the most mature of the four markets.

During the same five-year period, the strongest sector is expected to be energy and chemicals, with a CAGR of nearly 10%. Demand will also be strong in healthcare, communications and media, and high tech. We see relative weakness in transportation and retail and leisure.



The biggest users of consulting will continue to be the public sector and the financial services industry.

US Consulting Market Overview

The management consulting market in the United States continues to be the first place where changes in the business cycle become apparent, whether they are improvements or declines in the business. The current recovery cycle began in earnest in 2003 and the upward trend has been fairly consistent for the past three years. Individual firms have reported varying degrees of improvement in recent years, but 2005 was the first year in which nearly the entire consulting market benefited from the overall improvement. Most firm leaders are equally optimistic about 2006.

The UK market has been realising the upturn in consulting immediately after the US. In fact, local UK practitioners claim that as the upward trend continues, the lag between its effects in the US and the UK is diminishing. In continental Europe, the degree to which the market is improving tends to vary by country, although the overall message seems to be positive.

The US dominates the North American consulting market and remains the largest single country market in the world. The US market for consulting is among the most mature and presents plenty of opportunities for further growth. But while the largest volume of growth is coming mostly from US, spurts of high growth are more likely to occur in consulting markets located in EMEA, Asia Pacific, and Latin America.

The regulatory and security environments continue to be major drivers of consulting. The US consulting market is experiencing a shift from compliance – meeting the requirements of new regulations like Sarbanes-Oxley – to more strategic use of corporate data, typically under the heading of enterprise risk management. The financial services industry started the trend, but now an increasing number of industries are recognising risk management as a potential competitive advantage.

The consulting market in North America grew by 8.5% in 2005, driven primarily by business in the US. This upward trend was a significant improvement over the 1.9% growth rate in 2004.

As is the case globally, public sector and financial services companies are the biggest users of consulting. Healthcare remains a reliable client, and the energy sector is growing as companies direct some of their recent earnings to consulting projects.

Market Drivers

Energy Prices

Rising energy prices are having mixed effects on the consulting industry. In markets where this is creating revenue, such as the energy industry, consulting demand is growing, and firms specialising in those sectors are doing well. The benefit is also reflected in increasing demand for consulting in wealth management in parts of the Middle East.

Elsewhere, rising energy costs are slowing economic growth, and some industries such as transportation are going through belt-tightening, which in some cases means reducing spending on things like consulting.

The good news is that in some sectors, the response to rising costs in services such as transportation involves taking a hard look at the supply chain and seeking ways to make it more efficient. Consultants are often involved in such work, and engagements frequently end up addressing the entire sourcing question, ensuring that risks related to transportation costs, political uncertainty, currency rates, and trade issues are all properly managed.

Political Uncertainty

While analysing political uncertainty is a component of enterprise risk management exercises, it is also affecting consultancies' decisions to operate in certain markets and the consulting

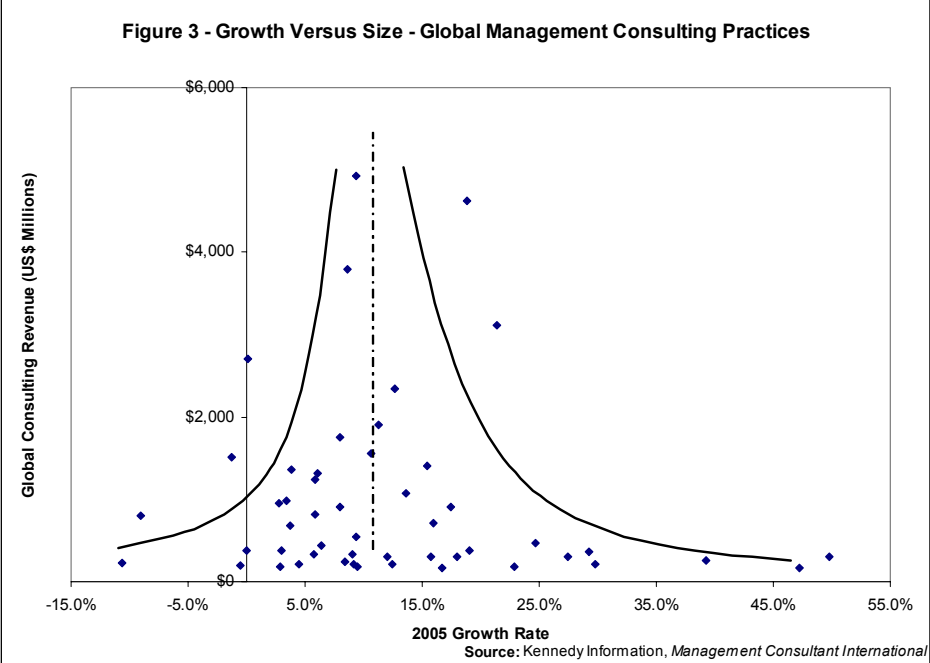
demand from companies in some countries. While USAID projects support some consulting projects, local clients in certain countries are focused more on survival than on strategy or operations management.

In parts of Latin America, for example, we find that the economic and political uncertainty has many local businesses taking a very shortsighted view of things. Strategy consultants and even those offering transformation in areas like HR services are finding it difficult to get clients to think more than one or two years out.

Globalisation

Globalisation of corporations is perhaps the biggest single influence on the growth and evolution of management consulting today. In addition to driving demand for consulting to help enable the client to function on a global level, it is causing clients to expect their consultants to be present in all markets or to provide capabilities readily in any place the client wants to do business.

This expectation is making the long-term success of mid-size consultancies even more challenging. Major tier-one firms have the ability to provide services in most markets, and they have the broad skills, bench, and infrastructure to be able to put specialists on the ground in any other place they are needed.



Smaller niche firms are often capable of providing the local expertise to those clients who are not working with global consultancies. They may win this work independently or by partnering with larger firms that do not have operations at their clients' destinations.

Being a small firm is less limiting than it once was. Establishing an international footprint is no longer reserved for large consultancies. Increasingly, we see small firms opening offices in other countries, recognising that even niche players can benefit from a global presence.

The mid-size firms – too small to be thought of as global and too large to be hired as specialists – will continue to find globalisation a challenging environment.

The recognition of a global presence as key to long-term success continues to drive mergers and acquisitions in the consulting industry. Lacking the ability to serve clients in their local

markets can mean losing out to a competitor. So firms are moving quickly to identify regional partnering or acquisition candidates. While some consultancies will try to be everything to every client in every market, others are taking a more moderate approach, realising they can serve smaller markets from nearby centres or using local partners.

This is resulting in numerous partnering opportunities for smaller firms in both established and developing markets. In countries where the regulatory or business environment makes it difficult for a US-based consultancy to establish an office and effectively penetrate the market, existing local firms that can provide language and cultural know-how as well as entrees into local client organisations are in demand. In developing markets or those that may be perceived as too small to justify opening an office, global consultancies will often partner with a local firm to test the market. If successful, the local partners often become prime acquisition candidates. In many cases, this provides a local or regional firm with the opportunity to serve clients beyond its current borders.

Client Issues

Aging Workforce

In addition to all the usual business challenges faced by client companies and shared with their consultants, many organisations are faced with an aging workforce that accounts for a significant portion of their top talent. They are looking to improve knowledge management, transfer of capabilities to new hires, and personnel retention and recruiting.

These are all areas in which most consultancies have done work internally, particularly as they have expanded globally and faced a tighter talent market, and some consultancies are using their proven internal approaches to help clients design a solution. Human resource consultancies are taking advantage of the demand, and an increasing number of recruiting firms are offering consulting services to capture some of the market.

Growth Agenda

In many markets, improving national and local economies are driving increased revenues. This, in turn, is causing business leaders to consider investing in growth. This represents a significant shift from the cost-cutting emphasis that dominated businesses in recent years. One path to growth involves mergers and acquisitions, and increased activity in this area is being fuelled by the return of investment capital availability. As companies combine in numerous ways, the impacts on systems, organisations, products and services, and personnel are creating opportunities for consultants.

Pursuing growth requires companies to not only launch entirely new projects – with the help of consultants – it also requires making organisation, systems, and process improvements that had been put on hold during the slow years.

Cost Management

Despite the renewed interest in growth and the response to a pent-up demand for projects that yield change and improvement, companies have not lost interest in reducing their costs. Any optimism concerning a lasting period of economic growth is tempered by shorter business cycles and an increase in external forces that could abruptly halt an upward trend.

Companies are determined to improve both their top lines and bottom lines. The need is driven by both a desire to be prepared for the next downturn and a more demanding stakeholder community. As a result, consultants cannot go to market with a growth formula for clients that does not also include a cost containment component.

This attitude is also reflected in how clients are buying consulting services. Despite an improving economic environment, there has been little relief in the downward pressure on consulting billing rates. Additionally, clients are more demanding about the consulting outcomes than they were a few years ago. They are unwilling to fund strategic or other pursuits that may not yield measurable returns.

Consultants increasingly are being expected to define discrete milestones and ensure a significant return on the consulting purchase. In some cases, firms have parlayed this into a shared risk arrangement under which the amount the client pays is linked to the degree of success achieved by the consultant. However, client interest in controlling costs makes the flip side unattractive – they are unwilling to pay more if the consultant over delivers, so shared risk agreements continue to play a minor role in the industry.

Regulatory Compliance

Consultants can often rely on governments to create environments that drive demand for their services, and the recent surge in regulations has been a windfall for the industry. Whether Sarbanes-Oxley or Basel II, companies are facing compliance rules that typically require changes in organisation, technology, and process, all of which enable better reporting.

The US got an early start, and many consultancies helped clients simply meet the minimum requirements that defined compliance. It soon became apparent that companies gained little from their investments, and now they are revisiting their newfound access to corporate information and attempting to create a competitive advantage.

In regions where new regulations were launched following the US exercise, clients benefited from lessons learned in the force-fit US approach. The current wave of engagements is providing companies with longer-term benefits than mere compliance.

The Future

Client-consultant relationships will continue to evolve, and firms will need to be flexible to keep meeting their customers' expectations in terms of contracting, staffing, and creating sustainable change. Consultancies, like their clients, will face recruiting and retention challenges, competing for experienced personnel that can deliver value. The willingness and ability to develop and maintain these capabilities depend, of course, on the continued strength of the consulting market.

Most consultancies seem to be much more aware of the fragile nature of this growth period than they were 10 years ago. The responses of businesses to political, corporate, social, and natural events are more pronounced and immediate than in the recent past. And while changes can sometimes provide opportunities for consultants, they are increasingly constraining the euphoria that should be part of the market this year.