

Course of Management Consulting

Managing a consultancy firm

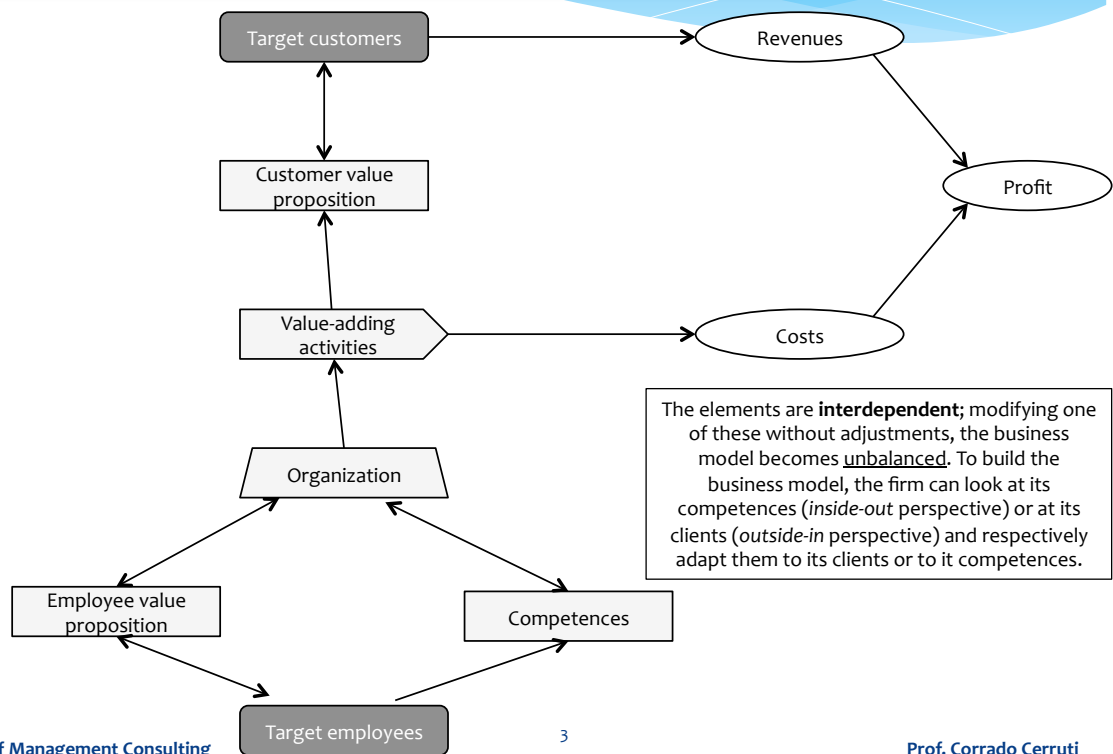
Professor Corrado Cerruti

Academic Year 2017/2018

Agenda

- Business model of the consulting firms;
- Organizational structures;
- Micro-structure of a project team;
- Economics.

Business model of the Consulting firms

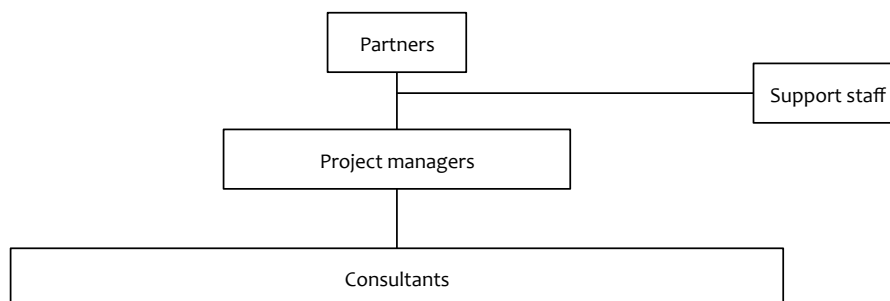


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Organizational structures – Professional partnership



This structure is the standard for consultancy firms organized as partnerships.

When consulting firms are set on *multiple offices*, we can distinguish:

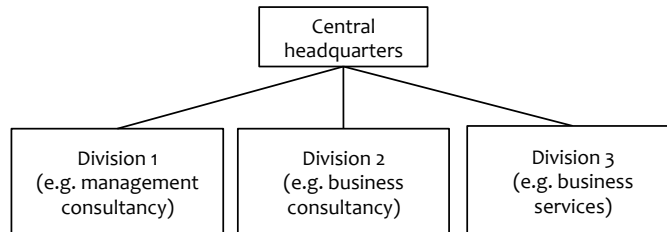
- *One-firm model*: offices are managed as one firm (offices results are shared);
- *Warlord model*: each office has a lot of autonomy and acts on its own.

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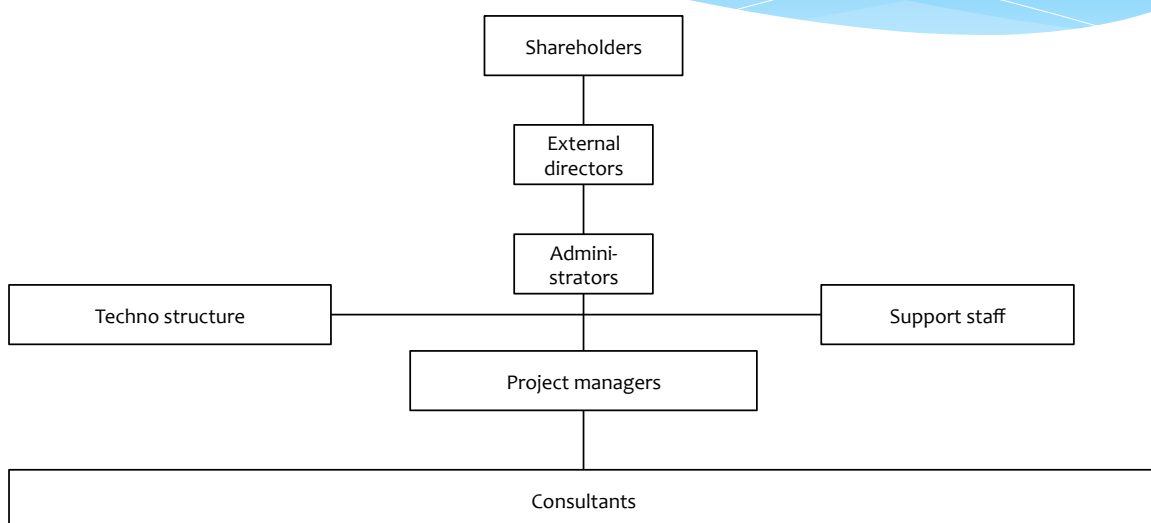
Organizational structures - *Diversified consultancy firm*



This structure is typically used by *large consulting firms with multiple services*.

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Organizational structures – *Managed professional business*



This structure is more common in **IT consultancy** or a **publically listed corporation**.
Also administrators and external directors are employee.

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Organizational structures – Legal forms

Legal liabilities: legal entity that exists independent of the owners. It is a way to limit legal liabilities for the owners and to attract external financial funding.

Sole proprietorship: it consists of a single person who is the only consultant in the organization and who may have alliances with other independent practitioners. The sole consultant is personally liable for any debt or obligation.

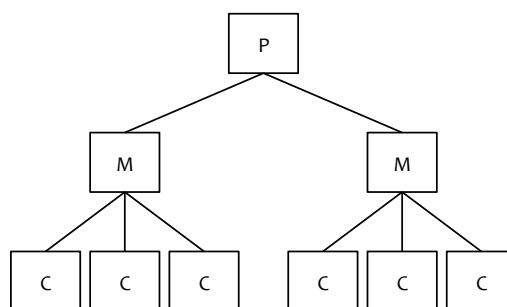
Partnership: it consists of 2 or more partners who run and own the firm.

Public Corporation has 3 characteristics a) *Funding:* firm that may have to access the financial markets to sell stocks and/or bonds. Partners no longer own the firm. b) *Legal obligations:* it is structured as a public corporations and has to comply with financial reporting legislation. c) *Financial obligations:* managers have to regularly pay out dividends to shareholders.

Internal consultancy: is a part of a larger organization, typically it is a department without a legal identity.

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Micro-structure of a project team



P: partner
M: manager
C: consultant

Team Leverage rate:

$$\frac{\text{Non partners}}{\text{Partners}}$$

It depends on:

- the type of project
- the type of consulting company

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The consulting project

A project is a contract with a Client
 ... Based on the contract
 the consulting firm deploys a **team**
 to **deliver** a set of agreed **results**
 within planned **deadlines**



team

deliver

results

deadlines

Economics (Revenue)

Functions	Average requirement per project	Target utilization	Required for 12 projects
Partners	0.5	0.75	8
Managers	1	0.75	16
Consultants	6	0.9	80

→ $(12 * 0,5)/0,75$

Target utilization: it shows the percentage of time available to execute projects. The rest of it is spent on other duties (training, internal studies, ecc.)

Economics: revenues - costs

Billings from clients: they may be calculated as a fixed amount (billed hours * rate of P/M/C * N. of P/M/C)

Economics (Revenue) – Billings for one project

Functions	Average requirement per project	Duration of project (hours)	Billed hours	Billing rate per hour (\$)	Billings (1,000 \$)
Partner	0.5	480	240	250	60
Manager	1	480	480	150	72
Consultants	6	480	2,880	100	288
Total			3,600		420

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Economics (Revenue) – Annual target billings for the firm

Functions	Capacity per function	Target utilization per person	Target billed hours per person	Target billed hours per function	Billing rate per hour (\$)	Target billings (1,000 \$)
Partners	40	0.75	1500	60,000	250	15,000
Managers	80	0.75	1500	120,000	150	18,000
Consultants	240	0.9	1800	432,000	100	43,200
Total	360			612,000		76,200

It is assumed that a year comprises **2000 working hours**.

Target billed hours per person:
2000 * target utilization

Target billed hours per function:
Capacity per function * target billed hours per person

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Economics (Costs) – Annual target billings for the firm

Functions	Target billings per function (1,000 \$)	Annual compensation per function (1,000 \$)	Billing multiple	Target billings minus compensation per function (1,000 \$)
40 Partners	15,000	8,000	1.9	7,000
80 Managers	18,000	8,000	2.3	10,000
240 Consultants	43,200	12,000	3.6	31,200
Total target billings minus compensation				48,200
Overhead				25,146
Profit				23,054
Profit per partner				576

Costs consist of wages (for P/M/C and support staff).

Billing multiple: it is the billing divided by the compensation. The higher the multiple for a function, the more profitable it is for the consultancy firm.

Profit per partner: Profit / N. of partners

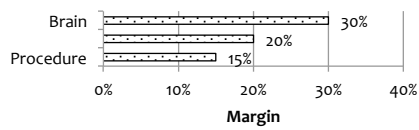
Economics – Profit per partner

Factor	Description	Value
Margin	= Profit/revenues	30%
Productivity	= Revenues per non-partners (Managers and consultants)	238,000
Leverage	= Non-partners/partners	8
Profit per partner	= Margin × Productivity × Leverage	576,000

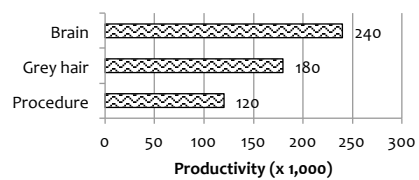
Profit per partner is considered a key performance indicator. It is normally well beyond the annual fixed compensation.

Economics – Productivity

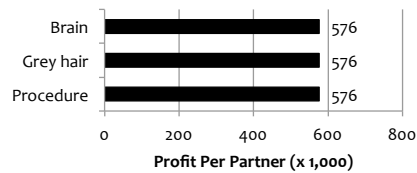
Margin



Productivity

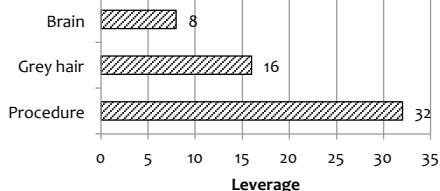


Profit Per Partner



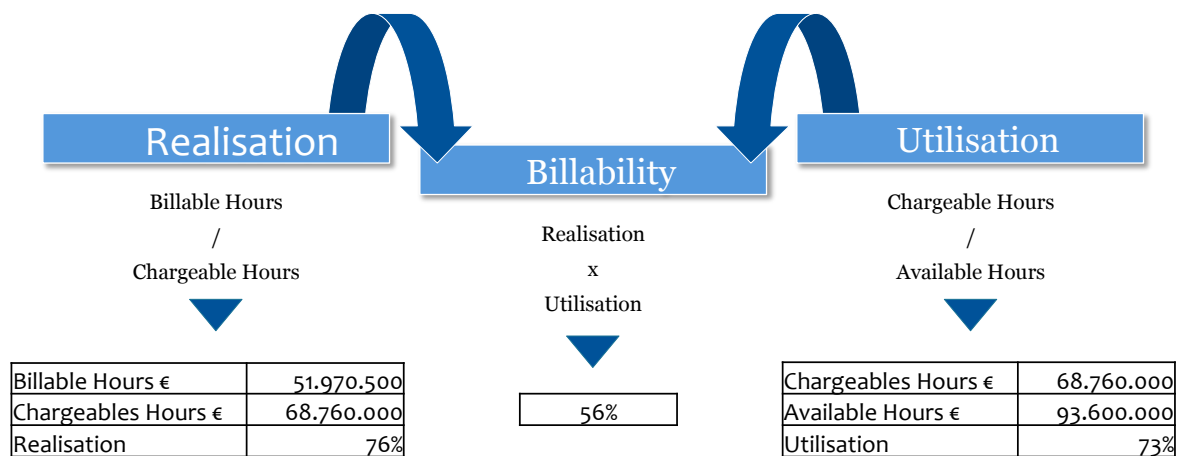
Productivity: billed hours * billing rate per hour.
It drives profit per partner.

Leverage

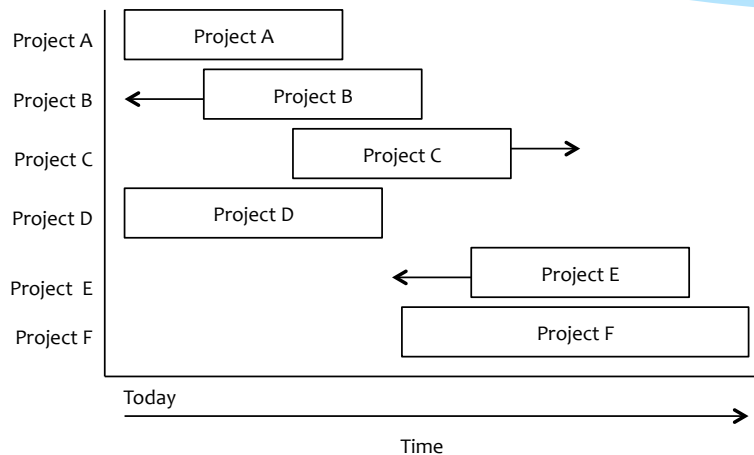


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Billability as an index of productivity



Economics – Capacity planning



Capacity planning: aims at maximizing the utilization of the consultancy staff and it is the main input for firm's recruitment targets and efforts. It is under the responsibility of senior partners.

E.g. The firm has a project capacity of 3. For project B the partner has to convince this client to start earlier; for project C the partner has to convince the client to postpone the start.

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Economics – Independence problem

The so-called “**Big-4**” have some problems in coordinating their project because of the fact, they provide both consulting and auditing services; in order to prevent cases in which the auditor firm isn't independent (is the most important rule to provide this service), then the MC firm has to check if it is already offered this kind of service to a client before offering a consulting service to the same client.

Usually, to prevent this situation, these biggest companies check if the client is **listed** in some stock exchange (especially the NY stock exchange); whether it is, the consulting project manager sends a clarifying request to the country risk manager who checks if there are some auditing services offered to the same client or other services that require the independence of the MC firm.

If the risk manager has some doubts about the independence, gives his comment to the lead client service partner, who has the **final decision** of assuming or not the consulting project.