Good News and Bad News

THE STRATEGY CONSULTING VALUE CHAIN IS BREAKING UP

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For years, consultants have been preaching to their clients that they should keep a close eye on what is happening to the value chains in their respective industries. John Haggle and Arthur Armstrong, for example, argued in their book *Net Gain* that the growth of the World Wide Web and other communication technologies, greater transparency, and increased competition would force companies to reduce slack and concentrate on those segments of the value chain where they can add maximum value. Much of this, indeed, has already taken place in industries as diverse as car manufacturing, computers, and banking. Today, we see the same happening in the consulting industry itself. In strategy consulting in particular, the value chain is disintegrating.

The Value Chain of Strategy Consulting

The service offering that integrated strategy consulting firms traditionally provide follows a fairly straightforward program. Broadly speaking, the value chain in this industry can be described as a four-step process (see Figure 1):

1. *Knowledge building* through information analysis and synthesis starts at the proposal stage of a client engagement and continues throughout the process. Information specialists gather data predominantly from public sources, such as analyst reports and annual reports, and synthesize these into company profiles, industry fact packs, and the like.

If full-service consulting firms are dinosaurs, what are you?

Figure 1. **COMPONENTS OF THE STRATEGY CONSULTING VALUE CHAIN**

Knowledge building ➡	*Project setup* ➡	*Strategy development* ➡	*Strategy implementation*
· Data gathering and synthesis · Analytical services (financial models, primary research) · Knowledge sharing and distribution	· Project scoping and planning · Resource requirement definition · Consultant selection and matching · Contract negotiation	· Issue structuring, issue analysis · Analytical problem solving · Strategic option generation · Option assessment and prioritization · Creation of implementation blueprint	· Development of implementation master plan · Definition of implementation initiatives · Setup of project office · Continuous guidance and quality control · Performance measurement

While information specialists screen public sources on a regular basis, consultants collect confidential client information primarily during the engagement. Findings from previous projects are often sanitized and shared within strategy consulting firms or transferred through personal interaction.

2. *Project setup* encompasses problem definition, work scoping and planning, identification of needed resources, staffing, milestone planning, and contract negotiation. Project goals, key success factors, and performance measures are determined up front in order to allow for the effective monitoring of a project's success at a later stage.

Increasingly, prospective clients conduct "beauty contests" in which a number of strategy consulting firms present alternative project proposals. Strategy consultants who prepare for a beauty contest must make up-front investments and take the risk that clients will enjoy a free lunch as they shop for knowledge.

3. *Strategy development* is the actual consulting work, which often takes place at the client's site. Most strategy consulting firms focus on identifying issues, analyzing problems, conceiving and assessing possible strategies for change, and creating the implementation blueprint. Because strategy development requires in-depth industry knowledge, analytical and creative capabilities, and sound business judgment and project management skills, it is not only the most difficult step but also the greatest value-added component of strategy consulting.

Large, integrated strategy consultancies claim to have a core competence in strategy development. However, increasing numbers of highly specialized boutique firms or independent professionals are concentrating on this part of the value chain.

4. *Strategy implementation* is execution of the proposed strategy. This phase is often divorced from strategy development and may incorporate a portfolio of implementation initiatives deriving from an implementation master plan. A dedicated project office ensures continuous project guidance and quality control. Projects typically have clearly defined performance targets (such as synergy realization across business units) and can be standardized to a certain degree. They are often closely interlinked with new IT requirements; hence, many IT firms have moved into the market for strategy implementation services.

Large, integrated strategy consulting firms traditionally operate knowledge building and client services (project setup, strategy development) under one umbrella but often separated into two teams. Knowledge-building teams work in research and information departments in the back office, while client services teams concentrate on the client site. However, client knowledge building and strategy development are typically presented as an overall package and priced as a lump sum. The differences in value contribution by the various activities are thus difficult for clients to recognize.

Industry Drivers Shaping Strategy Consulting

In recent years, we have seen the value chain in the strategy consulting industry begin to disintegrate. Four major factors drive this development.

- *Internet.* The Internet provides unlimited access to information sources across the globe. Large, integrated strategy consultancies previously derived competitive advantage from owning market research and data-crunching capabilities. They kept commodity services (such as information gathering and analysis) and high value-added activities (such as problem solving and option generation) tied closely together, both geographically and organizationally. Today, offshoring research services and graphical assistance to countries such as India that combine a well-educated workforce with lower labor costs has become a trend that some major consulting firms have already taken advantage of. Meanwhile, midsize players slow to adapt have been left behind.

■ *Narrowing skill gap.* The skill gap between strategy consultants and their clients has narrowed. Many consultants have joined the management ranks of their erstwhile clients. Firms in industries as diverse as telecommunications, banking, and auto manufacturing have established in-house consulting units or project organizations. Further, the shakeout of the last few years has left the labor market flooded with former strategy consultants ready to join firms in other sectors. At the same time, the power of some consulting firms to attract top-notch talent has weakened in the face of public criticism regarding their role in recent corporate scandals. They can no longer claim to offer services of unrivaled quality with respect to every single step of the value chain. Moreover, clients are reintegrating some of the activities that they had contracted out. In consequence, the provision of complete service cycles by a single consulting firm is becoming an anachronism.

■ *Client sophistication.* Clients are more demanding, having become smarter buyers of consulting services through experience and having former consultants as employees. They are requesting more senior advisors or specialists in place of project teams staffed primarily with juniors and now place greater emphasis on well-defined outcomes, higher quality, and measurable results. Consulting engagements have also become more transaction focused and shorter in duration.

■ *Competition.* Competition in the strategy consulting industry is on the rise. Driven by supply and demand, prices have declined and many strategy consulting firms have been forced to adopt alternative fee arrangements that shift risks from their clients' to their own shoulders. Many specialized service providers—such as Horváth & Partners in advanced controlling methods, and Frontier Economics in economics-based advice—are taking control of lucrative niche markets previously served opportunistically by the established consulting firms. Consulting firms are being forced to identify those stages in the value chain where they can deliver superior value.

Overall, we believe that both supply and demand factors drive the disintegration of the value chain in strategy consulting. As a result, the ability of consulting firms to combine multiple value chain activities into a single service offering is eroding. While this process is just beginning, we see it already affecting the structures and strategies of the incumbent players.

Traditional Business Models

Broadly speaking, the existing business models in the strategy consulting world fall into two groups: *strategy developers* and *strategy implementers*. While the top players in these two segments remain competitive, second- and third-tier players are having trouble.

Strategy Developers

The main strength of the traditional strategy development consultancies—the likes of Bain, Boston Consulting Group, Roland Berger, and McKinsey or smaller players such as Marakon and OC&C—lies in their ability to control the client interface. As long as integrated strategy developers build their advice on superior insight and tailor it to their clients' needs, their competitive edge remains intact. They benefit from their project track record and their ability to share and exploit knowledge across functional groups, industry teams, and geographic units. Yet even the top firms are facing the need to control costs, especially in the knowledge-building and strategy-implementation process, through efficient internal service offering or outsourcing, offshoring, or partnering with others.

Players with a smaller inventory of tools and industry experience, however, find it much harder to invest simultaneously in building long-standing client relationships and developing top-notch advisory capabilities. In times of depressed prices and lower profit margins, the return on these investments can readily fall below the cost of capital. Therefore, these players need to concentrate on what they can do better than the others—which is unlikely to be in areas such as data gathering, primary research, or analytical services or in

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the downstream part of the value chain (strategy implementation). Overall, we see the trend moving away from fully integrated strategy developers, although the top-tier players with the deepest pockets and the best repertoire of client contacts will be able to stay the course for some time to come.

Strategy Implementers

The business model of the large strategy implementers is seamless integration of high-quality advice, personnel-intensive services, and IT-based solutions (note the partnership between Accenture and SAP) in order to facilitate large-scale strategic changes. The key success factors for these firms include their ability to manage complex integration projects and their cost-efficiency, enabled by having standardized and scalable implementation services that can be benchmarked relatively easily. In order to gain better access to integration projects, many strategy implementers have built up internal strategic services groups that provide corporate strategy advice, or they have made acquisitions upstream (as in the case of EDS acquiring A.T. Kearney).

The strategy implementers are facing challenges on several fronts. The internal consulting units established by many clients often take over implementation tasks. For example, companies such as Shell, Siemens, and Credit Suisse are making greater use of their in-house consultancies for IT and implementation-related projects. The in-house consulting units of some multinationals (such as Volkswagen and Porsche) go even further and offer strategy implementation services externally. Another challenge arises from the difficulty of attracting and keeping heterogeneous groups of staff—consultants, programmers, operators, and many others—in the same organization. As a consequence, many strategy implementers are already disintegrating, subcontracting parts of their work to partner firms or joint ventures.

Emerging Business Models

While firms that have traditionally followed the two business models described above will be facing increasing pressures to adapt and concentrate on what they know best, the disintegration of the value chain is preparing the ground for new business models. Ironically, the shift toward these new business models is often driven by people who gained their primary experience in firms that represent the more classical business models.

Knowledge Builders

Knowledge builders are newcomers, such as Pipal, that offer their services not only to players in the strategy consulting industry but also to investment banks, research institutes attached to universities, and nonprofit organizations. Their service offerings range from basic data collection and market research to fully fledged analytical services. Key success factors in this business model are speed, the quality of analysis, reasonable costs, and the management of relationships with consultancies and other customers.

> *The provision of complete service cycles by a single consulting firm is becoming an anachronism.*

One of the successful new knowledge builders is Evalueserve, headquartered in New Delhi, India. Evalueserve provides a multilingual research team composed of experienced professionals with advanced degrees in business and technology. The team is complemented by a group of executives who are responsible for local sales and project management support. Through modern communication tools, Evalueserve provides immediate assistance to incumbent strategy consulting firms, consultant networks, and independent professionals around the globe.

Networkers

Networkers benefit from unbundling strategy consulting services. They focus on select parts of the value chain and have their network partners provide any additional services that might be required. For example, networkers may focus on project setup services as entry points into the strategy consulting industry and outsource consulting project work to their partner organizations. They often recommend individual specialists who work with internal project teams at the client site. Key success factors for these firms include the ability to make a tangible impact on the success of a consulting project by providing unrivaled project setup services and having a dense network of contacts with highly specialized partners.

One example of a new networker benefiting from the disintegration of the value chain is Cardea, a meta-consulting firm founded in 1999 and based in Zurich, Switzerland. Cardea is dedicated to improving the sourcing and management of external consultants on behalf of its clients. Its core services cover two of the four stages of the consulting engagements described earlier: In the *setup phase,* Cardea supports the client in defining the problem to be solved and evaluates alternative project and procurement strategies. The firm also helps assess the need for external expertise and is instrumental in evaluating and selecting suitable external consultants, as well as contract negotiation. In the *project phase,* Cardea helps its clients to manage and monitor consultants effectively, thus ensuring that the investment in a project pays off quickly.

Cardea creates the greatest value by helping clients select external consultants. Based on its proprietary database containing records of 700 professional service providers—often with detailed client satisfaction indices and other performance data—the firm is able to provide a well-qualified list of potential consultants to any client within a matter of days. Using reference checks, personal interviews, and other assessment methods to determine the optimal match between a client and a consultancy, Cardea winnows this list to create a short list in less than a week. The consultancies on the short list are then invited to present their proposals and discuss project conditions in detail, including availability, projected approaches, fee payments, and so on.

Since its foundation in 1999, Cardea has supported more than 250 strategy consulting projects for about 40 large and medium-sized Swiss and German corporations, including such strong brands as UBS, Credit Suisse First Boston, ABB, Allianz, and Munich Re. Its strength is rooted in the fact that it acts as a fully independent intermediary and does not provide project services. Any contract is between the client and the consultancy selected with Cardea's help, not with Cardea itself. The firm's revenue model is similar to those espoused by independent financial advisors. Cardea receives predetermined fees from the client, regardless of who ultimately carries out the project, thus ensuring that it acts in the client's best interest.

Another example of a new networker is a-connect, a Zurich-based consultancy founded in 2002. In contrast to Cardea, a-connect does not consider itself an intermediary advising others on how to make optimal use of consultants. It is a consulting firm in its own right, but it focuses on managing the client relationship while outsourcing as many operational tasks as possible. As is the case with leading strategy consultancies, a principal or vice president at a-connect "owns" a client relationship and serves as primary contact. Day-to-day project work is done by one or several of some 100 independent professionals who are selected and managed by the firm. a-connect outsources research, graphic, and administrative services to partners in India, South Africa, and the United States. For example, the firm partners with knowledge builders such as Evalueserve for specialist know-how, analytical services, and research tools. It facilitates project management, including contract negotiation, fee payments, expense accounting, and insurance and tax issues—and ensures quality control throughout the entire consulting project.

The value proposition of a-connect is to help its clients define skills, expertise, and time requirements for a particular strategy consulting project and then take care of the selection, matching, and placement of independent professionals. Its particular strengths derive from three sources:

- *a-connect offers a better match between client needs and consulting skills* than most traditional strategy consultancies do. It maintains a pool of independent consultants who provide expertise in consulting and line management. The firm has built up a detailed inventory with track records of these individuals, which helps in selecting the right person for a project.

■ *a-connect is more flexible and efficient* than traditional strategy consultancies since it outsources the risk of underutilized (human) resources. To work with a-connect, individuals must be financially independent of the firm.

■ *a-connect is able to provide project setup solutions* that differ from the "full project team" approach traditionally offered by the integrated strategy consultancies. For example, the firm might provide just one specialist or team of experienced "gray-haired advisors," leaving out the throngs of junior consultants who would typically accompany them in the established firms. Given that large corporations increasingly insource the operational parts of consulting projects, they may often be in need of experienced individuals with specialized knowledge who are able to work with internal teams.

The business model of networkers has the advantage of extreme flexibility. They do not need to employ their network partners and so take fewer risks than traditional consulting firms. On the flip side, they depend on the quality of services provided by their network partners and on their availability. At the moment, talent is still available in the consulting market because new communities of independent professionals are emerging, supported by an increasing number of electronic marketplaces.

Interestingly, the success of the networkers depends on their fiercest competitors, namely the large, integrated strategy consultancies. The talent pool of independent professionals required by networkers can be maintained only as long as the consultancies with the big brands hire, train, and finally dismiss people. So far, the networkers' market share is still relatively small. It will be exciting to see how the established players react if the networkers maintain current growth rates and advance further onto their turf.

Good News, Bad News

The disintegration of the value chain in the strategy consulting industry harbors good news as well as bad. The main beneficiaries of the development clearly are clients. The emergence of new types of players who specialize in a particular step in the value chain provides clients with greater choice and less need to rely on integrated consulting firms seeking to sell full-service packages. Moreover, disintegration of the value chain should ensure that fees remain compressed, thus benefiting even those clients who stay with their existing consulting providers. Disintegration implies that market prices for individual project stages are established, thus providing greater transparency and less opportunity for integrated players to apply fees for their higher value-added activities to subsidiary services in the value chain. If clients monitor the developments in the consulting market closely and choose intelligently, they can take a greater share of the value that can be generated by consulting services.

The news for the incumbent players in the consulting industry is more mixed. We believe the disintegration of the value chain has the potential to separate the wheat from the chaff. Add to that the increased competition in the market in general, the greater public scrutiny of consulting services following the scandals of the last few years, and the internal pressures facing consulting firms, and the outlook for those firms that used to offer relatively unsophisticated services for the prices typically charged by top-tier firms is rather bleak. The best advice that one can give to the firms concerned is that they should define the game in which they wish to play and undergo a process of targeted transformation toward that goal.

Firms with strong brands, deep reservoirs of industry and functional experience, stable internal architectures, and good access to clients should see the opportunities as well as the risks posed by the disintegration of the value chain. They can partner with new types of knowledge suppliers or other providers of intermediary services than was previously the case. They, too, face greater competition and price pressures, but as long as they control the client relationship and generate enough business on the back of this capability, they can afford to give away some parts of the activity chain or the subsidiary projects that are too small for their internal machinery. As with every redefinition of an industry, early movers who recognize the new opportunities and take advantage of them quickly are the ones most likely to benefit. ■

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