WHITE PAPER

Extracting Value From Professional Services

In a two-speed economy

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Introduction

Australia is experiencing what has been described as a "once in a generation" economic boom. Terms of trade are at record highs, inflation within target range and unemployment is consistently low. The modernisation of China is perhaps the single most important driver of these conditions. However, not everyone seems to be making hay while China's economic sun shines. Mining companies continue to make incredibly high profits at levels unmatched in Australian corporate history. Financial Services companies are undergoing deep structural changes coupled with job cuts and unconventional out-of-RB A-step interest rate movements to protect margins. Retail is also suffering; an industry major recently reported a 20% drop in half-year profit and forecasting a 40% drop on the full-year number.

This marked contrast in economic performance by different industries gives rise to the term "two-speed economy".

Industries running in the fast lane of the economy are operating on the higher gears of growth and profitability. Others are struggling to keep the engine from stalling, spluttering along in the slow lane, trying to maintain profit and remain viable.

This situation has significant implications for the procurement category manager, if their company happens to be in the slow lane. They have an important role to play in extracting value from, and reducing, the company's cost base. Particular attention is important to categories that are normally ignored in good times. This paper will focus on the value levers available in a two speed economy for extracting value from one of the most complex, and often ignored, of indirect categories: Professional Services.

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Professional Services Definition

For the purposes of this paper, the Professional Services category covers all advisory services with a defined outcome or deliverable. Examples of services under this category are Management Consulting or Legal services. Suppliers of these services are typically firms employing highly skilled and specialised individuals providing advice to business customers. In providing these services individuals leverage the intellectual property, tools and processes of the supplying firm.

Challenges with managing Professional Services in a Two-Speed Economy

In the slow lane of a two-speed economy Professional Services market dynamics create two key challenges for the category manager, namely increased costs and reduced compliance;

Increased Costs

High Supplier Utilisation

Perhaps the most important driver of Professional Services fee rates is resource utilisation. Professional Services firms essentially sell their resource's (read: staff) time. Billable Time is created when a resource is working on a client engagement for which the client pays the firm. The rest of that resource's time, where a client is not being billed (including annual leave and other entitlements but excluding weekends), is often crudely referred to as "Bench Time". Utilisation is the ratio of (Billable Time)x 100/(Billable Time + Bench Time), expressed as a percentage. All "Time" units are in days. The higher the utilisation rate, the more profit the professional services firm is earning for that resource. It therefore stands to reason that the higher a resource's utilisation, the more valuable their time is to the firm - creating a higher opportunity cost for that resource which the firm can pass on to its clients in the form of a higher daily rate.

In a two-speed economy many Professional Services firms will tend to have high utilisation rates because demand from companies in the fast lane of the economy increases substantially, requiring firms to allocate more resources to that sector (through hiring or redeployment). This drives up the opportunity cost of those resources, leading to higher charge out rates and adds to cost pressures of companies in the slow lane.

Increased Financial Discipline

A natural reaction for companies affected by the slow economy is to conserve money and reduce "discretionary spend". Professional Services is often considered just that. Companies tend to reduce the amount of legal or consulting advice ordered from third-party suppliers. They put off projects or manage them in-house, or both. Supplier firms respond to the drop in demand by redeploying resources to other geographies (locally or globally) or other sectors of the economy, creating a shortage of advisory resources to the slow-moving industry. This in turn drives up the opportunity cost of those limited resources and, in turn, their fee rates. Such a situation compounds the Professional Services cost pressures of companies in the slow lane.

Reduced Compliance

Organisational Restructuring

Organisational restructuring is a common reaction by companies grappling with a challenging economic environment. Business Unit consolidation, removal of management layers and reorganisation of staff positions are typical outcomes of this process. This situation creates a significant issue for the procurement manager; Compliance to preferred suppliers and process takes a dive. Managers who followed the proper procurement process for engaging a professional services firm have been replaced (indeed it took the category manager a lot of time to get these managers to comply in the first place). Personal Assistants who knew their way around the online system to set up a Purchase Order are no longer there. Accounts staff who understood the correct classification of Professional Services spend (instead of treating that ledger code like a miscellaneous bucket) have gone. The category manager is faced with new stakeholders who don't know (or don't care) about the procurement process, supplier invoices generated outside of the approved system (with no proper approvals) and compromised spend reports from AP data which has all-and-sundry items included under Professional Services. Ultimately category management and, in turn, benefits are compromised. This leads to upward pressure on the company's cost base.

Addressing the challenges

Step 1: Understand the category's position on the Professional Services Category Maturity Curve

In devising a strategy to extract value from Professional Services the category manager must first evaluate where they are on the category maturity curve. The maturity curve represents the "baseline situation" which effectively defines the organisation's readiness for change in the way the Professional Services category is managed. Without this understanding, actions are likely to either under deliver on existing potential or be too ambitious as to risk implementation paralysis (so much to do that nothing actually gets done). Professional Services category maturity is a function of the category management effort that an organisation invests and the degree of organisational compliance to the processes and systems created by that effort. From a procurement perspective a Professional Services category can generally be classified as:

- Unmanaged: Spend is not centrally controlled or influenced by policy, process or any significant procurement input
- Partially Managed: Some controls exist to manage spend
- Actively Managed: Full category management disciplines are actively applied to influence spend including supply, demand and supplier performance management

Key category characteristics along the maturity curve are described in diagram 1.

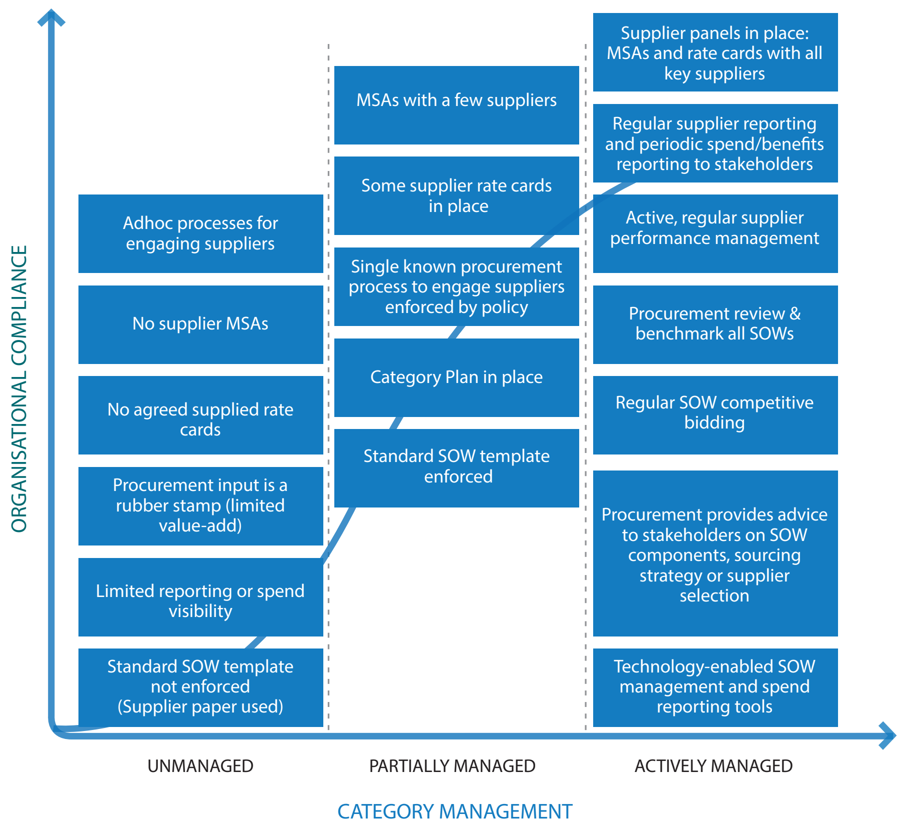

Diagram 1: Professional Services Category Maturity Curve

Step 2: Devise appropriate benefits strategies

As discussed in the previous section, two of the common challenges for procurement managers involved in Professional Services, are to:

a) Reduce, or minimise increases to, Professional Services charge out rates; and

b) Increase organisational compliance to preferred suppliers and processes

These objectives need to be addressed bearing in mind:

- Position on the maturity curve: Some strategies may not be useful depending on the category's position on the maturity curve. For instance, there is little point considering off-shoring category management tasks if currently the company doesn't have a well defined procurement process and high compliance – get it right onshore and then off-shore

- Tight cost management and a vibrant supply market imposed by the two-speed economy: This restricts the strategic options available. For instance, direct negotiations with suppliers to reduce rates will probably not be effective (if not counterproductive) since suppliers yield more negotiating power. Investing in eSourcing and Statement Of Work

- (SOW) management technology to increase compliance is probably not an option since the CFO will have little appetite to release the funds or organisational resources required. Investing in new interactive online reporting dashboards, while best practice, will also not be logical. Hiring a new category manager for Professional Services will probably run counter to the organisation's headcount management strategy.

Like most organisational change, travelling up the maturity curve is a journey that takes place over time. The earlier the category manager commences this journey, the more high-value benefits strategies they will have available when a two-speed economy occurs. Appropriate benefits strategies based on the category's position on the maturity curve are described in diagram 2.

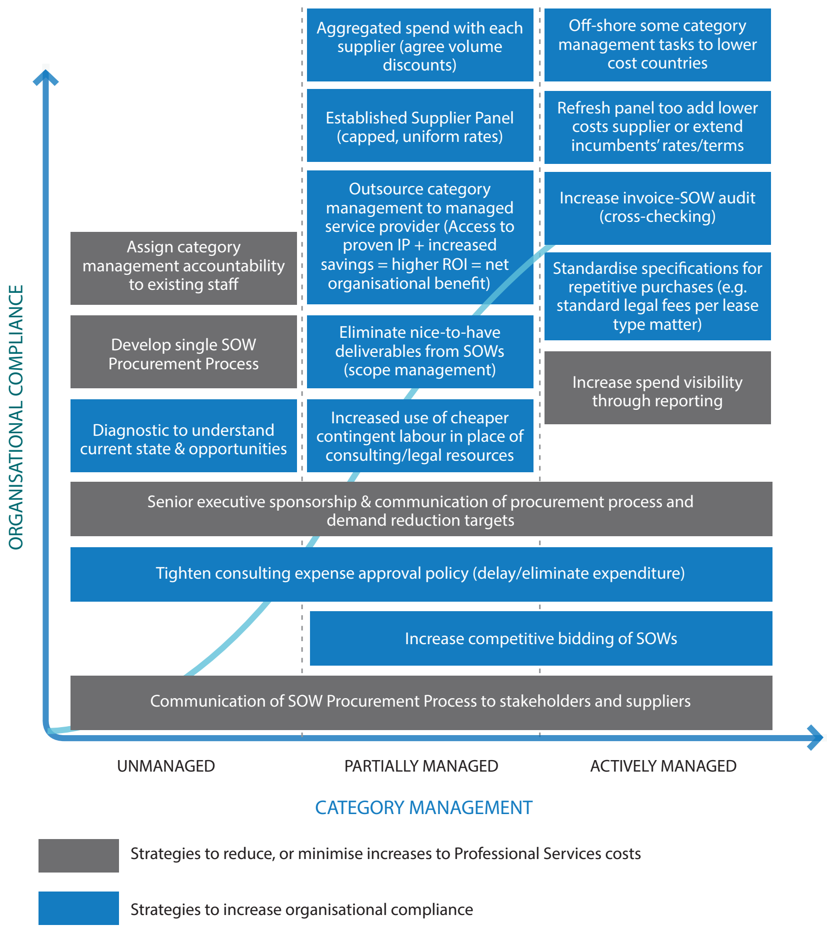

Diagram 2: Professional Services benefits strategies in the slow lane of a two-speed economy

Case Study

One of Australia's largest financial institutions extracted 11% savings while in the slow lane of the economy (see diagram 3). Key to success was the category's high maturity at the time the company experienced slow-lane market conditions. It's like having invested in training a racehorse (building up its stamina and muscles) which enabled it to win the race despite being faced with rain and a muddy track on race day. The category's maturity afforded the organisation high-value benefits strategies that would not have been available if the category were at the lower end of the maturity curve.

While moving up the maturity curve took time, significant benefits were achieved early in the process. This was important to build stakeholder support and compliance, as well as justify investment to move further up the curve. A diagnostic revealed significant opportunity to extract benefits through changes to supply model, processes and category demand management. Outsourcing category management to a Managed Services Provider enabled access to professional experience, capability and intellectual property taking the category further up the maturity curve. A focus on building stakeholder and supplier compliance helped engrain the category's processes and policy in the organisation's culture.

By the time slow-lane conditions affected the industry, the organisation's culture, stakeholders and suppliers were able to accept more advanced benefits strategies. Competitive bidding of SOWs doubled, leading to project-level savings. Lower-cost suppliers were easier to add to the well-oiled and functioning panel process. Enforcement of tighter approval processes was facilitated. Because of strong compliance and highly effective and mature processes, the organisation was able to consider and implement off-shoring some of the basic category management functions (saving costs). This will give the category manager more time to focus on strategic category tasks, to move further up the maturity curve.

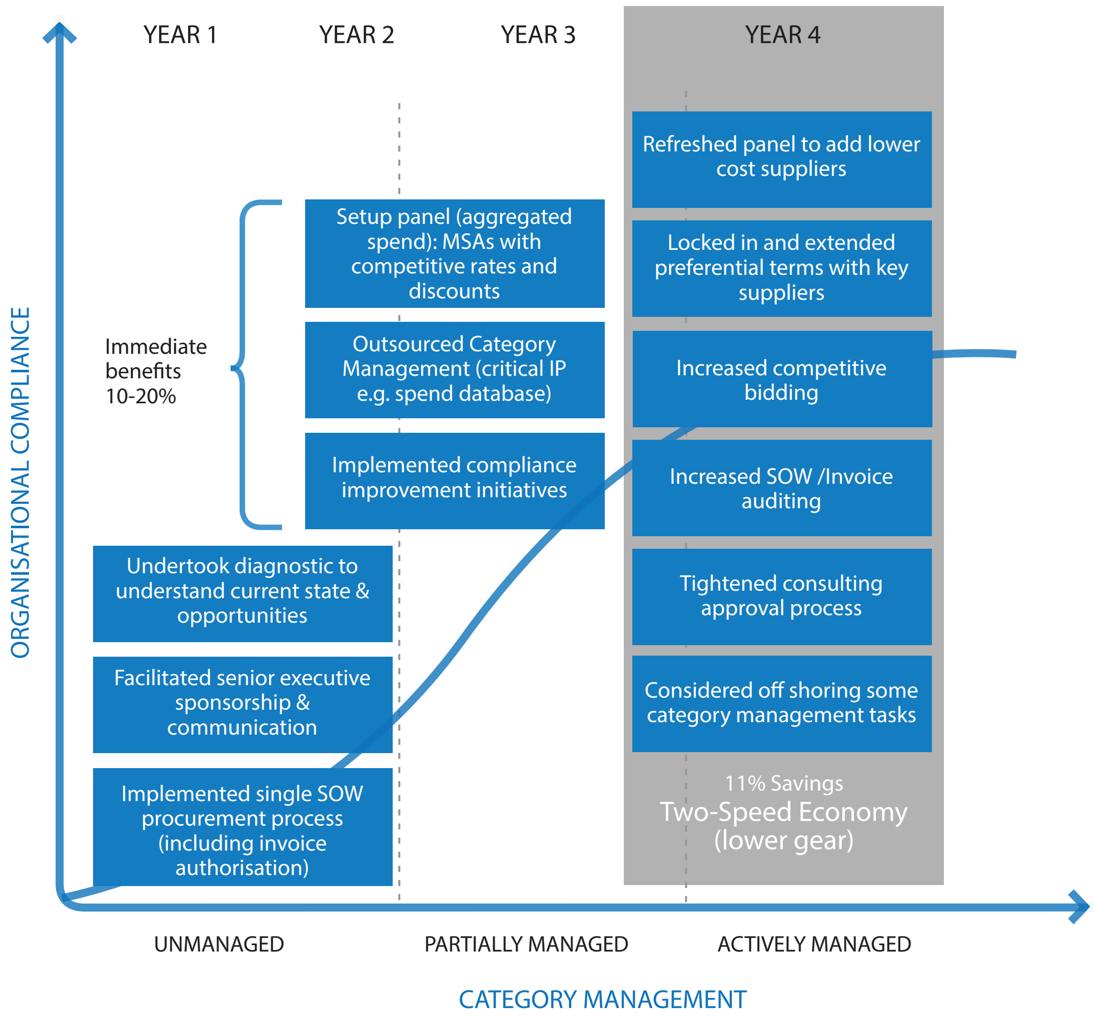

Diagram 3: Professional Services Category Maturity at a major Australian financial institution

Conclusion

The Professional Services category manager has an important role to play in reducing the company's cost base amidst the challenges presented by a two-speed economy. He must appreciate the upward cost pressures imposed by the supply market as well as the organisational readiness to change the way Professional Services is managed.

The maturity curve provides a guide to understanding the current category situation in order to assess organisational readiness for change. Armed with this understanding, strategies can be devised that enable the company to extract value from its Professional Services spend, ultimately reducing its cost base.

Increasing category maturity is more of a marathon than a sprint. Long term category strategies and goals need to be articulated and implemented. Ideally this will happen in favourable market situations, when it is easier to build stakeholder support and compliance. This puts the company in a stronger position to extract benefits from Professional Services spend if it ever finds itself in the slow lane of a two-speed economy.

About the Authors

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