

2008

Rewarded in heaven?

Sharing risk and
reward with
management
consultants



About Source

Sourceforconsulting.com is owned by Source Information Services, an independent company, set up in 2007 and based in London. Our aim is to create a better consulting market for clients and consultants. We do this by providing a platform and a range of real solutions for buying and selling consulting services that are founded on our core values of integrity, transparency, efficiency and intelligence.

Source was founded by Fiona Czerniawksa and Joy Burnford. Fiona is one of the world's leading experts on the consulting industry. Her books include: The Intelligent Client and The Economist book, Business Consulting: A Guide to How it Works and How to Make it Work. Joy Burnford has held senior positions at the UK Management Consultancies Association since 2003 and has extensive experience of marketing consulting services.

www.sourceforconsulting.com

About our sponsor Mott MacDonald

Mott MacDonald's business covers government, defence, education management, energy, healthcare management, industry, property, telecommunications, transport and utilities. They contribute to good management practice in numerous projects and businesses by transferring skills and methodologies across many sectors.

Their management consultants work globally with their customers to help sustain and improve their business performance through strategic and business planning, business improvement, resource investment planning and change management.

www.managementconsultancy.mottmac.com

Foreword

by David Cox, Mott MacDonald

I came into consulting from engineering: a world where budgets were tight and solutions had to be delivered; where success could be measured in the form of tangible outputs; where our job involved donning our hard hats and boots and going round the construction site to check that the project was progressing as planned. In contrast to this, management consultancies had a reputation for developing strategy and policy rather than delivering. The worlds of engineering and management consulting seemed poles apart.

But the more I have thought about this and the more I have sat down with managers and listened to their concerns, the more I am convinced that management consultants have a lot to learn from engineers. Indeed, my engineering and project experiences have led to some simple lessons which we have applied in our approach to consulting:

- ◆ Make the right investment decision. Balance the achievability and affordability of individual projects to determine the right overall portfolio.
- ◆ Take fast and pragmatic decisions that deliver outcomes and maximise benefits of a project.
- ◆ Select the right procurement process, the one that delivers the best value solution.

The engineering industry has used risk/reward relationships to deliver complex programmes such as oil platforms in the North Sea, Heathrow Terminal 5 and the upgrade of the rail infrastructure. Risks are identified, then allocated to the party best able to manage the risk. Payment terms are geared around successful delivery, not time spent. Most importantly, such projects are partnerships, with buyer and supplier dependent on each other. And that is critical both to organisations that need to deliver more at a time when budgets are being cut and to a consulting industry that does not just write reports, but implements systems, runs projects and manages change.

Progress is being made – and some of the case studies in this supplement show examples where this approach has been adopted in public sector programmes. Such arrangements are still confined to a minority of projects but I think the time is right to learn this lesson from the engineering world as well. Clients and engineers working in partnership has been key to the construction of the world's most admired buildings. Clients and consultants working together will be crucial if we are to build the world's most admired public services.

David Cox
Managing Director, Business and Technology Consulting
Mott MacDonald

Executive Summary

Using risk-reward as a means of paying for consulting projects is comparatively rare, despite much discussion of the subject over the last decade.

Risk-reward is not appropriate for all consulting projects: in some circumstances, it can make things worse, costing more and creating lasting tensions between the parties involved. However, there are firms whose services lend themselves to this approach and there are lessons from other sectors which can be valuable here. As this report illustrates, success in applying the principles of risk and reward depends on:

- ◆ Seeing risk-reward as a mechanism for achieving a given end, not as an end in itself or as a panacea for every problem.
- ◆ Having a clear understanding of the nature of services being bought.
- ◆ Identifying a clear set of meaningful and measurable metrics.
- ◆ Ensuring that the people working with the consultants are committed to success.
- ◆ There being an open and collaborative relationship between buyer and supplier.

Introduction

Economic downturns typically trigger renewed interest in paying consulting fees on a performance or risk-reward basis. With budgets for new projects drying up, it is logical for organisations to look for alternative ways to fund the things they want to do. A recent survey by Source bears this out: three quarters of procurement teams expect the proportion of expenditure on consultants paid for on this basis to grow in the future.

But short-term economic drivers are not the only reason why buyers want to move away from traditional time and materials or fixed-price deals: they also want to make consultants more accountable for their work.

Past experience also suggests that increased interest in risk-reward deals during a downturn will not be confined to buyers. "In 2002-03, the numbers of firms which were not only willing to accept risk-reward deals but actively encouraged their clients to use them increased dramatically," says Christopher Juul at Celerant Consulting. "There's nothing new in this."

So far, there has been far more talk than action, at least in Europe. Ten years ago, risk-reward deals were widely touted as the next big thing in consulting, but the evidence suggests that such deals account for around ten percent of

Organisations aren't yet asking us to do risk-reward more than they did, but they probably will. It always happens during periods of economic stress
Mark Goodridge, ER Consultants

What we're finding is that clients want more measurable outcomes
Bob Manuel, Charter Solutions

We're seeing much sharper negotiations but we haven't had a single client tell us that we've lost a project because a competitor offered more innovative payment terms
Paula Sussex, Atos Consulting

*Clients don't like paying the upside.
They just want us to bear the risk
without the reward*
David Bailey, Hitachi Consulting

*The difficulties are legendary. Who's
responsible for what? Are you looking
at short and long-term benefits?*
Arun Aggarwal, Tata Consultancy
Services

*The better a firm knows us, the less
likely they are to look for risk-reward
deals*
Julian Harper, Trinity Horne

*If we go into a client offering this type
of deal, they're often very suspicious
and think we may be hiding
something*
Russell Poynter-Brown, Davis Langdon

consulting work in the private sector and less than five percent in the public sector in the UK. In practice, what has happened are subtle shifts in the work undertaken: more work focused on tangible deliverables, a shift away from time and materials to fixed-price payment.

There are good and bad reasons for the relatively low-take up. Clients often feel uncomfortable agreeing to too large a reward. There is an unwillingness to experiment: "Who's going to get fired for paying a consulting firm on a fixed price basis?" asks Russell Poynter-Brown at Davis Langdon. Despite its name, risk-reward is often perceived to focus on transferring risk, rather than rewarding good performance.

In the public sector, where less than five percent of expenditure is paid for on a risk-reward basis, compared to around twice that in the private sector, scale, the complexity of stakeholder management bought and the procurement rules make risk-reward less feasible. "But the biggest factor is budgets," argues Al Geddes at Mouchel. "Public sector managers have to have a specific budget and it's difficult for them to go back to ask for more money, even though the consulting firm might have generated extra savings."

Where risk-reward is used, it may be for the wrong reasons. A client who is uncertain about the value the consultants will add on a particular project may choose this approach, not because they want to ensure a consulting firm's commitment to a specific goal, but because they want to avoid paying for a project that might fail.

Moreover, although risk-reward deals are often touted as a means of aligning the objectives of customers and suppliers, there is a real risk that they will do the opposite. "Risk-reward is often a tool of inexperienced buyers who think they'll save money," argues David Rankin at KAE. "If they don't think a project is going to be successful, they shouldn't be buying it. Suppliers are only going to agree to it when they're sure they can deliver, so the client ends up paying over the odds." Clients want to spend less on something that costs more to deliver; suppliers want to get paid more for something that takes less time. "When you work the logic all the way through, their goals are utterly incompatible," says Rankin.

The aim of this report is to examine whether risk-reward arrangements for consulting projects can work and, if so, how.

Case study : National Grid

David Jones has recently returned to Mott MacDonald having spent nearly two years working with a £100 million a year programme with National Grid to refurbish and replace overhead lines and buried cables in the West of England and Wales; one of six 5-year strategic alliances. The role of Jones and his team was to provide a wide range of support including scheduling, programme reporting, risk management, cultural development, communications and information management, setting up the IT infrastructure and strategic planning. Understanding the relationships between the partner construction companies, other suppliers and the client was a critical part of this. Historically, National Grid had used traditional cost-plus pricing but, under pressure from its regulator, these new contracts had been let on a risk-reward basis. "We would start the year with a target cost," says Jones, "calculated on the basis of the cost of the raw materials, plant provision and labour, a process with which construction companies are very familiar. We then had an open discussion about risk: what the risks were, what they could cost us if they occurred and how much we would be prepared to invest to either prevent them occurring or mitigate their impact." That money was then put aside in the budget: any money left over at the end of the year, because a risk had been avoided or because its impact had been lessened, was split 50:50. Half was shared between the suppliers involved, however, they could only receive this half if they had met certain, pre-agreed critical success factors and performance targets (safety was one). The

actual value of the gain was dependent on performance; meeting 80% of targets meant receiving 80% of the gain (provided the CSFs were achieved). The other half went into an investment fund from which bonuses could be paid to the best alliance. Decisions on bonus payments were taken by a supervisory board, chaired by the National Grid with senior people from both its side and its suppliers'. "This was as much about good communication and raising the standards of work undertaken each year, as it was about completing work on time and within the budget," he says. This second fund could also be used to cover the costs of additional projects aimed at increasing the efficiency of the whole programme. "Say you had an idea for a new portable safety sign for work in remote areas, the supervisory board could agree to pay for its development on the basis that it could then be used in all its alliance work, not just in the work carried out by the supplier who came up with the idea," says Jones.

Case study : Redcats

Redcats, part of the La Redoute retailing group, used Impact Plus (now Hitachi Consulting) on an entirely risk-reward basis to help them improve performance. "We did it originally because we were sceptical about what a third party could deliver," says Bernard Conlon who was responsible for the project. The experience of working with a UK consultancy where the fee had been tied to performance but open-ended meant that Conlon and his colleagues were also concerned they would end up paying an excessive fee. "So this time we put a cap on the fee and defined a much clearer way to measure the incremental, tangible benefits to the business." It sounds easier than it was. In order to isolate the benefits they could attribute to the consultants, they had to take into account the projects they might have done themselves but then take out those they wanted to do but, realistically, were never likely to get around to. Conlon's team also had to analyse how long the benefits were likely to mature, eventually using a 12 month period because it took into account the highly cyclical nature of retailing. "And we had to get our finance people on board with it," he points out. "The last thing we wanted was internal disagreement when it came to calculating the fee." With these parameters established, Hitachi's consultants carried out an initial scoping phase in order to come up with a long list of initiatives for the business to decline or accept. "Once we'd agreed which projects we wanted them to focus on, we imposed a three-year moratorium on doing the ideas for ourselves, so we couldn't just take the consultants' ideas and implement them ourselves for free," says Conlon. But the key to success was the relationship between the two companies. "It was very much a partnership," he says. "Having set up a clear set of ground rules, we had to keep to the spirit of them, not start haggling about the details." From the consulting side, David Bailey at Hitachi Consulting agrees: "This type of project only works where you've agreed some rules around the project and where the senior people on both sides trust each other."

Case study : BBC

"Risk-reward works in relation to consulting projects if the assignment has clear deliverables and you have a team to work in parallel with the consulting team," says Jim Hemmington at the BBC. "You have to start by asking what you're trying to achieve by bringing consultants in, what the deliverables are, as well as the dependencies across the organisation as a whole. If you can articulate and measure these, then risk-reward is going to be an appropriate and effective tool." Risk-reward is the latest step the BBC has taken to ensure it gets good value from consultants, a journey that has already seen the Corporation make greater use of "second tier" consulting firms and focus on the delivery of benefits. "The archetypal consulting process has three phases: scoping, recommendations and delivery," Hemmington points out. "We're turning the discussions round so that we talk about the deliverables first, what we want to achieve from a business point of view. Having defined that value, we're in a better position to be clear about what we want to achieve to consulting firms." Sometimes this takes the form of actual savings, but there are non-financial objectives as well: recent years have seen Hemmington and his colleagues pay increasing attention to skills transfer, thus ensuring that the Corporation learns from consultants rather than becomes dependent on them. "We've changed the nature of the dialogue we have when we commission a consulting project," he says, "to focus on the skills we want to acquire and the responsibilities each side has in the process." The incentives offered to the consulting firm may also be non-financial: although the BBC may link fees to performance, it is also willing to act as a reference site or to allow the consulting firm to re-use the intellectual capital created in a specific assignment for other clients.

According to Hemmington, there are two critical factors in making risk-reward work with consultants. "The first is ensuring you have agreement from the finance department on the numbers you use," he argues. "At the BBC, all consulting projects have to be approved by the finance director and the first thing she's going to ask is what the savings are and what value will be created for our organisation. The second is to be absolutely sure how those benefits or savings are going to be delivered. It's not enough for the consultants just to make recommendations or write reports."

Applying the lessons from elsewhere

Risk-reward deals have been relatively common in big outsourcing projects for some time, where large-scale suppliers can leverage their financial strength. Typically, they involve price reductions over time, based on the assumption that the supplier will gain economies of scale and efficiency improvements which can be shared with the client, and/or a bonus structure that rewards the supplier for achieving specific milestones or targets. "If we weren't willing to do risk-reward outsourcing it would materially affect our credibility and ability to compete," says John Yarwood at Atos Origin. "Our willingness to accept such contracts has been fundamental to success," agrees Kevin Johns at BT. Indeed, risk-reward is now so commonplace that competitive advantage comes from finding innovative twists to the formula. "You really have to explore how value is going to be created for both sides," says Johns. "It's not just a question of discussing deliverables and costs – the areas you'd usually focus on in a conventional procurement process."

Case study – BAA Framework: BAA negotiated contracts with its key suppliers tied to the volume of work they did. The more work a firm undertook, the more profits it earned, but never to the point of super-profits. "The deal had to be reasonable for both sides," says Derek Fryer at Mott MacDonald, one of the firms that worked with BAA on this basis.

The company could – as many other organisations have done – have chosen to try and beat its suppliers down on price but it recognised that such tactics were likely to backfire when it came to the quality of service it received and that they were unlikely to deliver the scale of savings sought. It might have been reasonable to cut suppliers' prices by 10-15 percent, but a 30 percent improvement required suppliers to re-think their way of working and find new solutions to long-standing and intractable problems. It also required BAA itself to work differently as some of its suppliers' costs were driven by the way BAA required them to work.

It was a new way of working for BAA and plenty of change evolved as a result. One important lesson was to ensure it was not just an excuse to offload all of its risks onto its suppliers or to avoid rewarding its own team: risks and rewards had to be shared. "It's not just the supplier

Trust is fundamental to any relationship, but it's particularly important in risk-reward deals

Kevin Johns, BT Global Professional Services

Risk-reward works well in longer-term relationships, where there's a high degree of trust

Al Geddes, Mouchel

Applying the lessons from elsewhere

You can't do risk-reward from day one. You have to trust each other and be willing to put some money at risk in the future
John Yarwood, Atos Origin

that needs to be incentivised for success," Fryer points out. "The client needs to ensure that its own staff will gain as well. That doesn't necessarily have to be a monetary reward: recognition schemes, such as employee of the month or a celebratory dinner for those who have done well, can be just as effective."

There are some lessons here from both outsourcing and engineering projects which could usefully be applied to risk-reward projects in consulting:

- ◆ The intended benefits of the projects are measurable and are under the control of the supplier to deliver.
- ◆ Experience counts for much here: clients should be wary of entering into risk-reward deals with suppliers with little or no track record in this area.
- ◆ Risk-reward is not just a way of buying services: it also has implications throughout a project's lifecycle. The British Standards Institute, for example, divides such projects into three distinct stages: strategic workload, the engagement process and project management.
- ◆ Both sides need to be treated equitably: Too often in consulting, risk-reward is seen (by buyers) as a rod with which to beat consultants' backs, and (by consultants) as an opportunity to earn super profits.

Of course, we have to be wary about assuming that these lessons are applicable to consulting projects. "Outsourcing and engineering companies have a huge advantage because their work, unlike most consulting, is clear and tangible," points out Mark Fearn at The Berkeley Partnership. But there are consulting projects which are more tangible, so why is risk-reward not applied in those cases? "It's frustrating," comments Russell Poynter-Brown at construction consultancy Davis Langdon. "On the construction side we have open-book accounting and regularly work on a risk-reward basis, but when it comes to business consulting, clients often revert to fixed price or time and materials. Moreover, there's a school of thought that says you shouldn't need to incentivise consulting firms to do a good job because that's what they should be doing anyway."

Risk-reward in the consulting industry

The term risk-reward covers a multitude of sins, but can be categorised in three ways:

- ◆ **Carrot or stick?** Here, the focus ranges from the negative ("If you don't achieve X, we will not pay you Y.") to the positive ("If you achieve X, we will pay you Y.").
- ◆ **Standard fee or bonus?** Meeting a target may simply entitle a consulting firm either to a "normal" fee, typically calculated on a time and materials basis, or to some type of bonus.
- ◆ **All or part?** Many consulting firms are willing to put a proportion of their fees on the table, perhaps as much as 20 percent. In such arrangements, the firms effectively invoice for their costs during the project but have to wait to its satisfactory conclusion before they earn their profits. However, a minority of firms are prepared to put their entire fees at risk, much as lawyers are prepared to work on a no-win-no-fee basis.

The attitude of consulting firms ranges widely, from outright rejection to complete acceptance, and is almost entirely driven by the type of services provided. Generalist firms, working on projects where the scope is uncertain or ambiguous and which require considerable interaction with a client's own staff, do very little, if any, risk-reward work and are encountering no increase in demand for it. But there are other firms, often specialists in a particular field where projects are more likely to be measurable and self-contained, which regularly adopt this approach.

Case study: the Gap Partnership

The Gap Partnership specialises in negotiation. "We help improve clients' ability to negotiate, so our work is all real money and achieving a better bottom line through negotiation," says James Read. Almost all the work the firm does has a risk-reward element to it, typically combining a daily fee approach, with a measurable gain-share based on the substantial money saved through strategic negotiation.

"People say that risk-reward deals can be a source of conflict, but that doesn't have to be the case," says Read, "as long as you have a clear way to measure the difference the consultants make and have a way of sharing the benefits."

Case study: Celerant Consulting

"From our very first project, Celerant Consulting has worked on a performance basis for every single engagement – that's more than 1,000 projects," says Christopher Juul. Celerant focuses on operational improvement, so its achievements are, by the standards of consulting, tangible. But even here measuring the firm's contribution can be a challenge. "The first couple of weeks of any project are crucial," he says, "because we have to agree the key performance indicators, then baseline them. If we can't agree these, then we don't proceed with the project: having a collaborative relationship is critical to success." Typically, projects are fixed price with a percentage of fees dependent on agreed targets being achieved. "We also make a commitment that if, at the end of the project, we haven't achieved what we said we would, we'll continue working, at our own expense, until we've done so," says Juul.

Case study: Right Management

Historically, outplacement was viewed as a simple transaction, but a growing sense of social responsibility and concern over reputational damage means that organisations increasingly want to be sure that they are actually helping their employees. "That's changing what we do," says Liz Macham at Right Management. "We're doing less assessment and CV writing, and more one-to-one support. And, rather than try and put people into the first job we can then wash our hands of them, we'll stay with them until they're settled and satisfied, however long that takes. We can even stay in touch with them for years. By doing this on a fixed-price basis, we take the risk of there being some people who take a lot of time to decide what they want to do, but our responsibility doesn't end until they say so."

Case study: PIPC

PIPC, a programme management consultancy, has carried out risk-reward projects with several large-scale clients including Littlewoods and Alliance Trust. "This approach works well for specific types of assignment where the deliverables are tangible and measurable," says Daniel Meere. "It can also be applied to specific phases where the benefits can be quantified, even if they can't be for the project as a whole." It is an important approach to be able to offer clients, he believes, because it allows them to do something they might not otherwise have been able to afford: "They can pay for the project out of the savings," says Meere. "At Alliance Trust, it meant that we could deliver greater benefits: for every £1 they spent with us, they had £5 back in bottom line savings."

Pitfalls to avoid

There are four primary problems associated with risk-reward projects:

- ◆ **An expensive option?** Clients who put a risk-reward deal in order to reduce the price they pay may be in for a shock: risk-reward is not necessarily a way to get something done more cheaply. "If you don't have a clear idea of why you need consultants or can't manage them effectively, risk-reward can actually end up being more expensive," says Nigel Issa at Atos Consulting. Clients can end up paying a premium for work which should, if the project had been correctly scoped, have been part of the base-level service. There are knock-on effects across the market: consulting firms will charge higher fees to all clients to cover the risk they are taking on with a few. Moreover, the fact that a consulting firm offers to work on a risk-reward basis does not necessarily change the way it thinks about its costs internally. "Time and materials still dominate most firms' thinking, economically and culturally," Rick Simmonds at Alsbridge points out. "Because consultants are in the business of selling time, everything they do is mapped against that model. Clients think they're getting something else and can end up being disappointed that nothing has materially changed."
- ◆ **Not an easy option:** People typically underestimate the amount of work involved in setting up a risk-reward deal. You have to develop a business case, evaluate the possible scenarios, sell the concept to potentially cynical colleagues, and that is all before you start measuring and tracking the benefits the consultants should be delivering. Risk-reward requires an investment of people's time which can be greater than conventional contracts: "You're trying to change things and that takes time," warns Derek Fryer at Mott MacDonald.

You have to be careful what you ask for

Keith Bissett, Bourton Group

Pitfalls to avoid

Risk-reward inevitably makes you look at things slightly differently. We'd rather just do a good job
Steve Watmough, Xantus

Risk-reward undermines the consultant's ability to act independently; you risk losing something whilst gaining nothing
Charles Scott, The Berkeley Partnership

◆ **Difficult to measure the benefits:** "The big issue here," says Bob Manuel at Charter Solutions, "is that it's nigh-on impossible to link the outputs you're measuring to the work of the consultants." Charter Solutions is a marketing consultancy: "We might be working on a project to increase sales of a specific product when the client puts the price up. How can anyone isolate the impact we've had when so many of the factors that may determine a given outcome are not within our control." And because the benefits are hard to measure and attribute, the temptation is to rely on metrics that are too simplistic and generic to be useful. "Many clients waste time creating them, then never put them into use," explains Rick Simmonds at Alsbridge. "Or they become trapped in endless negotiation, to-ing and fro-ing about who's responsible for what and whether something falls inside or outside the scope of the project that's been agreed," adds Charles Scott at The Berkeley Partnership.

◆ **The wrong behaviour:** We all know that metrics and targets have a direct impact on what people do – and this applies as much to risk-reward work as it does to any other area of business. Suppose you have a team of consultants implementing a new IT system whose payment depends on ensuring it goes live on a specific date: they are more likely to cut corners in order to meet that deadline. They will act in their own interest, not that of their clients. Mark Goodridge at ER Consultants has spent time working in the steel industry: "I worked on two similar construction projects, one of which involved a risk-reward payment, one of which didn't. It was the latter that was more successful because payment by results can have unintended consequences and the wrong metrics can drive a lot of highly reductive arguments about who's done what."

Making risk-reward work in practice

So, what are the most important lessons when it comes to applying risk-reward payment structures to consulting projects?

1 Be clear about what the consulting project is trying to

achieve: Don't start from the assumption that risk-reward is the right approach. "It's something you should decide based on what your organisation is trying to do," says Julian Harper. You should also be wary of changing metrics part-way through a project. Risk-reward deals are particularly vulnerable to economic downturns: if you put a risk-reward contract in place to ensure commitment from a supplier, it may not work effectively as a mechanism for lowering the price: "Contracts set up to create value or improve service can end up focusing on cutting costs in a way they were never intended to," observes Kevin Johns at BT Global Professional Services.

2 Don't expect risk-reward to be a panacea:

Risk and reward is a poor substitute for good management. "If your desire to use it is driven by concerns about the consulting firm's ability to do the job, take out more references," advises David Bailey. Consultancy adds value when you use the right firm at the right time on the right project, not because you have changed the payment terms. Equally, as with any supplier, consulting firms should not be being rewarded for delivering their "standard" service: rewards, if they are going to be used, should be for performance that exceeds expectations, not just for simply meeting them.

3 Don't use risk-reward as a substitute for picking the right firm:

One of the reasons why organisations consider risk-reward is that they are concerned their objectives and those of the consulting firm they are working with are not aligned. "If that's the problem," advises Mark Fearn at The Berkeley Partnership, "then they would do better to pick a firm whose internal metrics and culture support what they're trying to achieve." Consultants paid bonuses for selling more work will inevitably focus on that; those who know they will only get promoted if their client satisfaction ratings are high will concentrate on delivering a good service.

Risk-reward depends on the contract, and the contract depends on the work
Mark Goodridge, ER Consultants

Success still depends on choosing the right supplier: putting a risk-reward arrangement in place doesn't make the supplier any better, or any better suited to your needs
David Rankin, kae: marketing intelligence

Making risk-reward work in practice

You can be too short-termist when it comes to risk-reward: you need to look at what you want to achieve over a longer period and build the right incentives around that
James Read, the Gap Partnership

We want to do more risk-reward work, but practicalities – a fluid environment, having a joint client-consultant team – add complexity and make it difficult to do in practice
Keith Bissett, Bourton Group

4 Focus on large-scale, long-term projects: For risk-reward to work effectively, the potential bonus for a consulting firm has to be big enough for it to feel the risks are worth taking. That, in turn, means that the benefits to the client have to be sufficiently high that, if the bonus is paid, there is no quibbling over or resentment at its size. Equally, putting in metrics to encourage the consulting firm to generate immediate returns may compromise a project's overall value because corners may end up being cut.

5 Define the type of service you are buying: "Project selection is critical. Clients who haven't done this before may be tempted to apply it to an open-ended piece of work," says Steve Watmough at Xantus. Some consulting services have outputs that are both more tangible and easier to attribute to the consultants (or someone else). The two key deciding factors are the level of ambiguity involved and the extent to which the consulting does (or does not) have control over the outcomes. "Where there's a lot of ambiguity around what's involved and involvement from the client side is high, time and materials is the better option", argues Charles Scott. Equally, the more discrete the work is, the simpler the problem and the more static the circumstances, the more appropriate risk-reward becomes. "Risk-reward only works if you can tie the improvements achieved directly into the actions taken by the consulting firm but, typically, there are so many external variables that it's nigh-on impossible to do this," agrees LCP's Jeremy Hammant. The exception that proved his rule was to support a third-party logistics company as it responded to an invitation to tender from a client. "This was an unusually clear-cut case: we got a bonus if they won the work," says Hammant.

Making risk-reward work in practice

5 Measure what you want to be managed: Most risk-reward work focuses on project-related metrics such as deliverables, budget and timescales. While important, these will inevitably tend to focus the attention of the consulting team on the means, not the end. It may be more effective in the long-term to connect the consultants' work with the way in which they work and/or the business benefits. "For the work we're doing with UK Borders, we've put some of our fees at risk if we don't transfer our skills and knowledge," says David Cox at Mott MacDonald. "We've a methodology for doing this and it's a culture we feel comfortable with."

7 Identify metrics you can measure: In a risk-reward deal you have to be able to measure success, but defining appropriate measurements may not be easy. So what makes a good metric?

- ◆ Decide what is in and out of scope. Are, for example, the benefits of existing projects included or excluded?
- ◆ Have a scoping phase: Because finding the right metrics can be difficult, risk-reward projects are often preceded by a short scoping phase typically paid for on a traditional time and materials basis. Once you have quantified the benefits, you will be in a better position to judge what metrics will be appropriate.
- ◆ Establish a baseline, but ensure it covers a reasonable period, avoiding cyclical peaks and troughs in an organisation's performance.
- ◆ Nominate a source of independent arbitration – the senior management team perhaps – which has sufficient authority to resolve disputes.
- ◆ Measure performance throughout the project, not just at the start and end. One of Atos' clients set up a part of their intranet where the cumulative score of its suppliers were tracked. "They could see at a glance the difference that consulting firms had made," recalls Nigel Issa, "and it meant people didn't just jump to the conclusion they should bring consultants in but checked out their performance first."

There should be a "golden source" of numbers: a set of data which everyone, including people in the finance team, agree is valid, otherwise you'll end up with two sets of numbers and fall out over it
Daniel Meere, PIPC

Making risk-reward work in practice

You can fire a consulting firm at a day's notice: What greater incentive is there for the firm to do a good job?
Charles Scott, The Berkeley Partnership

- ◆ Be clear about who is responsible for doing what.
- ◆ Keep things simple. "You need a robust performance management system, not a cottage industry," says Russell Poynter-Brown. "It's tempting to overcomplicate things and try and prove benefits to the last penny. You can end up in a situation where you've generated some modest savings but spent ten times as much trying to prove it."

8 Consider alternative risks and rewards: If your aim is to provide a consulting firm with the motivation to perform above and beyond what the contract specifies, there may be better ways to achieve this than conventional risk-reward. Financial reward is not everything: "If we're given the choice between more money and the chance to win a follow-on piece of work, we'll almost always go for the latter," says Russell Poynter-Brown. Offering continuity of work (on a subsequent phase of a project, for example) may be more attractive in economic terms than a straight-forward bonus. Equally, it might be more appropriate to couch a penalty in terms of service credits (the firm has to work for free). Reputation is also important, so making it clear that you will be willing to provide a reference where the firm's service has been exceptional is another powerful incentive.

9 Think about your internal metrics: The success of using risk-reward depends on having a clear and meaningful set of metrics which can be accurately monitored. It is much easier to do this in an organisation where measuring and managing overall performance is important. "If your organisation already takes the way it evaluates managers seriously, then it's much more likely to be able to devise meaningful key performance indicators for less obviously measurable benefits, such as change management," agrees Sally Russell at Right Management. The converse is also true: organisations that find it hard to evaluate their own performance are unlikely to excel at measuring others". It is also critical that the metrics used match those applied to the consulting firm: a procurement team that is measured on short-term cost-cutting is not going to be interested in measuring a consulting firm's ability to add value in the long-term. Indeed, risk-reward

Making risk-reward work in practice

contracts do not work well where the pressure to perform is one-sided. "Clients have to put some skin in the game too," says Christopher Juul at Celerant, "otherwise everything becomes a problem the consulting firm has to fix." "If a risk-reward project is driven solely by a procurement manager, it's unlikely to succeed," agrees Arun Aggarwal at Tata Consultancy Services. "There needs to be a solid connection between the ultimate client and the consultant."

10 Build an open partnership: Risk-reward contracts do not work where the relationship between customers and suppliers is adversarial because they will only add to the tension between those involved. Perhaps the single, most important lesson learned has been the recognition that risk-reward has to be collaborative effort. "You have to be clear about what you're trying to do and what the barriers are likely to be," says David Cox at Mott MacDonald. "Our position is that we will be open about the things that drive our costs. If a client can help us cut our costs we will pass on some of the savings to them. Risk-reward won't work where organisations fall back on traditional behaviour or try to be too clever with their performance indicators. There has to be openness and a constant dialogue."

If the internal measures of the company are dysfunctional, risk-reward won't work
Keith Bissett, Bourton Group

Mechanical approaches don't work well because someone will always end up feeling cheated
Rick Simmonds, Alsbridge

Contributors		
Name	Firm	Email
Arun Aggarwal	Tata Consultancy Services	arun.aggarwal@tcs.com
David Bailey	Hitachi Consulting	DBailey@hitachiconsulting.com
Keith Bissett	Bourton Group	Keith.Bissett@Bourton.co.uk
Bernard Conlon	Otto UK	Bernard.Conlon@otto-uk.com
David Cox	Mott MacDonald	David.Cox@mottmac.com
Mark Fearn	The Berkeley Partnership	mark.fearn@berkeleypartnership.com
Derek Fryer	Mott MacDonald	derek.fryer@mottmac.com
Al Geddes	Mouchel	alastair.geddes@mouchel.com
Mark Goodridge	ER Consultants	mark.goodridge@erconsultants.co.uk
Jeremy Hammant	LCP	jeremy.hammant@lcpconsulting.com
Julian Harper	Trinity Horne	julianharper@trinityhorne.com
Jim Hemmington	BBC	jim.hemmington@bbc.co.uk
Kevin Johns	BT Global Professional Services	kevin.johns@bt.com
David Jones	Mott MacDonald	David.Jones@mottmac.com
Liz Macham	Right Management	Liz.Macham@right.com
Christopher Juul	Celerant	Christopher.Juul@celerantconsulting.com
John Yarwood	Atos Origin	john.yarwood@atosorigin.com
Bob Manuel	Charter Solutions	bob.manuel@chartersolutions.co.uk
Daniel Meere	PIPC	
Sally Russell	Right Management	Sally.Russell@right.com
Russell Poynter-Brown	Davis Langdon	Russell.Poynter-Brown@davislangdon.com
David Rankin	kae: marketing intelligence	david.rankin@kae.com
James Read	Gap Partnership	James.read@thegappartnership.com
Nigel Issa	Atos Consulting	nigel.issa@atosorigin.com
Charles Scott	The Berkeley Partnership	Charles.Scott@berkeleypartnership.com
Rick Simmonds	Alsbridge	rick.simmonds@alsbridge.eu
Paula Sussex	Atos Consulting	Paula.Sussex@atosorigin.com
Steve Watmough	Xantus Consulting	Steve.Watmough@xantus.co.uk

Sponsored by Mott Macdonald



How to contact us

Source Information Services Ltd
No 1 Cornhill
London
EC3V 3ND
Tel: 0845 293 0993

© Source Information Services Ltd 2008

Registered office: 26 Aldebert Terrace, London, SW8 1BJ. Registration No: 06439935