

Staffing to Solutions: Is It Worth It?

There are few IT services firms left out there that have not jumped on the band-wagon and journeyed down the yellow brick road of higher margins to Oz, or as it is better known in the IT industry: Solutions.

One by one over the last couple years, profitable, well-oiled staffing machines have bought in to the lure of the solution, with its \$1trillion worldwide market, it's higher margins, higher billing rates, and overall higher price tag per engagement. Such firms have exhausted enormous resources on marketing campaigns, image campaigns, name-changing campaigns, sales-force and consultant training initiatives, and general overhauling to make the transformation into a shiny new solutions provider.

Was it worth it for the company? Is this a better environment for the employee?

The simple answer is yes AND no. There are many ways to make money in this industry, and solutions models come in a variety of packages, including:

- ?? Integrated IT Solutions
- ?? Specialty Staffing
- ?? IT Consulting
- ?? Management Consulting
- ?? Project Management
- ?? e-solutions
- ?? Project Outsourcing

The list goes on, but the point is each model has a different financial and staff structure that comes with its own set of possibilities, problems, and results. However, the real victims here are those firms caught in the middle. Firms that have one toe in the solutions pond and one in the staffing pond trying to operate in what should be two distinct business models, seem to have the greatest difficulty, expend the greatest effort, and post the worst numbers. Conversely, those firms that derive most of their revenue from either the staffing model or one of the solutions models tend to post the best financial results.

The transformation to a solutions firm can be a painful experience. This transformation typically brings with it up to a 40% reduction in won business, and in two-thirds of the engagements, IT projects result in delays and cost overruns, primarily stemming from overly optimistic expectations set by the sales force and the overwhelming complexity of some of the engagements. Yet, the lure of higher margins and greater revenue are almost irresistible to even the battle-hardened giants of the IT services industry.

To be successful, the numbers show that companies should pick a path and dive in headfirst. For example, the average operating profit per employee in firms that derive over 80% of their revenue from supplemental staffing services is \$9,000. The average operating profit per employee in firms that derive between 50% - 80% of their revenue

from supplemental staffing is \$7,400 (Specifics' 2000 IT Services Productivity, Practices, and Trends Study PPT), and that's only counting the firms that reported and operating profit, many had losses. Further, the 2000 PPT shows that firms that derive over 50% of their revenue from managed project work posted a 42.3% average gross margin, while firms that derive 20% - 50% from project work posted a 33.2% average gross margin.

On the other side, the average operating profit per employee in firms deriving more than 50% of their revenue from project work was \$8,500 while this same metric was \$9,000 (as mentioned above) for firms doing over 80% supplemental staffing.

The gross margins are higher, the billing rates are higher, and the revenue per engagement is significantly higher for solutions firms. However, the average utilization rate for billable employees in solutions firms is significantly lower, and the complexity of selling and managing solutions work brings with it significantly higher SG&A expenses.

The implication here is rather manifest: The solutions model is a far more complex business and an expensive model to operate, while the staffing model is far more simple and less expensive but yields lower rates and margins. Firms that try and operate in both arenas rather than focus on one business model often end up with the worst of both worlds, mostly because they don't cut their losses. Contractually they cannot walk away from projects in trouble, and emotionally they are committed to underutilized resources.

From the employee's perspective, however, the prospect of switching to a solutions business model can be exciting. Working in a solutions environment carries with it a greater level of prestige relative to being farmed out by a "body shop." Consultants get the opportunity to work on different engagements with different clients that have, or are supposed to have, a fixed beginning and ending. Consultants also have the opportunity to broaden their knowledge base and learn the intricacies of different industries and businesses working with various clients.

Further, the path towards career advancement becomes clearer for those who have the desire to become senior project managers and account managers. The very nature of these projects requires continual education in the form of hard and soft-skills training, and as a result, employee turnover for solutions firms is significantly lower than the turnover in services firms. The 2000 PPT shows that the average overall turnover for firms deriving more than 80% of their revenue from supplemental staffing services is 46.3% (higher than the national average of 43.6%), while the average drops to 23.1% for firms doing more than 50% solutions work. However, though it happens less frequently, turnover of key technical personnel engaged in a complex, fixed-time and/or fixed-fee integration project can be far more painful for a solutions provider. Similar to financial results, the average turnover increases significantly for those firms trying to meld both business models.

What all this means is that there is no optimum business model. The bottom-line profitability of solutions-based firms versus staffing firms is not significantly different in most cases. The point is, until firms learn how to manage both business models

simultaneously, which may never happen, the most prudent course of action appears to be picking a fork in that yellow brick road and sticking to it.