March 31, 2000

Dear Client,

Mercer Consulting Group (MCG) adds Delta Consulting Group to its corporate services stable. MCG is the consulting unit of Marsh & McLennan companies, and currently includes William M. Mercer (HR), Mercer Management Consulting (strategy), National Economic Research Associates (economic analysis), and Lippincott & Margulies (corporate identity/branding).

The addition of New York-based Delta, founded by David Nadler in 1980, compliments Mercer's overall HR focus. Delta specializes in corporate organizational design and change management consulting. Terms were not disclosed, but Delta will now go to market as Mercer Delta, and its 100 employees are added to MCG's ranks.

<table>
<thead>
<tr>
<th>MCG Practice</th>
<th>Staff Size</th>
<th>1999 revenues</th>
<th>% of total MCG revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>William M. Mercer</td>
<td>12,500</td>
<td>$1.6B</td>
<td>80%</td>
</tr>
<tr>
<td>Mercer Management Consulting*</td>
<td>1,200</td>
<td>$0.3B</td>
<td>15%</td>
</tr>
<tr>
<td>National Economic Research Associates</td>
<td>275**</td>
<td>$0.1B</td>
<td>5%</td>
</tr>
<tr>
<td>* includes Lippincott &amp; Margulies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>**billable consultants; does not include total staff</td>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>

The acquisition adds a limited number of high-quality pros (100) and juicy margins on limited revenues ($41 million). More importantly, Delta provides Mercer the bridge between HR and strategy. Delta has an impressive client roster - 75% of its 200+ clients are Fortune 500. Blue-chip clients and high profitability ($410,000/pro) points to a premium acquisition price; our estimate would be 2.5x revenue.
Delta’s Nadler is a prolific author like Mercer’s Adrian Slywotzky (who came to Mercer via the CDI acquisition nearly three years ago). Nadler wrote Champions of Change and co-wrote Competing by Design and Executive Teams. Be assured the pair will collaborate on future publications.

We often question the wisdom of consulting acquisitions due to cultural conflicts and the difficulty inherent in blending different professional services. But Mercer Delta is a logical fit and considerably bolsters Mercer’s value proposition to clients.

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Repeat business amounted to 66.4% of total consulting fees, according to the Association of Management Consulting Firms. AMCF surveyed 62 consultancies (revenue range $1M-$15M+) in its 1999 report: Operating Ratio’s for Management Consulting Firms. Among other findings, the report notes the number of billable hours spent per week varies by position.

<table>
<thead>
<tr>
<th>Employee</th>
<th>Billable hours/week</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Partner</td>
<td>20</td>
</tr>
<tr>
<td>Junior Partner</td>
<td>25</td>
</tr>
<tr>
<td>Sr. Management Consultants</td>
<td>30</td>
</tr>
<tr>
<td>Management Consultants</td>
<td>30</td>
</tr>
<tr>
<td>Entry Level Consultants</td>
<td>30</td>
</tr>
<tr>
<td>Research Associates</td>
<td>23</td>
</tr>
</tbody>
</table>

Source: AMCF, Operating Ratios for MC Firms

A consultant averaged 26.3 billable hours a week (or 59.3% of available hours if you believe a workweek is still 40 hours). For those high-profit firms boasting higher utilization rates, there is a laundry list of non-billable activities (i.e. recruiting) that siphon time from a consultant’s workweek and increases the likelihood of burnout.

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Deloitte Consulting is quietly swimming in the same familiar waters as its peers. But unlike other Big 5 firms, Deloitte has avoided splashy announcements regarding its future. Look for that to change over the next few months.

Just last month, Deloitte set up a $500 million venture capital fund to invest in internet start-ups. The VC fund coincided with the naming of Doug McCracken - former leader of the America's practice - to succeed Pat Loconto as managing partner. Deloitte also surpassed competitors with a good 1999 in terms of revenues ($2.3B) and growth in North America and Europe.

Deloitte Consulting Revenue Growth: 1999

<table>
<thead>
<tr>
<th>Region</th>
<th>1998 Revenue</th>
<th>1999 Growth</th>
<th>1999 Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Americas</td>
<td>$1,285M</td>
<td>34%</td>
<td>$1,722M</td>
</tr>
<tr>
<td>Europe</td>
<td>$290M</td>
<td>53%</td>
<td>$445M</td>
</tr>
<tr>
<td>Asia-Pacific</td>
<td>$184M</td>
<td>16%</td>
<td>$214M</td>
</tr>
</tbody>
</table>

Like the others, Deloitte has been building its e-business practice and presence. The firm appointed Cathy Benko - formerly a principal in the firm's healthcare practice - as global e-Business practice leader in early November 1999, and a month later appointed Steve Riordan national director of e-Business consulting services for emerging strategic clients.

The firm says Riordan will focus on small and middle market clients, a target group Arthur Andersen actively courts. Deloitte claims to be building thought leadership in the space with studies on e-Business and other matters through its Deloitte Research unit. But Tom Kiely, who headed Deloitte's thought leadership program, recently left to join Viant in a similar capacity.

Under McCracken, Deloitte seems intent on rejiggering its image. Two weeks ago the firm announced an IBM initiative echoing AC's joint venture with Microsoft. Deloitte Consulting will train 2,000 consultants to bring IBM's e-business technology to organizations in North America.
More mega-alliances with tech giants will be announced in the near future, but we still wonder if these large-scale consultant/technology vendor marriages will truly benefit clients. Consultants may ultimately be seen as painters who work with just one color.

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Repackaging services is no longer the best way to differentiate consulting. That’s one of the primary findings from Expertise Marketing, a Concord (MA) marketing firm that studies professional services.

Expertise outlines the goals of marketing for consulting firms in its new report: Differentiation: How Are Professional Service Firms Using it to Compete? The report covers accounting and executive search, among other professional services.

Consulting Use of Differentiation Approaches (ranking)

<table>
<thead>
<tr>
<th>Differentiation Approaches</th>
<th>1999</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repackage current services</td>
<td>59% (1)</td>
<td>18%</td>
</tr>
<tr>
<td>Improve or evolve our current services</td>
<td>56% (2)</td>
<td>56% (1)</td>
</tr>
<tr>
<td>Reorganize practices or lines of business</td>
<td>51% (3)</td>
<td>31%</td>
</tr>
<tr>
<td>Develop a new positioning</td>
<td>51% (4)</td>
<td>18%</td>
</tr>
<tr>
<td>Use new techniques and tools to “deliver” our services (i.e. printed reports now delivered via CD-ROM).</td>
<td>43% (5)</td>
<td>31%</td>
</tr>
<tr>
<td>Add new variables to our prices</td>
<td>41%</td>
<td>39% (5)</td>
</tr>
<tr>
<td>Train professionals to follow our proprietary methodologies</td>
<td>39%</td>
<td>43% (3)</td>
</tr>
<tr>
<td>Enter into joint ventures, alliances, or referral networks with firms that extend our services</td>
<td>37%</td>
<td>53% (2)</td>
</tr>
<tr>
<td>Hire specialized individuals.</td>
<td>37%</td>
<td>39% (4)</td>
</tr>
</tbody>
</table>

Source: Expertise Marketing, 2000
Joint ventures and alliances jumps to second place, reflecting the activity we’ve seen this year. In addition, repackaging current services isn’t a huge part of the plan for firms next year: most firms have already reorganized to make themselves more nimble to offer e-services.

Hiring and training will be used as differentiators more often next year. The undying characteristic of consulting – improving and evolving services – will take center stage as firms are still trying to get a grip on all the opportunities in the e-services space.

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**Andersen Consulting creates a hybrid public/private consultancy with its new e-unit plan.** But the more interesting scenario focuses on how the firm adds 1,000 new partners by year’s end, which almost doubles the current partnership of 1,300.

Wider profit distribution and an altered partnership track are separate, but parallel, issues. The financial incentives for gaining true partner status are enormous, as demonstrated below:

**Sharing the Wealth**

<table>
<thead>
<tr>
<th>AC Group</th>
<th>Total People</th>
<th>AC Ventures contribution*</th>
<th>E-Unit share</th>
<th>Expected ROI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners</td>
<td>2,300**</td>
<td>$100,000,000</td>
<td>$43,478</td>
<td>$5-$60/per</td>
</tr>
<tr>
<td>Non-Partners</td>
<td>40,000</td>
<td>$200,000,000</td>
<td>$5,000</td>
<td>$5-$60/per</td>
</tr>
</tbody>
</table>

* 2000 calendar year
**assuming AC adds 1,000 partners as expected.

But making partner and being a partner are two different propositions. Consulting partners at major firms primarily sell services that are delivered by junior staff. Andersen’s challenge is to identify partners from within the up-and-comer ranks who will fit the profile. Merely offering a sizable carrot to those ill-suited for partnership’s demands may prove counter-productive.
Ken Dawson, head of Alpha Publications and chronicler of global management consulting trends, discusses the true logistics of Cap Gemini’s acquisition of E&Y’s consulting practice.

"In assessing the announcement of an offer by French Group Cap Gemini for Ernst & Young’s consulting arm, an interesting question is 'Who gains most from the deal?'

The offer will yield a firm having combined revenues of around $8.3 billion. This is based on reported revenues for 1999 of $4.3 billion for Cap Gemini and $4 billion for E&Y. By the way, wherever Cap Gemini’s figures have been reported in euros, we treat them as U.S. dollars since that was the going rate until a couple of weeks ago.

What we end up with, of course, is not a consulting firm, but an entity like EDS or CSC, which purveys software, outsourcing and related services, one of which is consulting. Their latest revenues were $16 billion and $9 billion, respectively. In the same bracket, we have to recognize Andersen Consulting (revenues of roughly $9 billion) and in the background, IBM at around $30 billion.

Cap Gemini is reported to be offering around $11.5 billion for E&Y, according to the Financial Times. This is based on the offer of a maximum of 43.5 million shares plus $375 million in cash. Cap Gemini’s share price on the Paris exchange was 256.5 euros. As E&Y’s accounting and consulting arms have around 6000 partners, the offer works out at an average lump sum of nearly $2 million per partner. Not bad, but a far cry from Goldman Sach’s IPO deal last year which netted 18 lucky partners some $2 billion per person.

Is E&Y selling out too readily? The consulting arm’s growth in recent years has been nudging up to 30% per annum, whilst that for Cap Gemini has been in the single digits; the strong growth in earlier years were fueled by acquisitions. Pre-tax profits for Cap Gemini last year were $266 million, or 6.2% of revenues. We don’t know the equivalent for E&Y, but if its achievement was in line with the rest
of the Big Five, it would have been around 20%. So E&Y ought to be
doing Cap Gemini a big favor.

One is drawn to suspect a greater vulnerability by E&Y in regard
to future growth than may appear on the surface. Equally, the firm
may see greater prospects for growth with Cap Gemini than are
apparent. As a token of vulnerability in the current market, E&Y
fired a number of its people recently who were long in experience in
ERP and Y2K problems, but were short in e-business.

Maybe Cap Gemini can offer something in e-business E&Y doesn’t
have? But that doesn’t stack up readily. Around $1 billion of E&Y’s
consulting turnover is reported to be in e-business already or around
25%, which is much the same percentage as for what KPMG is currently
claiming. By contrast, Cap Gemini recently set up a unit of 1,300
people specializing in e-commerce. That sounds a lot, but against a
total employment level of 40,000 people, that’s useful rather than
momentous.

What about the value of the paper Cap Gemini is offering? If
it’s based on a price earnings ratio of around 89, which was the
figure being quoted a couple of weeks ago, that, in turn, might be
thought generous for a firm which has been experiencing single digit
growth. In fairness, Geoff Unwin, executive vice-chairman is
forecasting growth in the double digits. But 89 is a pretty high
rating for what it is currently achieving.

So what is the benefit of the deal? David Wilson, head of E&Y’s
European consulting unit, says “The proposed merger is market-
driving. There was a time a few years ago when a big consulting
project added up to around $200 million. Now it’s in the $1 billion –
$2 billion range. This reflects the global ambitions of our major
clients. To be in the bidding for projects of that size, you have to
be regarded by clients as a top or big player. There’s also the point
that, whereas E&Y is strong in IT consulting at the business advisory
level, Cap Gemini has enormous technical strengths, so we are
complementary.” It can also be recognized that Cap Gemini has gotten
nearly nowhere in the U.S. in terms of profitability or name
recognition and will benefit from the E&Y connection. But here we are
again, praising E&Y’s virtues and not Cap Gemini’s.
So there has to be a residual something or other which accounts for E&Y’s love affair. It’s rumored that E&Y’s consultants are brassed off with the accountants. That could explain something. But here’s a question for the consultants: Are you selling yourselves for a mess of pottage?”

Ken Dawson is author of the "The Market for Management Consultancy Services in the U.S.A." and heads Alpha Publications in the U.K. He can be reached at 44-1494-675942 or www.alpha-publications.com.

Yours truly,

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