

CMA INVESTMENT CONSULTANTS MARKET INVESTIGATION

14 May 2018

Financial Performance and Profitability

Redington response to CMA working paper

The CMA is currently not minded to undertake an assessment of economic profitability, hence is not able to conclude whether providers of IC and FM services have earned persistent excessive profits. We have no further comments at this stage on the CMA's profitability analysis and generally agree with the difficulties identified by the CMA in undertaking an assessment of economic profitability.

COMMENTS REGARDING PROFITABILITY OF ALTERNATIVE FEE MODELS

As we have highlighted in previous papers, we think that it is important that clients can compare total costs when considering consultants using alternative fee models and agree with the CMA that it is important to improve transparency of quoted fees versus actual fees for both the client's own contract as well as for each consultant across their client base.

When looking at profitability, the CMA may, however, also wish to consider the relative profitability and relative value-for-money received by clients under different charging models as different fee models and client tenure affect profitability and not all clients/consultants work on Time and Material charge out rates.

Under a fixed fee model for example, taking on a new client is typically more expensive than ongoing servicing of existing clients, so fixed fees will often have low or negative profitability in early years, due to getting to know the client and understanding their requirements, and implementing changes accordingly. This leads to a longer term view on profitability, achieving a steady state after say a minimum three year time frame.

Therefore, the maturity/tenure of the "client book" can have a material impact on an IC firm's overall profitability. If a material proportion of the client book is in "take on" mode; in the first two years of a relationship say, the overall profitability could be low, even if the long-run steady state profitability is higher. This creates a headwind against fast growth with fixed fees.