Coming of age for a consulting company: An entrepreneurial transition case study

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ABSTRACT

Brumagim [2010] developed an entrepreneurship case (The Best Backgammon, Inc. case) that can be used for assessment of learning (AOL) to support AACSB international accreditation. The case developed in this paper is also in the area of entrepreneurship and is also an AOL component, but looks at a completely different business environment (management consulting versus manufacturing) and decision context (entrepreneurial transition versus startup issues).

The case involves two principals in a private consulting firm who are considering various strategic alternatives, including whether to take their company "public". Students have to analyze and evaluate strategic alternatives available to the firm, and specifically, the advantages and disadvantages of becoming a publicly traded company. Students have to decide the best course of action and to provide their reasons. The case is based on a real-world situation of a small, but successful, private consulting firm that has reached a point where a strategic assessment of the firm's future is appropriate. It is designed so that students can gain exposure to a real-life situation.

The student evaluation is based on extensiveness of literature search, creativity in developing different transition strategies, coherent and logical argumentation, and clarity and professionalism in style of writing. Extensive Teaching Notes and Assessment Rubrics for student evaluation are provided. The case can be used as the entrepreneurship component of a senior level capstone course in business strategy or in an MBA entrepreneurship strategy course.

Keywords: consulting industry, forms of ownership, entrepreneurial options, costs-benefits of IPO versus internal growth

INTRODUCTION

Brumagim [2010] developed an entrepreneurship case (The Best Backgammon, Inc. case) that can be used for assessment of learning (AOL) to support AACSB international accreditation. The case developed in this paper is also in the area of entrepreneurship and is also an AOL component, but looks at a completely different business environment (management consulting versus manufacturing) and decision context (entrepreneurial transition versus startup issues).

The case involves two principals in a private consulting firm who are considering various strategic alternatives, including whether to take their company "public". Students have to analyze and evaluate strategic alternatives available to the firm, and specifically, the advantages and disadvantages of becoming a publicly traded company. Students have to decide the best course of action and to provide their reasons. The case is framed in terms of a small, but successful, private consulting firm that has reached a point where a strategic assessment of the firm's future is appropriate. The case is designed so that students can gain exposure to a real-life situation faced by small private companies which have achieved a certain level of growth and success.

The student evaluation is based on extensiveness of literature search, creativity in developing different transition strategies, coherent and logical argumentation, and clarity and professionalism in style of writing. Extensive Teaching Notes and Assessment Rubrics for Entrepreneurship Evaluation [Table 5] and Quality of Writing [Table 6] for student evaluation are provided in the Appendices. The case can be used as the entrepreneurship component of a senior level capstone course in business strategy or in an MBA entrepreneurship strategy course.

Serafina Invicelli, age 38, and Horatio Brutus, age 55, are the principals in the successful management consulting business Invictus Solutions, which they started together ten years ago. Together they have grown their business from a start-up to a well-respected consulting business headquartered in Chicago with offices in Boston, Dallas, Washington, D.C., New York, Los Angeles and San Francisco. The firm employs approximately 300 billable consultants and has a support staff of about 100 employees. Revenues for the last fiscal year ended December 2008 were slightly over $165 million. All of their office space is leased and not owned. So far, the firm has been capitalized primarily by the two principals.

Serafina is a PhD in Economics and Horatio is an attorney and also has an MBA. Serafina has established a reputation as an economics and statistics expert while Horatio has leveraged years of experience as a corporate executive into a successful management consulting practice. Their particular niche client market is small to mid-sized businesses that are looking for reasonably priced management assistance in dealing with a variety of business issues as well as plans for improving their businesses. Clients also include various government agencies.

At their 10th anniversary celebration, Serafina and Horatio were asked about their plans for the future. They did not have a ready, well conceived plan to answer the question, but realized that it was crucial that they think critically about their own and the firm's future. Being consultants by training, they started collecting facts and developing possible alternatives for the future of the firm.

As the two principals reflect on ten years of being in the consulting business, they are considering different strategic alternatives for their firm. They have developed a list of various widely divergent choices that are available to them. These are: (1) Maintain the status quo and grow at the natural growth rate; (2) Enhance the growth rate through principal-financed expansion; (3) Enhance the growth rate through substantial bank lending; (4) Enhance the growth rate by admitting one or a very small number of professional partners who enlarge the capital base; (5) Merge with a similar size or larger consulting company; or (6) become a publicly-traded company and cash out if the Initial Public Offering (IPO) is successful. They realize that there are different risks and rewards associated with different strategies.

CONSULTING INDUSTRY OVERVIEW

Consulting industry history

Serafina and Horatio discovered that recent trends in the consulting industry indicate a shift from private firms to publicly traded firms. Formerly, management consulting was an industry dominated by private partnerships. However, since 2003, only 29 of the largest 75 consulting firms are still private. As of 2004, 17 of the top 20 consulting firms are now publicly traded [Adams & Zani, 2005]**.** The ranks of the largest management consulting companies by revenues according to Careers in Business Research (August 2009) are as stated in Table 1 (Appendix).
Management consulting firms began to proliferate after World War II as the United States transitioned into a peace-time economy. Management consulting has grown, with growth rates in the industry exceeding 20% in the 1980s and 1990s. In 2010, total global revenues for management consulting exceeded $345 billion while domestic consulting revenues were approximately $160.5 billion [Plunkett Research, 2011].

Scope of consulting industry

Consulting practices cover the entire gamut of business issues and there are as many different types of consultants as there are business issues that need to be addressed, including information technology, healthcare, general management and strategy. Consulting firms offer expertise, experience and knowledge that their clients lack. Generally, there are three types of consulting firms:

- The traditional business consulting firms which offer a wide array of consulting services to a wide range of clients. Companies in this sector include firms such as McKenzie and Company, Booze, Allen and Hamilton and The Boston Consulting Group;
- The specialized or boutique firms. Examples include Watson Wyatt (human resources and compensation) and Hewitt and Associates (benefits);
- The technology consulting firms: Accenture Ltd. is probably the most prominent and it derives the majority of its revenues from technology consulting. (Accenture is not a pure-play tech consulting company)

The consulting industry consists of firms of all sizes, from self-employed, one-person, work-from-home practices, to the large multi-practice, global companies. The industry is comprised of educated, experienced professionals with about 74% having a bachelor's degree [Bureau of Labor Statistics, 2008-09].The consulting business, not unlike other industries, has gone global with many of the large consulting firms maintaining offices in Europe and Asia.

Where do consultants come from?

Consultants come to the profession from several different routes. Some are refugee managers and executives who have been terminated from their employment. Then there are the "entrepreneurs", which may also include "retirees," who decide to leverage their years of experience and expertise into part-time work. Others are academics who possess great theoretical knowledge which they desire to leverage into economic advantage. Finally, in years in which consulting positions are considered desirable by newly minted MBAs, the profession attracts recent graduates. Since start-up costs and barriers to entry are relatively low, the consulting business is a very competitive one [Reh, 2011]. "There has been an explosion of smaller shops. It has become easier for small firms to navigate the marketplace due to better electronic tools, availability of relevant datasets and the general escape of qualified professionals from the 'grind' to be found in larger firms" (Careers in Consulting, http://www.careers-in-business.com/consulting/mcfacts.htm) [2011].

Consulting industry culture and work attributes

Critics of high-fee consulting services say that a consultant will borrow your watch to tell you the time and send you a bill. The consulting business is a "personal service business." Generally speaking, clients hire a person, not the firm. Once a consultant-client relationship is established, consultants become a valuable commodity with respect to generating revenue or managing costs for the firm. Consultants are sometimes characterized as either revenue generators or producers, although the most successful consultants are both. The "revenue generators", also called "rain-makers," are skilled at client development, i.e. finding clients who are willing to retain the firm. The "producers" actually perform the client work and are generally not rewarded as well as the rain-makers are. Compensation arrangements in firms can become complicated affairs in terms of rewarding consultants [Peterson, 2010].

The work environment in consulting firms can be very demanding. More often than not, individual consultants have little or no control over their workday. Client demands and schedules take precedence. It is not unusual for consultants to travel extensively on client engagements, which can last several months. This is especially true in the larger, multi-practice firms. Accenture, the world's largest consulting firm, has positions that go from zero to 100% travel depending on the specific consulting position (careers.accenture.com). "Consultants can work long hours. The firm expects them to provide clients with 'no excuse' customer service. In addition, many consultants travel to and live at the site of the client company, although they generally return home every weekend" (http://www.arts.cornell.edu/career/careers_in_management_consulting.pdf) [2011].

As a consultant progresses within a firm, he/she assumes responsibility for "client development," i.e. attracting new clients to the firm. Many individuals are neither comfortable nor particularly adept at developing a "book of business," i.e. clients. Consultants who routinely find themselves either "on the bench," i.e. not engaged in client projects, or who cannot generate clients find themselves at risk of being terminated. Between disenchantment and burn-out, the "glamour" of consulting soon loses its appeal. Annual employee turnover of 12.5%, or higher, is possible (http://www.consulting-news.com/article_display.aspy?P=adp&id=2079) [2005].

Professional service organizations are unique in that their "assets," the individual consultants, can literally walk out the door with their clients, potentially damaging the firm severely since lost clients are lost revenues if there is no non-compete agreement. Consulting firms, like other professional service organizations, remain constantly exposed to sudden and possibly dramatic adverse changes to their business. Therefore, a certain "critical mass" can insulate firms from drastic changes. In other words, smaller companies tend to be more vulnerable to adverse changes [Peterson, 2010].

Consulting industry trends

A research study conducted by Plunkett Research [2011], Plunkett reported the following:

Globalization.

Much of the recent growth in the industry has come from increased global demand for consulting services. Consultants are retained because they possess expertise, experience and skills not currently available in developing countries such as China, India and Brazil. The major consulting companies maintain offices in Europe, Asia, and South America. However, the boom in consulting outside the U.S. diminished in 2008 as a result of the global economic downturn. This trend seems to be reversing itself because "With their fees under pressure and merger and acquisition activity still sluggish, management consulting firms are turning to emerging markets like China and India for growth" (www.consultingcase101.com) [2010].

Information Technology.

Information technology (IT) consulting is one of the fastest growing segments within the consulting industry. Services in this segment include hardware systems design and implementation, software design and website design and operation. This segment also increasingly includes the outsourcing of IT services to consulting firms by clients (www.accenture.com).

Current Outlook.

The consulting industry is not immune to the slowdown in the world economy. Both the private sector and government have cut their spending budgets. The end result is that competition in the consulting industry will become more intense. And while there are some positive signs that a mild recovery is underway, especially with the government stimulus package, the large traditional consultancies may face increased competition from smaller, niche firms. Therefore, size and name recognition could provide a competitive advantage [Plunkett, 2011].

INVICTUS SOLUTIONS BACKGROUND

Invictus Solutions Practice Areas

Invictus Solutions falls into the category of a traditional consulting firm consisting of a number of practices within the firm, which provides a variety of professional services to its clients. The firm assists client companies in understanding regulations, evaluating and implementing compliance programs, and analyzing the potential financial risks of management programs. The firm helps clients in evaluating and implementing appropriate business solutions with respect to business problems. The firm's practice areas mirror very closely those of one of its competitors, Navigant Consulting, Inc. which are detailed below (www.navigantconsulting.com). [2011]

Risk management and compliance:

The services range from conducting a company-wide risk assessment for the purpose of recommending audit improvements and compliance programs, to conducting individual investigations. Specific services include:
Regulatory compliance reviews
Recommending corporate governance programs

Economics and statistical services:

Specific services include:
Evaluation of strategies for settling versus litigating claims
Statistical data analysis
Business valuations
Identifying and monitoring performance metrics

Corporate fraud investigations:

Invictus Consulting has earned a reputation as experienced business investigation consultants. It has experience and expertise in preventing, detecting and investigating risks or threats to various aspects of a business. Specific services include:
Special investigations
Management and employee fraud
Training on fraud awareness and prevention

Financial and accounting services:

The firm has expertise and strong project management experience analyzing financial processes, financial reporting and internal controls. It does not, and cannot, provide independent accounting services. Services include:

SEC reporting and disclosures
Strategic and operations planning

Company Clients:

Invictus Solutions has a variety of clients in such diverse industries as banking and finance, various retail businesses, real estate development, energy, pharmaceutical, industrial equipment, telecommunications, and consumer products as well as various agencies of the U.S. government. Many clients are repeat clients who have employed the firm previously. The firm continually attempts to sell/market its other consulting services to its current clients as a way of growing its business (known as "cross selling" or "cross-servicing"). Generally, the firm acquires new clients by word of mouth, since, as a private company, the firm does not have the same visibility as compared to some of its well-known competitors like Navigant Consulting.

While the two principals have performed a significant amount of new client development, they continue to emphasize the importance and necessity of client development to the more senior consultants in the firm. This responsibility is essential not only for individual advancement and growth, but also for the long-term survival of the firm.

Company Competition

Depending on the particular practice area, Invictus Solutions has any number of competing consulting firms offering similar services. Navigant Consulting, Inc., a New York Stock Exchange (NYSE) company (symbol NCI), is the firm's closest competitor. The practice area offerings are very similar. Another competitor is Huron Consulting (symbol HURN) (www.huronconsultinggroup.com). Huron Consulting is also a NYSE company.

While both Navigant and Huron compete with Invictus Solutions in a number of practice areas, their service offerings are broader. For example, in addition to the practice areas mentioned for Invictus Solutions, both Navigant and Huron offer services in Accounting and Finance, Disputes, Government Contracting and E-Discovery. Huron also offers consulting services in Restructuring and Turnarounds, Transactions (Due Diligence Investigations), Strategy and Operations.

Company Culture

Serafina and Horatio have intentionally created a professional, yet casual, non-threatening atmosphere within their organization. Horatio commented on his firm's culture:

"I like to believe the consultants at Invictus Solutions find a professional, stimulating yet comfortable work place. We encourage our consultants to devote non-billable time to non-project related learning. Also, we have tried hard to create an environment where all of us have the opportunity to enjoy a healthy work/life balance. If our consultants can find that balance, Serafina and I continue to believe that ultimately, they will be more productive and happy employees."

Both of them are concerned about what effect “going public” might have upon the carefully nurtured culture they have created for their firm since publicly traded firms are subjected to unrelenting demands for continually improving performance, which results in more outside scrutiny.

Company Financials

The firm has grown and has performed well as a private company. Selected financial information for the past three years is set forth in Table 2 (Appendix).

STRATEGIC ALTERNATIVES

As Serafina Invicelli and Horatio Brutus contemplate their firm’s future, they begin to investigate the reasons why so many consulting firms have decided to “go public” and evaluate whether an IPO is a viable strategic alternative for their firm. The IPO of Goldman Sachs, the venerable Wall Street investment banking firm, is illustrative, albeit exceptional and in no way comparable to the small/medium size Invictus Solutions. Goldman Sachs raised $3.6 billion of capital in its 1999 IPO. After going public, according to the Goldman Sachs 2000 and 2008 annual reports, the company grew from $25 billion in revenues in 1999 to $46 billion in 2007. On the IPO date, the 221 senior partners at Goldman Sachs held shares worth $63 million per partner.

More instructive to Serafina and Horatio, however, was the 1996 IPO of the Metzler Group, a small private consulting company, which, after a series of acquisitions, eventually became Navigant Consulting, Inc. The 1996 IPO raised $37 million. As Table 3 (Appendix) shows, following the IPO, Metzler embarked on a series of acquisitions growing from $149 million in revenues in 1996 to $244.6 million in 2000 Also, their growth rate was much higher than Invictus Solutions which is growing less than 10 percent.

They also researched the New York Stock Exchange (NYSE) Listing Application, the NYSE Listed Company Manual, as well as the Securities and Exchange Commission rules and regulations pertaining to publicly traded companies, specifically disclosure and reporting requirements [SEC]. They recognize that becoming a publicly traded company will require new compliance obligations. The firm will need to retain attorneys and outside public accountants to assist them in complying with the various rules and regulations.

For example, as a result of the excesses which came to light in the early 2000-2002 time period, Congress enacted the Sarbanes-Oxley Act (“Act,”), which addresses corporate compliance and governance issues. The Act imposes additional requirements on publicly traded firms, such as personal certification by the chief executive officer and chief financial officer regarding the accuracy of financial statements; internal control systems; a “whistleblower” procedure monitored by an independent audit committee. Serafina and Horatio have enjoyed growing their business and have immense pride in their success and accomplishments as business owners. In addition, they particularly take pleasure from the status associated with being the firm’s owners. While the administrative aspects of operating their firm tends to be tedious and trivial at times, they, nevertheless, like the ability to have an influence on their firm and enjoy being able to set the firm's direction. However, they realize that a review of strategic alternatives is both timely and appropriate. Although Invictus Solutions are focusing primarily on an IPO, they are also willing to consider other strategic options.

CASE ENDING QUESTIONS:

1. List and evaluate the various advantages and disadvantages of becoming a publicly traded company.

2. What other alternatives should the principals consider? List and evaluate the advantages and disadvantages of each of these alternatives?

3. Evaluate the legal implications of "going public".

4. Decide on the best course of action for the firm, i.e. stay private, take the firm public (IPO), or another alternative. Give reasons to support your decision.

TEACHING NOTES

The teaching notes consist of Learning Objectives, detailed discussion of relevant issues, and Student Evaluation Rubrics.

LEARNING OBJECTIVES

The instructor should give homework assignments and conduct class discussions to focus on the following concepts and points regarding critical attributes of the different forms of ownership of a service business and their respective complications and financial and psychological costs-benefits:

- List and evaluate the various advantages and disadvantages of becoming a publicly traded company.
- What other alternatives should the principals consider? List and evaluate the advantages and disadvantages of each of these alternatives?
- Evaluate the legal implications of "going public."
- Decide on the best course of action for the firm, i.e. stay private, take the firm public (IPO), or another alternative. Give reasons to support your decision.

Issue 1. List and evaluate the various advantages and disadvantages of becoming a publicly traded company.

Students should be able to identify the following three advantages of being a publicly-traded company.

A. Access to Equity Markets

Unlike a private company, which has limited opportunities for raising capital (primarily the owners' personal capital investments), publicly-traded companies can tap the financial markets for their capital requirements. Justifications for going public include the ability to finance acquisitions, capital to finance growth and stock to fund expansion.

The 1996 Metzler Group IPO raised $37 million. Following the IPO, Metzler (which later changed its name to Navigant Consulting, Inc.) embarked on a series of acquisitions, which continued until 2000 when the company was forced to retrench due to poor performance. However, the company grew from $149 million in revenues in 1996 to $244.6 million in 2000. A portion of most of these acquisitions was financed with Metzler (Navigant) stock, which financing option would not be available to a private firm like Invictus Solutions Consulting.

Stock is commonly used to finance a portion of an acquisition (NOTE: The instructor could ask students why stock is used to fund an acquisition). Not only does issuing stock lessen the cash outlay for the acquired company, stock also offers sellers the promise of increasing wealth if the stock, which is received as a part of the purchase price, appreciates in value. A typical purchase price formula would consist of cash, stock (equity in the acquiring company) and an "earn-out" bonus, i.e. pay for achieving specified performance goals. The percentage of each portion of the formula and the amount of each is a subject of negotiation between the buyer and seller.

B. Equity Ownership

A major inducement for any owners wishing to take their firm public is the opportunity for a large payday upon the sale of their stock holdings in the new publicly traded company, as well as the continuing possibility of significant wealth appreciation through equity ownership. Once again, the Goldman Sachs IPO is an example of the potential riches associated with an IPO. On the day that Goldman Sachs went public, the 221 senior partners at Goldman Sachs held shares worth an eye-popping $63 million per partner [Goldman Sachs, 2000].

Equity is also used as a form of compensation for employees, which can be an inducement to either join a company, or remain with a company. Stock has the benefit of allowing employees to own a part of the company, to participate as an owner, as well as an incentive to perform well and be productive. Equity ownership also, theoretically, aligns the interests of the employees of a company with those of its shareholders (goal congruence), since employees have a vested interest in ensuring the company performs well, which ideally is reflected in a higher stock price.

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C. Size

Size matters in professional services organizations (NOTE: the instructor might ask "why" size is important in a professional services organization like consulting). Big is not necessarily always better. But in a professional services organization like consulting, the larger the firm, the less likely it is that the loss of any one or two "rainmakers" will have an adverse affect on the firm. For example, in a firm with sales of $100 million, the loss of a consultant who is responsible for generating $10 million in revenue dramatically affects the firm. However, if the firm's revenues were $500 million, the departure of a rainmaker will have a less serious impact.

Issue 2. Evaluate the legal implications of "going public.

Students should be able to identify the following five disadvantages of being a publicly-traded company:

A. Legal Implications – Transparency

The legal implications of becoming a publicly traded company are significant. Publicly traded companies exist in a "fishbowl." The federal securities regulations require elaborate disclosures about all aspects of publicly traded companies, including personal information about the executive officers and directors. Even prior to the corporate scandals which came to light in the early 2000-2001 time period (Enron, WorldCom, Tyco), publicly traded companies were required to make disclosures concerning financial results, compensation arrangements and personal information about their officers and directors. The idea behind these required disclosures is "transparency," i.e. the extent to which investors have ready access to corporate personnel and financial information about the company.

For example, the Securities and Exchange Commission (SEC) has promulgated elaborate disclosure rules in connection with the content of proxy statements sent to shareholders when soliciting their votes on various corporate matters [Schedule 14A, 17 CFR 240.14a-101]. Item 402 of Regulation S-K requires disclosure of director and executive officer compensation such as salary, bonuses, stock ownership, stock option awards, severance arrangements ("golden parachutes") and perquisites (company offered benefits like cars, club memberships etc.). The regulations also require biographical information about the directors and officers (Items 103, 401 and 404(1) and (b) of Regulation S-K). The idea being that investors are entitled to know in detail information about the individuals charged with operating a company in order to make an informed investment decision. In a private company, the principals maintain a certain anonymity and privacy. Financial results are shared only with the owners. The firm is not subject to outside scrutiny since there is no public disclosure of firm results, personal information or compensation. Compensation is confidential whereas in a publicly traded company, compensation arrangements of senior executives are not only very public, but also quite detailed. Because of the very public nature of officer and director compensation disclosures in a publicly traded company, security and safety issues are a legitimate concern.

In addition, each stock exchange has its own rules concerning listed companies. For example, Section 303A, entitled “Corporate Responsibility,” of the New York Stock Exchange (NYSE) Listed Company Manual provides that the board of directors must consist of a majority of outside directors (Section 303A.01); elaborate rules concerning Audit and Compensation Committees are contained in Section 303A.05 and .06; development of corporate governance guidelines, i.e. director qualifications and responsibilities are in Section 303A.09; Section 303A.12 provides for CEO certification that the CEO is unaware of NYSE violations [NYSE, 2009]. Section 204 entitled “Notice to and Filings with the Exchange” requires notice to the NYSE for any number of business occurrences including changes in capital, changes in directors or executive officers, or changes in auditors.

B. Legal Implications – Cost

Going public is not an inexpensive undertaking. There are significant upfront costs associated with an IPO, such as listing on an exchange, preparation of a registration statement and prospectus, printing and legal fees, outside independent accountant expenses. For example, the minimum listing application fee for the NYSE is $37,500 plus $.0048 per share for a $75 million offering; $0.00375 per share for an offering between $75 million and $300 million and $0.0019 per share for an offering over $300 million. (The maximum listing fee is capped at $250,000) [NYSE, 2009].

Various authors have calculated the costs for going public. Draho [1998] in his book entitled “The IPO Decision: Why and How Companies Go Public” stated that the “direct costs … of a typical $100 million IPO with 10 million shares listed on NASDAQ would involve direct costs between $8.4 million and $8.8 million” (these costs include attorney’s fees, accounting fees, underwriter spread (profit), printing costs, SEC fees, state fees, transfer agent and miscellaneous fees). Ritter [1998] estimated total direct costs of an IPO in the range of 16.96% for IPO’s of $10 million or less to 5.72% for IPO’s of $500 million or more, where the costs are a percentage of the offer price of the stock. He calculated that the average total direct costs are 11% of total proceeds from the IPO. Lastly, Entrepreneur Magazine [2005] in an article entitled “Going Public” estimated IPO costs of “no less than 25%” of the company’s stock offering.

In addition, publicly traded firms have significant ongoing expenses. While there have always been expenses associated directly with being a publicly traded company, such as legal and accounting fees and annual membership fees for an exchange listing (for example, the minimum annual listing fee for the NYSE is $38,000), costs have increased since the passage of the Sarbanes-Oxley Act of 2001 (Act). The Act was passed by Congress as a direct result of the numerous corporate abuses that came to light during 2000-2002. Even more transparency was the order of the day. The Act requires compliance on a number of levels including enhanced accounting procedures and policies, routine audits, increased internal controls and adoption of corporate governance programs to mention a few. The additional cost of compliance is not insignificant. Estimates of first-year compliance costs range from $4.6 million for large companies ($5 billion in sales) to $2 million for medium to small companies. The average cost of compliance with the Act is estimated at $2.9 million [Hartman, 2007]. (NOTE: It might be interesting to ask students to guess what the annual costs of compliance are).

C. Equity Downsides

(i) While equity is a powerful incentive and motivator, there is a "dark" side to equity: investors can experience tremendous losses, occasionally due to conditions or circumstances which are beyond a company's control. For instance, poor results for a market leader may adversely affect stock prices in other companies within the same sector or industry. Invictus Solutions will have to consider the possible negative effects on morale should the company's stock fail to increase in value, or worse, suffer declines in value. In the first 10 months of 2008, the S&P stock index lost 34% and the DOW Jones Industrial Average dropped 29.7% (the S&P fell 16.8% and the Dow Jones fell 14.1% in the month of October 2008 alone) [Steverman, 2008].

(ii) When there is too much focus on increasing the stock price, two unwelcome side effects are possible. The first is short-term thinking (managerial myopic decision making). There may be decisions required for the long-term viability of the company, which may result in lower short-term earnings. Lower earnings can adversely affect the stock price. For example, a company may need to invest capital in research and new product development, or to upgrade/modernize facilities. Since budgeting for the future can have short-term negative financial consequences, it may adversely affect a company's stock price leading to a temptation to defer costly, but necessary, expenditures.

The second "unwelcome" consequence of too much focus on a company's stock is the temptation to take shortcuts in order to inflate stock price. Examples abound. Students could cite Enron and WorldCom as instances where senior management's excessive preoccupation with increasing stock values led to abuses. (It has been reported that Bernie Ebbers, the former CEO of WorldCom, would check the company's stock price several times a day).

D. Investor Expectations

Unlike a privately held company, publicly-traded companies face considerable pressure for results from outside sources. These include shareholders who invest in a company expecting a return, sometimes unrealistic, on their investment; fund managers whose compensation is tied to the performance of the companies in their portfolio; and financial analysts who follow the company. Since most shareholders (over 60%) are now institutions such as mutual funds, insurance companies, pension funds and hedge funds, there is reduced loyalty to a particular company in favor of expected returns (although large pension funds which have a long-term perspective do focus on the quality of management) [American Bar Association, 2009]. Large institutional investors like the California Public Employees' Retirement System (CALPERS) can and do exert pressure on management. They can also influence changes in management and board membership. Going public would entail constant pressure for financial results. As one CEO stated, "there's no fourth quarter when you're the CEO." In other words, the attitude of new investors is "what have you done for me lately." There is always some investor who just purchased a company's stock and is not interested in past successes (NOTE: The instructor could ask students what their attitude would be if they recently purchased stock in a well-managed, high performing company and the company's performance does not meet their expectations).

E. Culture

(NOTE: The instructor might ask students to define "culture").
Culture is a set of beliefs, values and customs of a group. While it is an intangible, its importance and significance to an organization cannot be underestimated.

As the principals of Invictus Solutions evaluate the IPO option, one of their major considerations will be to evaluate the impact of becoming a "public" company on the culture of their firm. They learned through their research that in firms that went public, less time was being spent on learning and career development because of the pressure to generate billable hours to satisfy investor expectations. Career development is an area that Serafina and Horatio actively promoted.

Moreover, the two principals are concerned about breaching the "psychological contract" between their firm and its employees. Many of the firm's consultants were recruited directly from college with an expectation of working in a small private firm where the external pressures for results are absent, or at least reduced, and where there is the prospect of becoming a partner or equity owner who shares in the profits. There is a "psychological contract" formed during the recruiting process, i.e. an expectation by prospective employees that the firm will continue to "honor" its contract by maintaining the firm's culture. In addition, not all consultants fit well in a large, results-dominated organization and prefer a more flexible environment with less outside pressure. Going public would alter the firm's culture possibly disappointing some employees, and/or causing morale problems.

Issue 3. Identify and evaluate the advantages and disadvantages of the following three strategic alternatives:

A. Status Quo

(NOTE: The instructor might ask students what they believe the most obvious strategic alternative is).

The most obvious alternative for the firm is to stay a private consulting firm, i.e. maintain the status quo, and simply continue operations as they have in the past. There are several advantages to this option:

(i) Less outside pressure and scrutiny. There would be no need for elaborate SEC disclosures about the firm's performance, personal information about its officers/directors and their compensation. Moreover, there would not be the same constant pressure for continually improving financial results. Additionally, the owners would not only maintain anonymity and privacy, but also would have more independence, control and flexibility in operating their firm.

(ii) No compliance costs. By remaining a privately held company, the firm would not incur the additional expenses associated with compliance requirements, i.e. outside public accountants, legal fees for various disclosure issues, stock exchange fees, printing and shareholder meeting costs.

(iii) The firm could retain its culture. Consulting firms grow by adding billable consultants. One source of new consultants is college graduates. Some individuals prefer working for a small company where the culture fosters an atmosphere that is informal with less bureaucracy. By remaining a private firm, the owners can continue its carefully nurtured culture.

(iv) The principals can maintain their "status" as owners of the firm. While this is an intangible factor, its importance should not be underestimated. One of the authors has personally witnessed the adjustments that former owners of acquired firms struggle with after the acquisition. Once the euphoria of the big "payday" fades, real morale problems can arise.

There are several disadvantages to remaining private:

(i) Growth opportunities may be more limited As stated earlier, publicly traded companies can leverage their size, visibility and can use the capital markets to fuel growth. This option is often not available to private companies of a particular size.

(ii) Financing options may be more limited. Credit in the current economy is tight for non-gilt-edged firms because of the harsher lending standards of banks that have been decimated by the global economic crisis that began in 2008 [Razaki et al., 2010]. Banks have become more risk adverse. Up to this point, the two main principals of Invictus Solutions have financed the firm primarily through their own resources with some capital coming from other principals. However, there are limits as to how much continuing personal investment in the firm is prudent.

(iii) No equity cash-out. While there are certain restrictions generally imposed by the underwriters concerning how soon the principals can liquidate their stock holdings in a newly created publicly-traded company ("lock-up provisions"), there would be no large payday if the firm remains private. Also, there may not be equity upside potential or the ability to compensate consultants with equity.

B. Remain private but make acquisitions in order to grow.

Consulting firms, like other professional services organizations, can grow by either raising fees, getting more work from current clients (both ways referred to as "organic growth"), signing on new clients, or acquiring other firms. Of the first three mentioned ways to grow, the firm can only control raising its fees, which is always a delicate balance between meeting ever increasing expenses and yielding to the pressure from clients to hold the line on fees. Securing additional work from current clients and finding new clients is not guaranteed. Therefore, growth by acquisition becomes a serious consideration.

The advantages of an acquisition are:

(i) The firm can grow. A firm can raise fees, or sell more services to current clients. But with an acquisition, the firm acquires new clients and new billable consultants virtually instantaneously. The firm can also diversify into new practice areas overnight, thereby short-circuiting the tedious and time-consuming process of building a new "book of business" in a practice area from scratch.

(ii) The firm acquires new talent, experience, expertise and resources, which it can market to current and prospective clients.

(iii) If integrated properly, the new combined firm should experience certain operating efficiencies, i.e. more billable consultants generating revenue and profits with the same, or slightly increased number of support staff. Savings are possible since support functions like accounting and human resources can usually absorb new consultants with little or no additions to their staff.

The disadvantages of making an acquisition are:

(i) Acquisitions are risky. While financial projections (pro forma financial statements) can make a firm appear attractive as a potential target company, there are intangible considerations. Statistics show that the failure of most mergers and acquisitions lies somewhere between 40-80% [Anonymous]. Acquisitions that are outside the existing core competencies are more risky than those that are horizontally in the same specialty space. Research also suggests that a primary reason for such failures is "people issues." Every organization possesses a culture and personality and, when companies combine, there can be culture clashes: for example dress codes; how expense reports are handled; flexibility of office hours and the formality or informality in an office. Therefore, the post acquisition assimilation and integration of an acquired firm are critical to the eventual success of an acquisition.

(ii) Increased overhead expenses. As a condition of some acquisitions, especially of a privately held firm, the seller will require the buyer to hire all of its employees, including non-billable staff. Owners of small firms who are selling their company and "cashing-out" feel an obligation to their employees who have been loyal and want to return that loyalty. While this contingency is factored into the financial justification for the acquisition, it does limit the savings an acquirer can achieve from the acquisition. In addition, the seller may have office, and/or equipment leases, or other obligations which the buyer must assume.

(iii) Overvalue the target company. Acquisitions take on a life of their own. It is sometimes difficult for management to make a decision to "cut losses" and move on after investing a significant amount of time, resources and money pursuing a target company. So there is a tendency to push the acquisition through even when it stops making good financial or business sense. Closely associated with this disadvantage is assuming the debt of the target company, or taking on too much debt to make the acquisition.

C. Sell firm, i.e. be acquired by another company

The advantages of selling the firm are:

(i) Cash-out by owners. The potential exists for a large cash payment. Private acquisitions can be as financially rewarding as an IPO without all the legal consequences.

(ii) Equity. If the acquiring company is publicly traded and offers stock (equity) as part of the purchase price, the potential exists for additional wealth if the stock appreciates in value.

(iii) Shedding administrative and operational responsibilities. The day-to-day duties and responsibilities of running an organization can be time-consuming and frustrating. It is very likely that most, if not all, these responsibilities would be handed off to other individuals within the acquiring company.

The disadvantages of selling the firm are:

(i) All that glitters is not gold. It is not uncommon to pay the purchase price of an acquisition with a combination of cash, stock and an "earn-out." While the amounts and percentages of each portion of the formula are subject to negotiation, a typical purchase price formula might be one-third cash payable at closing (subject to tax, which obviously reduces the pay-out); one-third in some form of equity, if available, which the acquirer may require the recipients to hold for a period of time in order to insure key employees stay; and finally, one-third in the form of an "earn-out." An earn-out provision provides that payment is subject to the achievement of certain performance goals, i.e. revenue or profit growth goals, for example. An individual's failure to achieve such goals reduces the purchase price that the seller anticipated receiving for selling the company. In sum, there may be severe "buyers' remorse" after the deal once tax is paid, the stock received decreases in value and/or earn-out goals are not achieved.

(ii) Loss of status/prestige. This factor is extremely subjective and intangible. However, it should not be taken lightly. Serious morale issues can be encountered by former owners (principals) of acquired consulting firms who face difficult adjustments in merely being "one of the crowd". While generally, former owners negotiate a title and position with the acquiring company, the fact remains that after the acquisition they may be one of several hundred similarly situated consultants. An "A" student might recognize this morale issue.

(iii) Loss of influence/control. This disadvantage is closely related to the previous one. After being "in charge," previous owners may find it difficult to accept not being a policy maker or decision maker in terms of the firm's operations.

(iv) Assimilation. Consultants from the acquired firm will have to adapt to a new culture, one which may be very different from the atmosphere and environment of the acquired firm. While some consultants might actually welcome a more structured and focused workplace, others may feel uncomfortable. The "fit" within the new organization may prove to be difficult for some resulting in departures of competent and experienced billable consultants. A certain amount of attrition should be expected.

(v) Non-compete agreements. (NOTE: Ask students to define a non-compete and explain the purpose of a non-compete agreement. You can also ask their views on non-competes, i.e. are they fair, what's a "reasonable" duration). Imagine paying several million dollars to purchase a business only to find that the previous owners have started a competing business. To prevent this possibility, it has become the norm to require that key employees of the acquired firm execute non-compete agreements as a condition of the closing. These agreements provide that the person signing the non-compete will not be allowed to compete, or work for a competing company for a certain period of time.

Issue 4. Decide on the best course of action for the firm, i.e. stay private, take the firm public (IPO), or another alternative. Give reasons to support your decision.

One alternative to "going public", and the most obvious alternative, is simply to remain a private firm. Given the steady, but unspectacular, growth of the Invictus Solutions, an IPO may not be attractive at this time. Generally, companies electing to go public have growth rates which exceed 10% annually, as shown in Table 4 (Appendix).

A slight variation to remaining private is growing the company with acquisitions. Organic growth, i.e. increasing fees, acquiring new clients, or doing more work with existing clients, while less risky than acquisitions, will most likely not result in dramatic revenue growth. Growing the firm through acquisitions of other consulting companies has the potential of dramatically increasing revenue since consulting firms generate revenue from billable consultant hours. The more consultants there are, the greater the revenue. In addition to adding new consultants and clients, acquisitions can also add new service lines not currently offered.

There are risks to growth by acquisition. Probably the biggest risk in acquisitions is cultural fit, especially in people intensive organizations like consulting firms. Different styles, values and traditions are intangibles that often derail the most thoroughly researched and investigated acquisitions. At the end of the day, the acquired "assets" are people. Small business owners and employees transitioning into a larger organization often chafe at the sometimes impersonal and bureaucratic culture of the acquiring firm.

Another alternative to the IPO is to sell the firm, i.e. be acquired or merged into another firm. As mentioned in the Teaching Notes, there are obvious advantages: cash-out, possibly less stress, fewer management/administrative responsibilities. From a business standpoint, there could be significant strategic synergies to be achieved by selling out to another firm. Given the age differences of the two principals, there could be a difference of opinion about this alternative. However, there is sufficient merit in selling a viable, reasonably successful firm to warrant serious consideration by the two principals.

While there is no "right," or "best" answer to the question of which strategic alternative is most attractive, an "A" student might suggest that Invictus Solutions remain private for the time being, while putting out "feelers" for a possible sale of the firm. There are certain advantages to this approach. The firm can continue to operate while positioning itself as an attractive acquisition candidate;

Invictus Solutions can take steps to grow the company, either organically or by acquisitions, to better position itself for an eventual IPO; and lastly

The principals, having at least considered strategic alternatives, can take some time to evaluate and decide whether remaining a private firm remains the best possible choice. Being an independent firm is not without its benefits; status, control, continued employment and comfortable income.

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APPENDICES

Table 1: Consulting Firm Rankings: 2009

Names	Revenue (in millions)	Structure
Accenture	$25,300	Publicly traded
Cap Gemini	$12,270	Publicly traded
KPMG	$7,270	Publicly traded
PriceWaterhouseCoopers	$6,900	Private
Deloitte	$6,300	Private
McKinsey & Company	$5,300	Private
Booz Allen & Hamilton	$4,100	Private
Boston Consulting Group	$2,400	Private
Bain & Company	$1,600	Private
Oliver Wyman Group	$1,500	Private
Booz & Co.	$1,000	Private
Roland Berger	$1,000	Private
AT Kearney	$785	Private
Huron Consulting	$630	Publicly traded
Navigant Consulting, Inc.	$355	Publicly traded

Source: http://www.careers-in-business.com/consulting/consrank09.htm

Table 2: Selected Data for Invictus Solutions for 2010, 2009, 2008
(Dollar Amounts in Thousands, rounded)

	2010	2009	2008
Revenues	165,000	141,000	126,000
Revenue growth %	17%	12%	14%
Net Income	24,000	18,000	14,000
Net Income growth %	25%	22%	18%

Table 3: Revenues of Navigant Consulting, Inc.

(Dollars in Millions)

2000	1999	1998	1997	1996
$244.6	$219.4	$202.5	$183.7	$149.9

Source: Form 10-K for Year ended December 31, 2000 for Navigant Consulting, Inc.

Table 4: Fourth Quarter 2010 IPO's

Company Name	Revenues (in millions)	One Year Sales Growth
SciQuest, Inc.	$36.2	21.5%
China Cache International Holdings Ltd.	$39.8	6.3%
Amyris, Inc.	$64.6	365.1%
QR Energy, LP*	$72.8	74.1%
Rig Net, Inc.*	$80.9	10.0%
Fortega Financial Corporation*	$83.1	48.4%
Sow Fun Holdings*	$127.0	22.0%
China Ming Yang Wind Power Group Limited	$171.6	843.2%
Rhino Resource Partners, LP	$419.0	4.4%
Elster Group	$1,600	11.0%

Source: http://www.moneycentral.hoovers.com/global/msn/factsheet.xhtml?COID=161788
*http://www.moneycentral.hoovers.com/global/msn/factsheet.xhtml?COID=160162

Table 5: Entrepreneurship Evaluation Rubric

Exemplary	Acceptable	Marginally Acceptable	Not Acceptable
Student's work correctly identifies not only the main but also the secondary issue(s) in the assignment.	Student's work correctly identifies the issue(s) in the assignment.	Student's work correctly identifies the issue(s) in the assignment.	Student's work fails to correctly identify the issue(s) in the assignment.
Student's work correctly applies and clearly demonstrates a deep understanding of relevant framework(s) in her/his analysis.	Student's work correctly applies and demonstrates an understanding of relevant framework(s) in her/his analysis.	Student's work either fails to apply or misapplies a relevant framework in her/his analysis.	Student's work fails to apply any framework in her/his analysis.
Student's work identifies all of the important stakeholders.	Student's work identifies most of the important stakeholders.	Student's work identifies only the most obvious stakeholder(s).	Student's work fails to identify any of the relevant stakeholders in the assignment.
Student's work distinguishes between assignment facts and student's personal opinion.	Student's work distinguishes between assignment facts and student's personal opinion.	Student's work fails to distinguish between assignment facts and personal opinion.	Student's work fails to distinguish between assignment facts and personal opinion.
Student's work proposes several alternatives to the assignment's issue(s) – all of which demonstrate in-depth thinking and understanding.	Student's work proposes several alternatives to the assignment's issue(s).	Student's work proposes one resolution to the assignment's issue(s).	Student's work proposes a resolution to the assignment issue(s) based solely on personal opinion.
Student's work makes a strong, compelling case for her/his proposed resolution(s).	Student's work makes an adequate case for her/his proposed resolution(s).	Student's work fails to make an adequate case for her/his proposed resolution(s).	Student's work fails to make an adequate case for her/his proposed resolution(s).
Overall, student's work demonstrates an in-depth, nuanced understanding of how management principles and financial reasoning can be used to resolve the assignment's entrepreneurship issue(s).	Overall, student's work demonstrates a good understanding of how management principles and financial reasoning can be used to resolve the assignment's entrepreneurship issue(s).	Overall, student's work minimally demonstrates an understanding of how management principles and financial reasoning can be used to resolve the assignment's entrepreneurship issue(s).	Overall, student's work fails to demonstrate any understanding of how ethical principles and moral reasoning can be used to resolve the assignment's entrepreneurship issue(s) .

Table 6: Writing Quality Rubric

Exemplary	Acceptable	Marginally Acceptable	Not Acceptable
Ideas relevant to the assignment demonstrate sophistication of thought and are unique.	Ideas relevant to the assignment demonstrate clarity of thought.	Ideas relevant to the assignment are clear but general and/or simplistic.	Ideas relevant to the assignment are not clearly presented, well-developed and may be obvious or trivial.
Writer's central idea or thesis is communicated in clear, easy-to-understand language and the writer makes an eloquent case for why the idea(s) is/are worth developing.	Writer's central idea or thesis is clearly communicated and the writer makes the case for why the idea(s) is/are worth developing.	Writer's central idea or thesis is overly broad and/or vague.	Writer's central idea or thesis is not expressed.
Organization is very clear and has a very logical structure appropriate to assignment's topic, purpose and audience.	Organization is generally clear and generally has a logical structure appropriate to assignment's topic, purpose and audience.	Organization is not always clear and/or is structured in ways that are confusing to the assignment's topic, purpose and/or audience.	Organization is not evident and/or is confusing or incoherent.
Writer's reasoning or progression of ideas is exceptionally clear and none of the ideas must be inferred.	Writer's reasoning or progression of ideas is generally clear or is easily inferred.	Writer's reasoning or progression of ideas must be inferred and is not clear.	Writer's reasoning or progression of ideas is totally lacking.
Clear, sufficient and appropriate evidence is deftly used throughout.	Good, sufficient evidence is generally used.	Inconsistent and/or insufficient evidence is used.	Evidence is unsupported which may consist of assumptions, and leaps of faith.
Style demonstrates words artfully chosen for precision, appropriate level of specificity.	Style demonstrates appropriate words, meaning is clear.	Style demonstrates inappropriate word choice, unclear meaning.	Style demonstrates poorly chosen words, meaning is inaccurate or unclear.
Sentence style fits assignment's audience and purpose.	Sentence style fits assignment's audience and purpose.	Sentence style is awkward.	Sentence style is difficult to understand.
Almost entirely free of spelling, punctuation, and grammatical errors.	Any spelling, punctuation, or grammatical errors do not distract reader.	Recurring spelling, punctuation, and grammatical errors distract reader but still understandable with effort.	Recurring spelling, punctuation, and grammatical errors distract reader and muddle ideas beyond comprehension.
			Plagiarized