

History of Consulting

In the process of publishing a book, editorial judgment is applied to the content and length of each section. In the case of *Extracting Value from Consultants*, the chapter on the history of consulting was subject to this editorial process. The resulting chapter is an abridged version of the original chapter, combined with two other chapters. The condensed version in the book allows the busy reader to rapidly reach the chapters that discuss the solution to effectively select, manage, and disengage consultants.

For those who are interested in a more in-depth account of the evolution of the industry we have included the original, unabridged chapter here.

THE RAPID EVOLUTION OF THE CONSULTING INDUSTRY

Advisors have existed since the beginning of time--often providing advice based on subjective opinions absent of any structure, facts, expertise or relevant experience. Unfortunately there continue to be many people who are quite capable of expressing an opinion on something for which they know nothing about. Charisma and self confidence, after all, can go a long way!

A Century of Professional Consulting

More legitimately, academics, government leaders, and senior business executives have also been consulted for generations drawing upon the expertise and personal experience that they have amassed throughout their long careers. However, it was not until the late 1800s when the rational, logically structured problem solving approaches began to be formally applied to management challenges. Arthur D. Little, a chemical engineer who studied at MIT, founded his business in 1886. It is generally acknowledged that this was the first management consulting firm even though their focus was not on the management process but on contracted engineering research¹.

Frederick W. Taylor established his consulting practice in 1893 with an emphasis on time and motion 'scientific management'. While Taylorism influenced management thinking and industrial efficiency in the early 20th century, none of the consulting firms based on Taylorism principles ever emerged to become major consulting practices in the United States. Taylorism had greater

¹ This section draws upon the authors' experience in the consulting industry, consulting firm websites and Wikipedia descriptions of the consulting firms noted which are cited in the bibliography and the excellent book by D.McKenna (2006) *The World's Newest Profession*, (Cambridge University Press).

sustainability in Europe with PA Consulting, founded in the UK in 1943 and still in operation today, adding a stronger human dimension by making the worker a participant in the productivity change process.

Edwin Booz, a graduate of Northwestern University, established his firm in 1914. He promoted the concept that companies could be more successful if they could call on someone outside their own organizations for expert, impartial advice. John McKinsey, an accountant from the University of Chicago who is credited with advancing cost accounting disciplines, established his firm in 1926. He formalized “general surveys” (analysis of companies in financial difficulties) and systemized the process of soliciting new clients, particularly within the financial services community.

What propelled the large scale development of the management consulting industry in the 1930s was the U.S. post-depression anti-trust regulation that formally separated commercial and investment banking (including their internal research departments) and prohibited the sharing of anticompetitive customer information amongst bankers. This created a demand for external research firms and a third party conduit for pooling and sharing of industry information. This demand was adeptly filled by the management consulting firms of the day.

Roots of Strategy Firms

These early firms Arthur D. Little, Booz & Company, and McKinsey & Company remain with us today. They were all strongly influenced by academic institutions such as MIT, Northwestern and Harvard Business School. They also spawned additional firms where partners from these original consulting firms resigned and started up their own consulting practices. Boston Consulting Group (partners formerly from Arthur D. Little), AT Kearney (original Chicago office of McKinsey), Bain Consulting (started by BCG alumni), Cresap McCormick & Paget (former Booz employees), Oliver Wyman (also from Booz) were all off-shoots of these first generation firms. These early consulting firms were research oriented--taking an analytical approach to solving business challenges by framing the problem, collecting a fact base and then applying structured frameworks and tools, in order to produce a range of possible outcomes from which to select a solution to progress forward with. Combined with formal educational backgrounds and relevant consulting experiences they produced robust, logically precise yet practically applicable solutions to business problems.

These firms gave significant thought to how they communicated their findings and recommendations. They produced compelling story lines using a series of logically structured key messages coupled with simple yet content rich graphics (and, for most of the 20th century, without the benefit of computers, word processors or PowerPoint!). These consulting firms took pride in the “profession of consulting” where client interests came first; thought leadership was highly valued; and partners were accountable for developing the next generation of consultants so that they left the firm in better shape than when they themselves had become partner. In terms of their economic model, given the character of their projects, partner leverage was low, between five and eight, although standard rates were relatively high.

While AD Little maintained its emphasis on technical research and analysis studies, other firms like Booz, Cresap McCormick & Paget (acquired by Towers Perrin in 1983) and McKinsey expanded their service offerings into organizational design and productivity with a strong emphasis in the mid 20th century on decentralization and divisional structures. It was not until the 1970’s that “strategy consulting” became the premier service that Bain, Booz, BCG, and McKinsey are associated with today.

Going Abroad with Their Multinational Clients

In terms of geographic expansion, only in the late 1950’s did these American firms go abroad, predominately to Europe, leveraging multi-country assignments with companies like IBM, Royal Dutch Shell Oil, Monsanto, Dunlop Rubber, and ICI to build their overseas consulting practices. For European-based multinationals, there were perception and acceptance advantages to using a “neutral” American firm for making reorganizational changes across the nationalistic boundaries of Europe which helped to drive rapid growth amongst the American consultancies within Europe. European-born consulting firms were much slower to develop although some national champions such as PA Consulting (England), Cap Gemini (France), and Roland Berger (Germany) did eventually arise.

Computers Generate a New Breed of Consultants

A separate track in the consulting industry emerged as computerization became commercialized in the late 1950s and 1960s. Of profound significance was the U.S. Department of Justice’s anti-

monopoly decree in 1956 which prohibited IBM from offering professional advice on installing and using computers for 35 years for fear of IBM using their market power to direct clients to use only IBM computer equipment. As a result, a vacuum in computer consulting services emerged. This gave rise to programmer and technology service providers such as Computer Sciences Corporation (CSC) and Electronic Data Systems (EDS) which focused on supporting the application of technology to selected business areas.

Methodical Accountants Introduce Methodologies

One of the first mainstream computer applications to emerge was in support of the accounting function. Accounting firms quickly identified the need to provide their clients with advice on implementing and using these systems, and used progressively larger teams of accounting and technology resources on these projects. What emerged were consulting practices aligned with what were at the time the Big Six accounting firms – Arthur Andersen, Deloitte & Touche, Ernst & Young, KPMG, Price Waterhouse, and Coopers & Lybrand (the latter two merging to become PricewaterhouseCoopers). Being affiliated with accounting firms, they placed high value on professional service delivery necessary for client retention. But given the historical culture of these accounting firms and the nature of their audit and accounting work, compared to the strategy boutiques, these consulting practices were more linear in their thinking and adhered to well defined execution plans--systems development or implementation methodologies.

This methodical culture served the accounting consultancies well as the 1980s progressed and positioned them for the 1990s. At that time, Japan was approaching its peak economic performance causing industries in America to be intensely concerned about their ability to compete internationally thus spawning the re-engineering era. Both systems implementation and process re-engineering required large teams of resources for all the necessary data gathering, analysis, design, and development activities. Given the large scale of such projects, repeatable consulting methodologies (lists of steps to follow for successful implementation) were devised to provide a roadmap and to assist with the co-ordination of such teams. In terms of their economic model, partner leverage was typically between 10 and 30 people, although the average rate structure was lower than that of the boutique strategy consulting firms. Recruitment drew from the undergraduate level as the evolution of segregated service lines with detailed methodologies facilitated the deployment of less experienced staff.

Consulting Contributes Windfall Gains

During the 1990s, the consulting units of the accounting entities progressively became more independent, forming their own divisions although still contributing to profit pools of the combined entity so as to equalize partner earnings across the audit, accounting, tax, and consulting divisions. Because audit and accounting services essentially generate an annuity in the form of recurring fees from their clients, these provided year-on-year stability. The greater revenue volatility of the consulting division was offset by the windfall profits associated with very large scale contracts or occasional blockbuster annual revenues. At the end of each profitable year in the 1990s, the consulting division's partners would joke about how many Porsches they were funding for each accounting partner.

Differentiating Through Industry Focus

As the consulting industry became more competitive another dimension was applied to the consulting practice in order to allow further specialization and therefore differentiation within the standard consulting service lines--industry sector expertise. Basically, as functional service lines such as operations re-engineering mature, more and more competitors enter the fray offering similar services. Customizing such services to the needs of a specific industry sector offers another point of differentiation that can only be provided by the large global consulting firms or single industry specialists--the rest of the firms end up "stuck in the middle" and eventually fail or are acquired. A few strategy boutiques continue to maintain the position that industry expertise is not required for their data-driven approach.

For the vast majority of consulting firms, this additional resource management dimension within the consulting firm resulted in unimaginable complexity as partners and consultants now needed to be categorized along three dimensions: geographic location, service line, and industry sector. These dimensions had to be manipulated like a rubric's cube to identify resources to meet client demands. Training, recruiting and sales activities were all aligned around the industry dimension. But this created smaller sub-pools of resources, for which utilization was subject to industry demand patterns which could vary dramatically with shifts in the business economic cycle. Consulting

operations in regions without a critical mass of companies in a particular industry, such as in Asia and parts of Europe, become much more challenging to establish and sustain over time.

Revenue Maximization Emerges Supreme

As the pressure to grow average partner earnings increased, the bubble from the combination of Enterprise Resource Planning (ERP) implementations, Y2K (year 2000) remediation, and eBusiness “break your business” services changed the character of the consulting profession from one focused on client service toward revenue maximization. The criteria emphasized for admission into the partnership shifted from consulting abilities (structured problem solving, eminence and thought leadership) to sales generation capabilities (selling large projects and overseeing large project teams). While revenue from the average project in the 1980s would have been in the low hundreds of thousands of US dollars, by the late 1990s revenue per project was in the millions with eight digit project fees not being uncommon. Increasingly though, clients started to wonder whether the business value of such projects were commensurate with the high consulting fees being driven by large project teams.

The Next Generation

Y2K demands coupled with the declining cost of telecommunications also introduced to the global market a new breed of consulting firm, the India-based outsourcer. Many of these India-based firms such as Infosys and Tata Consulting have successfully extended their services from rewriting application code, to application development, with some even venturing into call centers and business process outsourcing. A few have also moved “up-market” into traditional management consulting services.

At the same time Andersen Consulting, CSC and IBM (who entered the advisory services business soon after their prohibition order terminated in 1991) began to more aggressively provide process and systems outsourcing services. These firms, and others, were attracted by the guaranteed income stream from multi-year contracts which are essential for existing or aspiring publically listed companies. Outsourcing services also allowed very high leverage of, and good margins on, relatively low cost resources. Unlike projects based at the client site, the junior resources of the outsourcing divisions were not operating under the scrutiny of their clients, allowing even more

flexibility in assigning staff and providing a valuable training ground for new staff. While all the foregoing was taking place, eBusiness, and the associated irrational exuberance for creating and funding “get rich quick” companies, spawned a whole industry of start-up consulting entities based on or promoting innovative uses of technology.

The Changing Face of the Industry

On entering the 21st Century, the consulting division of Arthur Andersen, Andersen Consulting, separated from its audit and accounting parent and went public as Accenture, in part, to obtain additional funding to support the increased capital requirements of their outsourcing services strategy. Their timing proved fortuitous. Shortly after this separation, the Enron scandal exposed the conflict of interests that audit firms have been harboring when there are financial incentives to promote and deliver consulting services to the same companies that they are supposed to have independence from as company auditors. The Enron failure resulted in the complete demise of Arthur Andersen and the enactment of U.S. Sarbanes Oxley (SOX) regulatory provisions in 2002 which in turn meant that all the remaining Big Four firms felt compelled to spin off their consulting divisions into separate firms in order for the consulting division to keep their clients without compromising the auditor’s independence. But out of adversity comes opportunity as SOX became a revenue boon for audit firms and some consulting firms. Companies were forced (due to time pressures) to pay huge sums of money, often at premium rates, for mind numbing process documentation services, often absent of analytical insights which could have improved such process flows and the operational performance of their client’s business, just to be “SOX-compliant”.

The consulting divisions that were part of Arthur Andersen (either not previously spun off with Accenture or rebuilt since that time) were sold off in varies pieces around the world primarily to the consulting divisions of the Big Four. Subsequently, E&Y Consulting was sold to Cap Gemini while PWC Consulting was acquired by IBM. Like Accenture, KPMG Consulting separated from its audit parent and became a public company renaming themselves BearingPoint (only to go into bankruptcy in 2009 with the European operations, being bought out by management, now being the only entity that operates under that name). Deloitte Consulting initially pursued a similar separation approach, and got as far as spinning off their Japan/Taiwan consulting practices which became ABeam Consulting, before reconsidering. Instead, Deloitte choose to disband the global consulting management model and re-integrate the consulting practices at a country level within their

respective audit and accounting member firms while carefully navigating within the stipulations of the Sarbanes Oxley provisions. In recent years, the E&Y, KPMG and PWC audit and accounting firms have once again been rebuilding consulting practices referred to as “advisory services” initially focused on risk management and related services that can be provided by people with an accounting background. PWC’s 2009 acquisition of BearingPoint’s United States and Japanese commercial consulting practices has essentially reversed the premise that audit and consulting services must be separated.

A Variety of Economic Models

Participants in the consulting services industry now span sole practitioners, traditional strategy boutiques, global full-service (strategy, process, systems, change management) management consulting firms spun-off from accounting entities, newly emerging consulting units of the Big Four audit and accounting firms, technology-based consulting divisions (e.g. IBM, HP), system integrators which were formerly the technology department of large corporations, application consultants of software providers (e.g. SAP, Oracle), Indian-based consulting and outsourcing firms, outsourcing companies and others.

As depicted in Figure 1, the economic models of these various consulting firms differ--primarily in terms of how they emphasize the variables of rates, leverage and utilization to drive profits depending on their core service areas.

Figure 1: Summary of Economic Models of Consulting Firms

Type of Consulting Firm	Consultant Rates	Partner Leverage Ratio	Consultant Utilization
Corporate / Operational Strategy	High	Low	Medium
Process Design	Medium	Medium	Medium
Systems Integration / Technology Consulting	Low	High	High
Systems & Process Outsourcing	Very Low	Very High	Very High

Those firms specializing in business strategy services generally need to spend more time providing concentrated insights to a variety of senior client executives. This necessitates more partner time

driving down average leverage ratios on each project to only five to eight consultants per partner resulting in a relatively high average hourly rate. In contrast, system integration firms enjoy leverage ratios of twenty to forty consultants per partner with a lower average hourly rate because the focus of the work is applying manpower to build and implement systems using defined methodologies. At the extreme end are outsourcing contracts which guarantee the firm a consistent multi-year stream of work (thus, no non-billable gaps between projects) with leverage exceeding 50 staff.

Creating further complexity in the consulting landscape, the strategy boutiques, in order to extend their revenue stream, have also been broadening their services offerings into process and systems consulting although the required culture shift and economic model transformation are not insignificant and were not always fully appreciated at the outset. In a similar manner, firms that originated in systems and process consulting have gradually extended their offerings into the other categories of consulting services.

Because buyers of consulting services have difficulty differentiating between the relative strengths and weaknesses of various consulting firms, these consulting firms have been able to expand their service areas. Buyers tend to purchase consulting services based on brand and existing relationships rather than by determining the best fit for the job and greatest value for money.

Refer to figure 4.3 in the book for a list of some of the most prominent consulting firms today (representing only a small percentage of the total number of firms in the industry) showing the service area that has been the historical core of the consulting firm, and the additional service areas they have developed some strength and capability in. Nonetheless, buyers should be aware that firms will market themselves to be equally capable in all service areas--consequently, you should look at whether the economic model of the consulting firm makes them suited for the services being offered from both a capability and a cost perspective.

Global Ambitions Falling Short

The result of this industry evolution is a bewildering array of potential providers of consulting services whose actual capabilities can vary quite dramatically depending on service area and

geographic location. Most of the largest consulting firms originated in the United States although a few have emerged out of Western Europe. Many consulting firms profess to have delivery capabilities around the world. The reality for these “global firms” is that depth in capable resources exists only in North America, capability is strong but fragmented in Europe (due to the diversity of languages and cultural bias), and is patchy and cyclical across Asia. Asia is an emerging market where the consulting firms and the skills of individual consultants are at different stages of maturity, even for global brands. Coupled with the different educational foundations and approaches to skill development in Asia, it makes selection of consultants there highly challenging.

Spoilt for Choice

It should be no surprise then that when an organization has a business challenge that requires external consultants to devise or implement a solution for, that it can be exceedingly difficult to select the appropriate consultants. Understanding how the consulting business works is a key factor in effectively selecting and negotiating with consultants, otherwise you will forever be at their mercy.