

Bridging uncertainty in management consulting: the mechanisms of trust and networked reputation*

Organization Studies, Feb, 2003, by Johannes Gluckler, Thomas Armbruster

Abstract

This article analyzes the market of management consulting and identifies institutional and transactional uncertainty as its principal features. Based on these uncertainties, we argue that competition in this market takes place on entirely different grounds than in other business sectors. We suggest that the main drivers of competitiveness are neither price nor measurable quality, but rather experience-based trust and a mechanism we label 'networked reputation.' An embeddedness perspective is employed to develop the concept of networked reputation as an intermediate mechanism that complements the duality of system versus personal trust and accounts for firm growth. We reinterpret secondary data on the German consulting market, illustrate the significance of these mechanisms, and demonstrate how management consulting is situated in structures of social relations.

Keywords: management consulting, business services, reputation, trust, networks, embeddedness

Introduction

The management consulting sector had remained a field largely neglected by scholarly investigation until academic interest emerged in the 1990s. The consulting market has grown worldwide significantly faster than gross national products, and has become one of the most dynamic service industries. In the 1990s in particular, the consulting market experienced immense growth (FEACO 1999; Kennedy Information Research Group 2000), and much debate has accordingly centered around the reasons for this boom. According to a structure-functionalist set of arguments, the development of the consulting sector is to be attributed to ongoing economic changes and the matching features of the knowledge-intensive firm (Tisdall 1982; Greiner and Metzger 1983; Starbuck 1992; Maister 1993). It is argued that the rapid progress of information technology and the increasing internationalization of markets prompt clients constantly to change organizational procedures, structures, and technology. Hence they hire consultants who deliver services based on up-to-date management practices and market information, and the consultants' knowledge about analytical procedures and change offers a variety of services and tasks that clients cannot perform on their own (Werr et al. 1997; Werr 1999; Armbruster and Kipping 2002; Ruef 2002). In transaction cost-based approaches, this line of thought has been formalized and suggested as a reason for consulting firms to exist and for existing as independent firms (Canback 1998, 1999; Kehrer and Schade 1995; Kaas and Schade 1995). The underlying rationale is based on Williamson's work and argues that clients economize on transactions with regard to asset specificity, frequency, and uncertainty. Markets, hierarchies, and hybrid forms of organization are distinguished as efficient organizational forms of economic exchange. It is argued that a market transaction of a consulting service prevails over in-house solutions if the frequency, asset specificity, and uncertainty of transactions are comparably low.

Whereas this debate has delivered explanatory approaches to the boom in management consulting, it has paid only scant attention to the competitive mechanisms of the consulting market and the specific constraints and characteristics of consulting transactions. Although empirical findings strongly suggest that competition in this service sector is not primarily based on price or cost (Dawes et al. 1992; Page 1995; Clark 1995; Lindahl and Beyers 1999), contributions to a theoretical account of the market mechanisms and the competitive logic in management consulting have remained rather scarce. Nayyar (1990) and Clark (1993, 1995) have suggested an important account from the perspective of informational economics. They have analyzed the information asymmetries in the consultant-client interaction, and their findings indicate that, under conditions of uncertainty, neither price nor institutional regulation can reduce information asymmetries. Instead, personal experience that evolves from interaction between clients and consultants becomes most important in reducing uncertainty and controlling for opportunistic behavior. In this paper, we further explore the impact of informal social institutions on competition in the consulting sector and analyze their implications for firm growth. Based on data obtained from the German consulting market, we theorize the market mechanisms from an economic sociology perspective, develop a sequential model of how clients select their

consultants, and thus outline how the competitive advantage of client networks contributes to firm growth.

The article starts with an analysis of uncertainty in the consulting industry. We identify the two most significant types of uncertainty in the consulting sector as (1) institutional uncertainty, which derives from the lack of formal institutional standards such as professionalization, industry boundaries, and product standards; and (2) transactional uncertainty, which derives from confidentiality of information, service-product intangibility, and the interdependent and interactive character of the co-production of consultants and clients. Whereas the latter group of characteristics generally apply to many knowledge-based services, the former are specifically characteristic of the open terrain of management consulting. Both kinds of uncertainty are proposed as aspects of the limited extent of institutional or system trust (Zucker 1986; Giddens 1990).

We then develop a systematic perspective on the ways uncertainty is reduced. We follow the embeddedness approach on the basis of the new economic sociology (Granovetter 1985, 1990; Smelser and Swedberg 1994), which treats uncertainty as endogenous to economic interaction. The argument illustrates how the exchange of advice for a fee is deeply embedded in structures of social relations. By carving out a mechanism we refer to as 'networked reputation' and distinguishing it from experience-based, personal trust on the one hand and from public reputation on the other, we develop an account of how competition for consulting transactions works. The central tenet is that a firm's reputation within a network of business relations represents a key factor of competitiveness for consulting firms. This competitive impetus is based on the idea that networked reputation reconciles the trade-off relationship between market scope, as a positive aspect of market interaction, and certainty, as a positive aspect of trust-based interaction.

In the last section, we reconstruct empirical studies in the German consulting market of the way clients choose their consulting partners and, thus, empirically illustrate that buying consulting services on the basis of conventional market mechanisms such as price or measurable quality is extremely unlikely. Instead, we propose an idealized sequential model of assignment decisions: first, public reputation segments the market into strata and competence areas; second, trust and mutual experience channel the decision within each segment; third, networked reputation, i.e. reputation mediated through business or private networks, determines the clients' decision about which consulting firm to choose; fourth, and least important in the process, is the notion that the choice is based on consulting fees. Consequently, we argue that market activities are strongly restricted to networks of business relations, which privilege informal social institutions of trust and networked reputation over arm's-length or cost-based interaction.

Formal Institutional Uncertainty

Ideally, business activity is segmented into sectors with clearly defined markets, legally and culturally agreed professional standards, and discrete products. The argument of this section is that none of this applies to management consulting. We sketch three areas of formal institutions which are rudimentary with respect to management consulting. Their absence reduces the degree of system trust (Giddens 1990) or institutional trust (Zucker 1986), which can be conceived of as a general institutional framework that coordinates actors' expectations and thus reduces uncertainty in interactions independent of individual sympathy or specific personal experience (Bachmann 2001: 348).

Unbounded Profession

Ever since the origin of management consulting at the turn of the 20th century, the spectrum of firms has been characterized by a variety of backgrounds such as engineering, accounting, law, or banking. In the course of increasing Taylorism at the beginning of the 20th century, individuals were consulted as 'efficiency experts' on production procedures and time and motion. Later on, the Glass-Steagall Banking Act in the USA in 1933, which separated commercial from investment banks, provided the grounds for the development of a consulting market, because banks were no longer permitted to provide consulting services to their customers (McKenna 1995). The consulting market opened up and business began to expand. By 1940 the number of consulting firms in the United States had quadrupled from only 100 firms ten years earlier (McKenna 1995). In Western Europe, US consulting firms opened offices in the late 1950s, and within 15 years they had a dominant role, before a

differentiation of national management consulting markets and institutions took place between 1975 and 1989 (Kipping 1999).

National associations from various countries have made several efforts to obtain protective designation of the term 'management consultant,' similar to that enjoyed by lawyers, medical doctors, engineers, accountants, or auditors. The latest attempt was made in Germany. In April 1997, the German association of management consultants, BDU, submitted a proposal to the German ministry of economics for a law to protect the designation *Unternehmensberater* (management consultant) (Gross 1999: 36). This law would have put a number of conditions on the use of the term 'management consultant,' such as educational standards or professional experience. In December 1997, the proposal was eventually rejected, on the grounds that such a legal restriction would be a constraint on the freedom of professional choice (Gross 1999). Limiting freedom of choice was declared to be reserved for cases where there was strong public interest in protection, i.e. for professions such as physicians and lawyers. The attempt to achieve legal protective designation of the management consulting profession did not succeed in other countries either. Based on material from 18 countries, Kyro (1995) concludes that the term 'profession' does not apply to management consulting. Referring to typical features of professions, such as a common stock of knowledge, professional educational courses, legal protective designation, and a recognizable separation from other professions, Kyro's conclusion is that management consultancy can at best be understood as a profession in terms of the identity of firms and individuals (1995: 247).

Thus, the professionalization of management consulting is a very difficult and long-term process. Contributing to this, leading consultancies have resisted efforts to introduce uniform labeling and professional status measures. The high flyers of the market in particular reject the idea of membership of professional associations. McKenna (1999) has shown that large consultancies prefer to use their own, widely recognized brand for differentiation purposes, and that they are concerned that any kind of standard qualification would make individual consultants more mobile, thus exacerbating the problem of retaining qualified personnel. The consulting business is, therefore, not protected by any educational or professional standards. This implies very low market entry barriers and permits any individual or firm to label their services 'consulting.' As a consequence, client firms face a remarkable degree of uncertainty, because there are no institutional clues to distinguish qualified from non-qualified consulting providers (Alvesson 1993; Clark 1995). This source of uncertainty has been referred to as performance risk (Das and Teng 2001). In addition, no measures are available to client firms to respond to inadequate consulting work. The absence of licensing standards, qualification requirements, or codes of conduct means that malpractice cannot be defined against a set of determined norms. In the United States, most courts hearing negligence cases against business consultants are unable to rule on malpractice, because there are simply no standards to judge them against (United Nations 1993: 20; Brockhaus 1977).

Unbounded Industry

The fact that management consulting is not a legally or institutionally protected profession has clear consequences in today's consulting markets. The combination of enormous growth potential and low institutional market entry barriers has led to extraordinarily high entry rates. An exemplary survey from the Cambridge Small Business Research Centre demonstrates that management consulting had the largest birth rate of firms (117.8 percent) compared with all other services (13.8 percent on average) in Britain between 1985 and 1992. Nearly 98 percent of this growth in the number of establishments is accounted for by small and medium-sized firms (Keeble and Schwalbach 1995). The dynamics of startups are further confirmed by the fact that 57 percent of the firms surveyed were established after 1980 and 37 percent after 1985. But the high rate of growth of startups is compensated for by a comparably high mortality rate. One-third of the firms in existence in 1985 had withdrawn from the market by 1990 (Keeble and Schwalbach 1995).

The industry is, however, not only open at the bottom. The boundaries with other industries have also become blurred as organizations from very different backgrounds and sectors migrate into management consulting and thus form a heterogeneous marketplace. First, the 'big five' accounting firms have extended their service portfolios to include legal advice, information technology, and management consulting in order to exploit growth potential in new industry segments (Kipping 2002). Regarding the advice provided by auditors or investment banks, it is often impossible to ascertain

where auditing or investment banking ends and where consulting begins. Second, formerly internal consultancy divisions of large corporations such as DaimlerChrysler, Siemens, and IBM have realized their competitive strength in the specialist fields of consulting and have started to offer their services in those markets. Hence, the consulting sector is open both to the bottom, because low barriers of entry imply high market volatility, and to the sides, because blurred boundaries enable organizations other than typical consultancies to provide consulting services. Uncertainty about the sustainability of the consulting firm, its professional background and status, and the qualification of its staff leads to a reduction in market transparency.

Unbounded Service Lines and Product Standards

The term 'blurred boundaries' applies not only to the consulting sector as a whole and to the background of its service providers, but also to the differentiation of service types. Although public reputation differentiates distinct core competences such as strategy or information technology (IT) among the top consulting firms, different kinds of services often overlap within a single consulting project, and the separation and distinction of these services would be artificial and largely pointless.

To take but one example, the boundary between strategy consulting and IT advice has been blurred ever since the consulting arms of the big accounting firms entered the IT consulting market and conducted mixtures of IT and strategy projects on a large scale. Moreover, management consultancies such as Accenture not only provide IT-related advice on the basis of project work, but have taken over routine operations (outsourcing) from their clients.

With respect to business process reengineering, one of the classical consulting tasks, it is often not at all clear which type of service is actually planned and provided. Benders et al. (1998) have done significant empirical work in this context. They investigated business process reengineering projects and found that consultants employ the term for a large variety of different services; there is thus a separation of the label from the contents of this management concept.

Consequently, the grouping of consulting services into strategy, information technology, operations, human resources, or marketing is based more on the public reputation of consulting firms than on clear-cut differences in services. This can also be seen in the fact that agencies or institutions that survey the demand for consulting services use different classifications of service lines and thus publish different and inconsistent data. To give but one example, the private market research agency Alpha Publications (1996) ascertains the market shares of IT services to be 44 percent and of strategy services to be 14 percent in Europe, whereas the European Federation of Management Consulting Associations (FEACO 1997) calculates figures less than half these for the former services and double for the latter. For clients of the management consulting market, then, it is very difficult to obtain unequivocal information about clearly defined segments of the market. The systems of service specialty are inconsistent and subject to interpretation by different groups and, especially, to self-ascription by consulting firms. Varying figures on market shares convey the ambiguity of service-line classification, which makes the market nontransparent for clients and the choice of adequate consultants additionally uncertain. The only information available to clients is the public reputation of firms for an area of expertise, but, as we shall see later, this is not a reliable source (Clark 1993, 1995).

In sum, the regulation of the consulting business in terms of legal or organizational norms and standards is minimal, which opens the market potentially to any individual or corporate service provider and increases performance risk. There are no formal requirements for the products and no institutional means to respond to malpractice, which makes it difficult for clients to choose a consulting firm for an assignment. The absence of general regulation at the societal level engenders a lack of institutional or system trust (Zucker 1986; Giddens 1990; Bachmann 2001).

Transactional Uncertainty

Formal institutions of legal, professional, market, and product standards are fundamental to regulated action, since they absorb some of the information asymmetry between service providers and potential clients. Conversely, the more formal institutions are missing, the more the uncertainty of economic action increases (Beckert 1999). According to ecological and new institutional approaches to organization theory (Hannan and Freeman 1989; Powell and DiMaggio 1991), formal

institutionalization is a common feature in the creation of any new industry or organizational field. Institutions evolve in a historically contingent process, easing transactions and creating institutional trust between transaction partners. From this angle, one would expect uncertainty to be only a temporary problem in the management consulting sector. Yet the consulting business is riddled with another source of uncertainty, associated with most knowledge-intensive services, namely its confidentiality, intangibility, and interdependency. We refer to these as aspects of transactional uncertainty.

Confidentiality and Relational Risk

The very nature of consulting often allows consultants access to confidential information within client organizations. They inquire about, sketch out, and assess client members' activities, obtain access to and analyze data that the client's competitors must not get hold of, and thus gain insights into internal operations, specific knowledge, and sociopolitical constellations within client firms. This knowledge renders the client potentially vulnerable to opportunistic behavior by the consultant (Nayyar 1990; Clark 1993). The opportunity of misuse does not necessarily refer to a blunt transfer of information to competitors. This would be subject to contract law and is usually regulated by nondisclosure agreements. The consultancy may handle confidential information in a wide range of ways, which could become detrimental to the client in an imperceptible fashion and thus cannot be subjected to law. As part of a consultancy's knowledge management, for example, client information may be benchmarked with data from other firms without the client knowing; project reports, presentations, and analyses may be saved in internal knowledge databases and downloaded when similar projects come up; or approaches and methods of handling problems that the client firm has developed itself may be appropriated for another client of the consultancy. These aspects together make for what Das and Teng (2001) call relational risk, i.e. the uncertainty associated with a consultant's tendency to act opportunistically in the course of a project. Moreover, the job mobility of management consultants implies risk for the client firm because a consultant may work for a competitor in the foreseeable future.

Except for criminal law, there are hardly any institutional means of reducing these risks. In order to create institutional trust with member firms, consulting associations 'urge' their members to practice according to ethical guidelines and codes of conduct. In the case of Germany, these are formulated by the German consulting association as 'principles of the profession' (BDU 2001). However, guidelines lack a legal framework and cannot be enforced by sanctions. Consequently, client firms have no guarantee that members of the association adhere to them. Monitoring a consulting firm's compliance with these guidelines is almost impossible. Codes of conduct at best encourage appropriate behavior, but there is no institutional guarantee against the possibility of misuse. Uncertainty and risk are carried by the client, who is forced to be eternally vigilant.

Product Intangibility

Standard theory offers two ways of competing with other firms: quality and price. This usually implies a choice between differentiation and cost strategies: competitive advantage is envisaged through either superior value creation or more efficient production of the product (Porter 1980, 1990). In markets of commodified goods, this information is sufficient to make product decisions and carry out transactions. However, these strategies prove to be inadequate in the management consulting market, since the quality of service is extremely difficult to measure (Nayyar 1990; Clark 1993). There is a fundamental difference between spot-exchange commodities and knowledge-intensive services. In spot-exchange commodities it is the producer who takes on the risk of production measures because customers can see, compare, and often test the product prior to purchase (Levitt 1981). Knowledge-intensive services, by contrast, are a case of deferred compliance, since the product will be generated in co-production only after the agreement is signed, and thus it is the client who takes on the primary risk. Consulting clients do not purchase ready-made products; instead they contract a consulting firm to perform a service in subsequent cooperation.

The point to be made is that the quality of consulting services cannot be assessed prior to the assignment, a circumstance that again raises the issue of performance risk (Das and Teng 2001). Moreover, because corporate development is contingent on a large variety of decisions and conditions, the quality of a specific consulting project is hard to assess even long after the project has

been finished. Performance evaluation is a subjective procedure with few objective criteria to refer to. If the quality of a consulting firm or a contracted performance is not objectively assessable, then price cannot be used as an indication of quality. Project results are unique and hard to compare with other projects, thus the intangibility of consulting services inhibits any objective price building. Consequently, prices do not resolve the uncertainty clients face when screening the consulting market for the best providers. Accordingly, as Lindahl and Beyers (1999) have found, service firms hardly ever pursue cost-leadership strategies.

Interdependent Cooperation

Consulting is traditionally conceived of as the sale of solutions to problems specified by the client prior to the assignment. Consultants are assumed to act as external experts who sell their expertise to passive and receptive client firms. This line of thinking reflects the internalized view of management consulting associations, in which consultants are represented as independent, objective advisers with superior know-how. However, it neglects the fact that management consulting is a two-way interaction that is ideally conceived as a process of mutual learning and cooperation. Wood (1996: 656) observes that the more competent a firm, the more likely it is to hire a consultant: 'Generally, consultancies tend to reinforce the strategic strengths of experienced companies rather than compensate for the weaknesses of the inexperienced.' Client firms certainly contract a consultant in order to improve on certain operations, but these firms' competence tends already to be on the competitive edge, which implies that consultants profit and learn from their assignments as well. Reciprocal interaction and co-production between consultant and client render consulting services nontransparent. The co-production of consultants and client members during the actual delivery of the service also means that the clients, at least potentially, share an important influence on the outcome of the interaction. The course of an assignment is thus highly contingent, because it depends on the goals, strategies, and skills of both parties on the one hand, and on their ability to cooperate on the other. In this respect, therefore, transactional uncertainty is mutual (Sturdy 1997).

The debate highlighting the power of service producers to control and benefit from an assignment points to the client's uncertainty, and it appears that consultants indeed make a considerable effort to control the relationship (Clark 1995; Ernst and Kieser 2002). In contrast to professions such as medicine or accounting, consultants may actually benefit from the absence of a clearly defined and codified body of knowledge and the consequent inability of clients to assess the quality of their service. The paradox rests in the fact that consultants are originally hired to reduce uncertainty (Ernst and Kieser 2002). The absence of standards opens the door to performance surrogates, as demonstrated by the debate about the communicative performance of consultants, the aspect of consultants' impression management, or their involvement in sociopolitical struggles within client firms (Czarniawska-Joerges 1990; Alvesson 1993; Bloomfield and Danieli 1995; Clark 1995; O'Shea and Madigan 1997; Clark and Salaman 1998; Fincham 1995, 1999). Consulting firms are required to mediate progress and detect the dominant party in order to ascertain the politically most acceptable solution. The degree of consent within a client firm and between the client and consultant is substantial in order for a consultant to stimulate a sell-on success, i.e. follow-up assignments with an existing client (Sturdy 1997). In conclusion, the interactive nature of consulting in the generation of a project result carries uncertainty for both parties -- for consultants because they depend on a collaborative and consent-based client attitude; and for clients because they depend on the consultant's capabilities, commitment, and integrity in the project.

Uncertainty Reduction through Trust and 'Networked Reputation'

Institutional and transactional uncertainty cause considerable asymmetries of information and action. The issue at stake seems paradoxical. On the one hand, low system trust and high relational risk render the choice of a consultant extremely uncertain; on the other hand, industries are increasingly making use of management consultants, as documented by the worldwide market growth. Hence, certain mechanisms must exist that bridge uncertainty and enable companies to make the right assignment decision. In this section of the article, we develop an account of how client uncertainty is reduced, and explore the consequences for the dominant market mechanism in the consulting business. Our argument is twofold. First, we draw on the new economic sociology's embeddedness perspective in order to distinguish market reputation, experience-based trust, and networked reputation as different social mechanisms of partner choice. Second, we formulate a tradeoff relation

between experience-based trust and public reputation and explore their constraints on firm growth. Networked reputation emerges as the predominant factor of growth under conditions of institutional and transactional uncertainty.

A Hierarchy of Partner Choices

When uncertainty constrains economic exchange and institutional trust is missing, then informal social institutions (Akerlof 1970; North 1990) are required in order to gain certainty for transactions. Recent advances in economic sociology and institutional economics emphasize the importance for economic relations of informal social institutions such as culture and shared cognitive schemes (DiMaggio 1997), conventions (Storper 1997), trust (Lane and Bachmann 1996; Nootboom 1996; Lorenz 1999), and reputation (Kollock 1994; Uzzi 1997). The embeddedness argument (Granovetter 1985) offers a meaningful perspective on how to grasp the enabling and constraining forces of informal social institutions in business relations. We elaborate on Granovetter's idea (1985: 490) that there is a hierarchy of three ways to choose a transaction partner. These modes of choice are discussed from a client perspective in which the client is assumed to pursue two objectives: choosing from a wide variety of consultants and gaining a maximum of certainty about them.

Public Reputation

In economic theory the market is usually presumed to link supply and demand. New institutional theory recognizes the market as a formal institution in which resources may be exchanged, although the partners remain anonymous to one another. The possibility for such a market to exist, however, is dependent on a substantial degree of system trust for the actors involved. Yet, as shown above, management consulting is not subject to professional standards, to a delimited industry, or to clearly identifiable products. Furthermore, clients are not able to decide on the basis of price, because information is asymmetric and incomplete, or on the basis of quality, because it cannot be objectively assessed. However, the market does provide an additional kind of information to clients: public reputation. Reputation is defined here as the perception of a consulting firm's past performance (see Clark 1995: 74). It is public when this perception has a general, anonymous source and circulates freely in the management arena.

The public reputation of style, approach, and capability that the large consulting firms in particular carry is transported in the media but cannot be attributed to individual experience. Consequently, the problem for the client is that such information remains at arm's length. Public reputation discloses overt information that is known to everyone, so that no client has any particular information advantage over anyone else. Under conditions of high institutional and transactional uncertainty, public reputation is an unsatisfactory mechanism of partner choice. Although it may signify general areas of competence and help stratify the market into layers of large, international firms on the one hand and small to medium-sized domestic or regional consultancies on the other, it does not provide reliable information on concrete performance quality or relational certainty for the client.

Experience-based Trust

In contrast to market interaction, personal experience is a very reliable ground on which to choose a transaction partner. When relations have been positive in the past, positive expectations guide future action (see the term 'process-based trust' in Zucker 1986; Lane and Bachmann 1996). Experience is an authentic way of assessing another person's action and helps to establish trust in the sense of the expectation 'that damage will not be caused even though there is both an opportunity and an incentive for the partner to cause damage' (Nootboom 2000a: 921). The fact that personal trust in economic exchange is derived from mutual social commitment also provides control for the interacting partners. Malfeasance against a trusted partner might subsequently trigger sanctions by the betrayed. Trust is a fundamental social institution that enables complex interaction such as the division of labor or the separation of performance and reward. It stabilizes interaction over time and embeds meaning, control, and solidarity into a structure of economic exchange. Under conditions of uncertainty, therefore, partner choices are driven by personal trust based on previous transactions. Once established, experience-based trust enables reciprocal and enduring relations, and individuals or organizations will tend to transact with trusted partners whenever they can draw on resources provided within the network.

However, experience-based trust has its limits, too. It evolves only slowly and its maintenance demands commitment and energy. Therefore, trust relations are limited to a small number of friends or business partners and do not encompass many partners within a market. Moreover, owing to the limited number of contacts, clients are biased to hire previous consultants even if their specialty does not cover the new problem area (the problem of overembeddedness -- Uzzi 1997: 59).

In sum, experience-based trust may imply two shortcomings. First, since uncertainty is high, client firms may cling to repeated hiring of accustomed consulting firms despite a lack of competence. And, second, experience-based trust limits the scope of potential partners. Consulting firms that would perform better in certain problem areas than the firms already known by a client will not be chosen, simply because there is no history of mutual experience.

Networked Reputation

Each of the two mechanisms above is limited in its utility for a client regarding the process of choosing a consultant. Although public reputation provides clients with a wide range of consultants, the quality of the consultants' performance cannot be reliably assessed. Trust relations based on experience create certainty for transactions, but they do not allow access to those consultants that best meet the requirements for tackling a specific problem. We therefore propose a third mechanism, which reconciles the deficits of public reputation and experience-based trust: networked reputation.

If a trusted party cannot provide the resources that are needed, their relations can be used in order to obtain trustworthy information about parties one is not connected to. A friend's judgment about another party serves as an essential criterion for our evaluation of that unknown third party. This mechanism communicates certainty through an already established network of trusted relations and thus helps to access additional resources. This kind of reputation is one of the very basic ways social networks operate. In contrast to public reputation, where an assessment of a person or firm is known to everybody, networked reputation conveys a far more personal and reliable credibility, since word-of-mouth discloses 'thick information' about potential transaction partners (Clark 1993; File et al. 1994). As Granovetter states, '[b]etter than the statement that someone is known to be reliable is information from a trusted informant that he has dealt with that individual and found him so' (1985: 490). The thickness and trustworthiness of information channeled through socially embedded networks inform the concept of 'networked reputation' as opposed to public reputation.

Networked Reputation, Competition, and Firm Growth

The transaction mechanisms of public reputation, trust, and networked reputation can be arranged along two dimensions: the degree of certainty on one axis, and market scope, i.e. the number of potential transaction partners, on the other (see Figure 1a). For the client firm, public reputation conveys the full range of possible consulting partners independently of direct trust relations (see Figure 1b, left-hand part), but it is accompanied by a considerable degree of uncertainty, because choice based on overt market information cannot be validated by the client's own experience. If formal institutional certainty is missing, then system trust is too low and uncertainty too high to trust in market information, because an assignment implies high expenses, high opportunity costs owing to the involvement of client staff, the relational risk of sharing sensitive corporate information, and a loss of valuable time.

In contrast, experience-based trust makes transactions very certain, but at the same time the number of potential consulting partners is limited to the client firm's set of direct trust relations (see Figure 1b, right-hand part). Experience from previous interaction provides the basis for establishing personal trust. It preserves existing relationships by reinforcing and stabilizing mutual commitment. But this mechanism per se does not widen the realm of partners, and the size of one's network largely depends on the amount of effort one invests in making new acquaintances and in developing trust on a step-by-step basis (Kollock 1994; Lane and Bachmann 1996; Lorenz 1999). There is a limited number of partners with whom one shares positive experiences and has established a trust relationship. A partner network can grow only slowly because any new trust relation is historically contingent and reduces the resources available to establish additional trust relations.

Hence, these two mechanisms offer opposing advantages, and networked reputation is suggested as a way of trading off both advantages: it offers considerable market scope and still communicates

trustworthy information on transaction partners. Networked reputation emerges as a vital competitive factor of firm growth for four main reasons:

1 From the client's perspective, a trusted partner's recommendation endows a consulting firm with credibility and reduces transactional uncertainty between the consultant and potential client.

2 Networked reputation operates as a social substitute for service quality. If the future performance of a consultant cannot be evaluated, confidential reputation is used to draw conclusions from the evaluation of previous performances. The act of objectively assessing the quality of a service is transferred to the subjective construction of a socially communicated evaluation. Hence, networked reputation absorbs consulting quality and becomes a key factor of competition.

3 The fact that networked reputation indicates competence and secures client networks implies a rise in the barriers of entry for competitors and newcomers. Keeble and Schwalbach (1995) found that a significant proportion of young consulting firms and startups already have contracts at the start of their business. This is remarkable because entrants in other industries and markets do not normally begin with a defined set of clients. This finding clearly supports the importance of enduring client relations and networked reputation.

4 The use of networked reputation widens the market scope, i.e. the range of potential consulting partners for a client. In addition to personal trust relations with a consultant, indirect contacts via a client's business partners are also taken into consideration (see Figure 1b, central part). The number of potential partners increases exponentially with the number of network contacts.

From the consulting firm's perspective, the operation of networked reputation not only preserves its existing clients, but also exponentially broadens the range of potential clients, since every satisfied customer might recommend a consultant to trusted third parties. Hence, networked reputation provides opportunities for both consulting and client firms. Clients benefit from networked reputation in that the business partners' recommendations widen the market scope for alternative service providers. Consulting firms benefit in that the number of potential clients increases because clients open their business networks to the services of a consulting firm. The certainty of transaction is maintained to the extent that firms trust their business friends.

Insights from the German Consulting Market

Empirical investigations conducted within the German consulting market provide ample information on the market mechanisms suggested here. Numerous studies have analyzed client companies and their decision criteria when choosing a consultant to hire. In the following, we review their findings in light of social practice institutions and thus provide empirical illustrations for our arguments. We are aware that considering research findings within a different conceptual context than the one in which they were constructed demands cautious interpretation and is not a substitute for original research to test hypotheses. Nevertheless, this exploration of German survey data provides considerable insights into the mechanisms proposed here.

Empirical Illustration of the Argument

In a survey of large client corporations in Germany, Kohr (2000) analyzed various steps in the process of selecting consultants. At each of these stages of (1) market screening, (2) pre-selection, and (3) final choice, clients were asked to evaluate the importance of a set of choice criteria. Two other German surveys asked randomly sampled client companies to rate their preferred criteria. In addition, they also asked consulting firms to rate the criteria they believed would predominate in a client's choice (Meffert 1990; Kaas and Schade 1995).

Table 1 gives the ratings for a list of criteria, with low numbers representing high importance and high numbers representing low importance. We first consider the criteria of low importance. As suggested in the theorized propositions above, price scores low for all ratings. Hence, fees are not the predominant driver in partner choice, which confirms the argument made earlier that the consulting product cannot be understood in terms of price. Its quality is not objectively assessable and consequently cannot be expressed in terms of a price/quality mechanism. Interestingly, Kohr's (2000) data show that fees are negligible at first, but become increasingly important the further the selection

process proceeds. This suggests that price matters only after uncertainty about the transaction partner and the expected quality of their performance has been bridged. The other results also support our propositions about public reputation, experience-based trust, and networked reputation.

Public reputation appears to play a key role in the area relevant to the client's demands. It signals the general perception and evaluation of consultants by the market. Research on market reputation has provided ample evidence that corporate image and public reputation are *ceteris paribus* positively associated with organizational success and inhibit market entry by new firms (Kreps and Wilson 1982; Dollinger et al. 1997; Ferguson et al. 2000). But the significance of public reputation largely depends on the institutional environment to produce a reputation. In the case Ferguson et al. (2000) investigated, an insurance company's reputation was generated and measured according to the ratings of independent rating agencies, which themselves had formal institutional legitimacy among the public. In other words, once institutions provide formal certainty, clients tend to depend less on informal devices in order to reduce uncertainty. However, this is not the case with the management consulting market, because it is precisely this institutional environment, and hence system trust, that is missing. Uzzi's (1996) ethnographic fieldwork provides evidence that market reputation inspires much less confidence than more informal sources of reputation. He quotes an entrepreneur's statement: 'Manufacturers can play hit-and-run for years before their reputation catches up with them' (1996:680). The important point, therefore, is that overt market reputation discloses only 'thin' and inert information on a consulting firm.

The effect that renders overt market reputation important for management consulting firms is a different one. Because consulting is employed not only to elaborate and solve problems, but also to legitimize corporate change among shareholders and the public (Meyer 1996; Ernst and Kieser 2002), market image certainly plays an important role in the selection of the transaction partner: it stratifies the market into firms with and without high public reputation, and thus separates firms such as McKinsey and Co., Bain, and the Boston Consulting Group, on the one hand, from medium-sized and small consultancies on the other. A survey of the German consulting market confirmed a previous study (Elfgén and Klaile 1987), in that it found that 76 percent of small consultancies' transactions were with small client companies (turnover less than DM 10 million), whereas larger consultancies drew 76 percent of their assignments from larger client corporations (Walger and Scheller 1998: 48).

The client's personal experience with a particular consultant or consulting firm has proven to play an equally important role in assignment decisions (see Table 1). The experience acquired through mutual project cooperation leads to trustworthy relations and eases future contracts. One-quarter of all client firms openly admitted that they did not pursue any market screening prior to an assignment decision (Kohr 2000), although an answer in this direction on the questionnaire would have been socially highly desirable. These firms directly contracted a consulting firm either from a long-list or as a continuation of a previous assignment. In all cases, the decision was based on mutual experience. One-half of the client firms surveyed in Germany maintained ongoing relationships with consulting firms. In turn, about 60-70 percent of the consultants' assignments were drawn from regular clients (Kaas and Schade 1995; BDU 1996). In Kohr's (2000) study, clients rated the prior use of a particular consultant as most important, and consultants also ranked personal client--consultant relations first. And this is in a sample of clients that is considerably skewed toward big corporations. It can be hypothesized that small and medium client firms are even more inclined toward trust and networked reputation modes of transaction (Meffert 1990).

The third cluster of criteria highlights the significance of networked reputation. The studies of the German market show that recommendation of a consultant by business partners, colleagues, and other firms is particularly important. In contrast to client firms, which gave networked reputation an average rating, consultants credited recommendation with significant impact. It can be assumed that the reason for this result is that it looks better for clients to report their choice as being based on formal criteria rather than on a business partner's recommendation. And, indeed, a change in methodology gives this conjecture validity. Both a survey by the German consulting association BDU (1991) and one by Strambach (1995) focused on information channels rather than direct decision criteria, and they consistently reveal a remarkably high effect of networked reputation. Colleagues and business partners were ranked highest for providing information on consultants, followed by other firms' recommendations, with the press and public sources of information coming in third place (see Table 2).

These studies have received even further support from another survey on German consulting firms, which found that client referrals were the single most important way of establishing contacts between potential clients and consultants (Enke and Geigenmuller 2001). Interestingly, information provided by professional consulting associations was regarded as least important. This finding also corresponds with the results of Kohr's survey in Table 1. He reports the lowest ranking for this type of recommendation. This confirms our proposition, because recommendation via an association is not a networked referral. Whereas business partners, colleagues, and other known parties supply 'thick' and trustworthy information, associations are able to provide only formal and not sufficiently 'thick' information about their members.

A Sequential Model of Assignment Decisions

Public reputation in a specific field of interest, experience-based trust, and networked reputation appear to be the most critical criteria in the client's choice of a consultant. These mechanisms combined with an interpretation of the survey data above provide grounds for deriving a general pattern of assignment decisions. We synthesize our analysis into a sequential model of assignment decisions, which prioritizes social institutions and concrete structures of social relations over purely economic factors of price and quality to encompass a four-tier sequence: (1) public reputation, (2) experience-based trust, (3) networked reputation, and (4) competitive price. Although the steps in this sequence may in practice overlap, their analytical distinction facilitates a heuristic analysis of a sequential decision-making process in terms of social relations.

1 Public reputation. Public reputation stratifies the consulting market into at least two strata of firms: a stratum of highly prestigious consulting firms on the one hand, and a stratum of less prestigious ones on the other. The 'household name' of the top consulting firms accounts for their distinction from the market segment of medium and small firms, as the research on status similarity suggests (Podolny 1994; Chung et al. 2000). In addition, within the layer of top-tier firms, public reputation accounts for a rough distinction between, for example, strategy and IT consulting firms. Certain firms are associated with certain types of expert knowledge or approaches, despite the fact that service lines are often difficult to distinguish. In particular, long-established large firms benefit from their individual brand. Nevertheless, public reputation serves to attract only attention, not explicitly deals. Although it may account for the perception of a firm in the public management arena, the information is not thick or trustworthy enough to be the only basis for an assignment decision.

2 Experience-based trust. Within a stratum of firms and field of specialty that now adequately delimits the concrete market on the basis of public reputation, the choice is driven by experience-based trust. Clients look for previous partners to carry on their relationship. This is consistently substantiated by studies of the German consulting market; for example, the BDU ascertained that 68.7 percent of its member firms' assignments are follow-up assignments (BDU 1996: 16). The German-based, global consultancy Roland Berger & Partner reports that as much as 77 percent of its revenues came from existing clients in 1999. Thus, if past interaction has been positive and commitments have been reciprocated, then client--consultant relations tend to become embedded into a social mutuality of shared information, values, and problem comprehension. However, as soon as clients are confronted with distinct challenges that cannot be met by those consultants with which they share a history of positive experience, then experience-based trust relations do not suffice to find an adequate partner.

3 Networked reputation. If the web of experience-based trust relations does not encompass the desired consultant, then trusted partners are asked for their own experiences to provide a credible source of certainty. Business partners who share positive experiences with consultants are approached in order to obtain thick, trustworthy judgments on consulting firms. In surveys where consultants were interviewed (Meffert 1990; Kaas and Schade 1995), networked reputation criteria scored high on importance. This intermediate form of credibility processed through networked reputation is lower than in experience-based trust, but far higher than in public information. The process of intermediate referrals has also been addressed in other research contexts, such as Granovetter's (1974) study on how to get a suitable job, or in research on consumer transactions (DiMaggio and Louch 1998). DiMaggio and Louch have described the active retrieval of information through a social network of contacts as 'search embeddedness.' Their research suggests that transactions are more likely to be channeled within a network if transactions are uncertain and specific, and when the risk of opportunism is high. All these features apply particularly to management

consulting. In contrast to search embeddedness, networked reputation is not limited to the active request for information, because a consulting assignment is not necessarily preceded by a search procedure. In many cases, a client recognizes a need for a project only after learning about a certain consulting firm and its services through business partners. Here, social networks and intermediary processes of networked reputation lead to contracts that otherwise would not necessarily have come up as projects at all. Recommendations are a part of day-to-day communication and are exchanged independently of concrete demand and decision contexts. Firms gather this information on consulting firms and may draw on this pool of suppliers legitimized through networked reputation for future projects .

4 Competitive price. As suggested above, fees are not the primary driving force in an assignment decision, although this argument rests on a contingency. Often, medium-sized firms do not opt for a first-tier consulting firm simply because they are constrained by their budget (Walger and Scheller 1998: 48). However, within a given budget range, price is not a very relevant decision criterion, which the survey data in Table 1 consistently illustrate. The significance of price is contingent on social institutions. There are two cases where the price mechanism may particularly matter. First, firms with a high degree of public reputation enjoy the opportunity to charge higher fees, because they benefit from a brand that signals a high degree of legitimacy. The point here is that a top-tier firm enjoys a brand name because of, rather than in spite of, their high fees. Thus the price mechanism follows a social rather than a purely economic logic and the meaning of price remains contingent on the existence of social institutions, public reputation, or networked reputation. Second, price becomes increasingly important as uncertainty in the consultant-client interaction decreases (see Kohr 2000). Bargaining over the terms of a project begins at the point where both consultant and client have made their commitment and embedded their relation in a context of mutual expectations. Beyond these two cases, price will hardly be a mechanism of regulation, although this may change with increasing competition in the future.

Several streams of thought about intermediary social processes have informed the concept of networked reputation that we propose here. In his concept of third-party trust, Coleman (1990: 180-182) elaborates on the idea of intermediate actors who establish contacts and enable interaction between actors who otherwise would not have any confidence in each other. He distinguishes advisers from guarantors and entrepreneurial types of intermediary in trust and argues that an adviser communicates trust between mutually unconnected parties and thus facilitates interaction between new partners. The mechanism of networked reputation corresponds to this, because an actor mediates trust at the risk of his or her own reputation if something goes wrong in the relations he or she has facilitated.

The importance of these issues has also been addressed in the concept of social capital. This notion draws on the benefits or returns that can be gained from the non-monetary resources of the structure of social relations (Coleman 1988; Burt 1997; Portes 1998). Similar to Coleman's account, structural-hole theory (Burt 1992, 1997) emphasizes the bridging of structural holes as a fundamental realization of social capital. When actors maintain exclusive relations with otherwise disconnected others, i.e. bridge structural holes, they maximize their chances of obtaining information advantages, particularly referrals (Burt 1997: 340), since each relation connects distinct groups of actors. Strategically, therefore, consulting firms may increase the growth effect within their own client network by engaging in several business networks rather than focusing on one single network, thereby avoiding a lock-in and rendering networked reputation more likely.

Networked reputation is important not just in the marketing context of client acquisition and customer relations. The literature on innovation, for instance, refers to intermediaries who introduce and connect cooperators and innovators. Here, the concept of networked reputation again contributes to a deeper understanding of the mechanisms at work. Nooteboom (2000b: 111) discusses intermediation by go-betweens in the context of innovation, where reputation networks save time and energy in building up idiosyncratic trust relations. New actors are credited with their trustor's trustworthiness and engage more rapidly in more dense interaction. This saving of time contributes to quick adaptation and innovation in organizational relations.

Although the mechanisms of public and networked reputation are analytically distinct, in that they trade the advantage of market scope against that of transactional certainty, these advantages may

empirically combine and reinforce both reputation effects in order jointly to reduce overall uncertainty. Often it is the combination of effects that consultants attempt to achieve. They expect public reputation to provide not direct assignments, but awareness and first contacts. Once contacts are established, they may proactively be directed to contact reference organizations in order to enjoy networked reputation. In so doing a climate is constructed in which a consultant is able to build up personal trust with a potential client. In some cases, public reputation may also be the outcome of the long-term formation of reputation within networks of business relations. Thus, long-established, large firms especially benefit from combining the analytically distinct mechanisms of public and networked reputation.

Conclusion

We have seen that management consulting implies a high degree of uncertainty for clients. This is because the degree of formal institutionalization, i.e. legislation, professional standards, certification, and sanction mechanisms, is very low and hence institutional barriers to entry are minimal. The lack of quality control and institutional setting allows for opportunistic behavior, increases the likelihood of dealing with inadequate service suppliers, and represents a performance risk for the client. In addition, management consulting, like most other knowledge-intensive business services, is performed after the contract has been signed, which shifts the risk of low quality or adequacy toward the client. Yet the demand for consulting services is consistently high, so there must be mechanisms that bridge these uncertainties.

We have suggested that these mechanisms are experience-based trust and networked reputation. Formal institutional and transactional uncertainty render these informal social institutions important, and, based on the finding that consulting relations are to a large extent repetitive and long-lasting, we have argued that networked reputation is the key factor of competition if assignments cannot be made within direct trust relations. We have presented secondary data on the German consulting market which lend empirical support to our analysis and which have led us to formulate a sequential model of clients' assignment decisions.

Historical and international research complements our argument. In his historical analysis of the post-war expansion of US-based consultancies into Europe, Kipping (1999) reconstructed numerous incidences of new assignments being acquired through local elite networks. He found that the large US-based consulting firm systematically 'relied on a small number of individuals from the host countries to play the role of "connectors" and introduce them to potential clients' (1999: 220). Moreover, the lessons from the German consulting market seem to hold in a cross-cultural context. Dawes et al. (1992) and Page (1998) asked senior managers of client companies in Australia and New Zealand to rate the most important criteria in the selection of a consultant. Their results are consistent with the market mechanism and hierarchy of partner choices suggested here. Furthermore, Clark (1995: 70-71) compared a number of empirical studies from the Anglo-American context to show that personal experience and recommendations within client networks play dominant roles in the choice of consultants. These studies make us confident that the perspective we have presented is valid in a cross-cultural context.

Overall, management consulting is a socially and culturally contextualized business. The growth, competitiveness, and market success of a consulting firm depend on its ability to create long-lasting and trustworthy networks of client relations. In contrast to the lack of formal institutional or cost-based barriers to entry, business environments based on trust and networked reputation have distinct barriers of entry for competitors and newcomers. Market entry often seems to be subject to a paradox, which in an Australian study was described thus: 'winning contracts in Australia and New Zealand is possible when there is a prior relationship to draw on' (Page 1998: 56).

The competitive power of embedded relations and the growth mechanism of networked reputation have to be recognized by consulting firms as an interactive marketing approach (Schade 1997; Filiatrault and Lapierre 1997) and as a proactive strategy to enlarge their clientele. A satisfied customer is a gateway to new clients, and the barriers that a positive reputation network creates against other providers are enormous. Moreover, channels of networked reputation are not limited to client-to-client referrals. Previous personnel of a consultancy can often facilitate reputation and new assignments. Many ex-consultants attain executive positions in corporations and are likely to

subsequently contract external consulting services within their network of trust relations (Kipping 1999; Amorim and Kipping 1999). Some leading consulting firms have realized this potential acquisition effect by documenting alumni careers and institutionalizing networks of post-employment relations in order to extend their webs of reference into client corporations. However, the majority of consultants still underestimate the importance of post-consulting activities in stabilizing existing client relations (Kaas and Schade 1995).

Although the empirical findings in this article have been based on an analysis of secondary data and cannot be interpreted with the same thrust as primary research, they strongly suggest that personal trust and webs of embedded relations drive a client's choice of a consultant. Certainly, original and more fine-grained research into the process of networked reputation is necessary in order to comprehend the operation of this mechanism more deeply and to place it into a broader framework of informal social institutions in the context of economic exchange. Moreover, the effects of the network mechanisms on the social construction of business problems and solutions within a consulting project are still to be explored. This is particularly interesting in the case of projects designed to legitimize unpleasant measures rather than to provide expert advice. Future research on the way informal social institutions affect the recognition of business problems and the evaluation of project results promises another step in understanding the management consulting business beyond the competitive mechanisms discussed here. To us, the intermediate mechanism of networked reputation represents a promising concept not only in marketing relations but also in other forms of interorganizational relations. In extending the dyadic model of system trust vs. personal trust, networked reputation seems a promising medium-range concept that focuses on the way business networks operate at the interstices of direct individual interaction and institutional structures.

[FIGURE 1 OMITTED]

Table 1

Criteria for the Selection of a Consultant in Germany

		Study 1 (1a)				
Market Mechanism	Selection Critieria	Client	Consultant			
Public reputation	Reputation in a specific competence area	1.9	1.3			
	General reputation	2.8	2.2			
	Advertisement by consultant					
Experience-based trust	Personal contact with the consultant	2.0	1.1			
	Prior use of the consultant					
Networked reputation	Recommendations by business partner	2.5	1.9			
	by other firm					
	by colleague					
Price/quality	Competitive fees	3.7	3.5			
	Service lines	2.9	1.6			
	Size of firm	4.3	3.4			
	Professional association's recommendation					
		Study 2 (2b)		Study 3 (Client) (b)		
Market Mechanism	Client	Consultant	Round 1	Round 2	Round 3	
Public reputation	1.6	1.7	2.7	2.9	3.0	
	1.7	1.6	2.9 4.4	3.2 4.6	3.3 4.6	
Experience-based trust	2.1	1.5	3.1	3.0	3.2	
			2.0	2.2	2.3	
Networked reputation	2.4	1.6	3.2	3.5	3.8	
	2.5	1.7				
			3.0	3.3	3.8	
Price/quality			3.2	3.0	2.5	
	1.8	1.9	3.0	3.3	3.2	
			4.0	4.5	4.6	

Sources: Study 1 -- Meffert (1990); Study 2 -- Kaas and Schade (1995); Study 3 -- Kohr (2000).

(a)Mean rating: 1 = max. and 6 = min. importance

(b)Mean rating: 1 = max, and 5 = min. importance.

Table 2

Sources of Information on a Consulting Firm

Information source	Study 4 (a)	
	Client (prior contact with consulting firm)	
Existing consulting relation	-	
Colleagues/ business partners	1.4	
Other firms, references	1.7	
Consultant, direct marketing	2.7	
Press	3.3	
Congress, fair	-	
Industry association	3.7	
Chambers of commerce	4.2	
Consultants directory	4.2	
Consulting association	4.5	

Information source	Study 4 (a)	Study 5 (b)
	Client (no experience with consulting firm)	Consultant
Existing consulting relation	-	2.2
Colleagues/ business partners	1.6	1.7
Other firms, references	2.2	2.3
Consultant, direct marketing	3.1	4.7
Press	4.2	4.9
Congress, fair	-	5.5
Industry association	3.6	Contact broker
Chambers of commerce	2.5	5.8
Consultants directory	4.1	
Consulting association	4.4	

Sources: Study 4 - BDU (1991)

(a)Mean rating: 1 = max, and 5 = min. importance, Study 5 - Strambach (1995)

(b)Mean rating: 1 = max. and 7 = min. importance (recorded).

Note

* We wish to thank John Meyer, Eike W. Schamp, Alfred Kieser, Michael Faust, Marina Della Giusta, Alexander Nicolai, Bent Ernst, Michael Woywode, the participants in the colloquium on organization theory at Mannheim University, and the anonymous reviewers of Organization Studies for helpful comments on an earlier draft.

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