

ECONOMIC FUNCTIONS OF MANAGEMENT CONSULTING FIRMS - AN INTEGRATIVE THEORETICAL FRAMEWORK

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INTRODUCTION

Although the advent of modern management consulting firms can be traced back to the 19th century, management consulting has come to the fore as a distinct service industry within the last three decades (McKenna, 1995; Wooldridge, 1997). However, hardly any other profession is more liked and disliked, envied but also trusted at the same time (Huey & Davis, 1993). But criticisms of consultancies are not merely fuelled by envy. Clients complain that consultants' competencies are rarely as high as promised, social and emotional skills are scarcely recognizable, advice given, and results accomplished do not correspond with raised expectations and charged fees, as well as that consultants would spend most of the time on identifying new problems than on those they have been contracted for (Anonymous 1996; Pinault 2000). But since that service has been and is being demanded at high levels, the institution "management consulting" must be able to fulfill some economic functions more efficiently than other organizational forms. Despite there is a growing research interest in consulting, so far there are only fragments of comprehensive theoretical explanation of the phenomenon. In our paper we address that lack of an integrative framework and discuss, what functions do management consulting firms at distinct levels of economic activity fulfill as well as which theories explain, why these functions are accomplished more effectively by specialized organizations rather than by the firm itself.

LITERATURE REVIEW

When examining the term management consulting, it is difficult to derive the term's substance by looking at the contexts in which it is used. The majority of publications dealing with management consultants are explanatory and provide different kinds of categorization (except e.g. Canbäck,

1998). Analyzing recent categorizations of management consultants' tasks (e.g. Anonymous, 2000; Bower, 1982) reveals, that reasons mentioned for contracting an external consultant can be related to three decisive issues in management decision making. The first issue is the management *capacity* for information gathering and analysis, that may be extended as consultants e.g. "have time to study the problems" and "have additional expertise". Consultants' *experience and specific knowledge* can be considered to be another issue, e.g. allowing to "see where you stand", to "transfer knowledge from other industries", to "avoid reinventing the wheel" and "focusing attention". As a third issue it is necessary to recognize that consultants may *enforce decisions*, e.g. "facilitating highly politicized decision-making" when no agreement can be found without external intervention.

These issues underline the exchange function between consultant and client (e.g. Kubr, 1996). The provision of knowledge, objectivity and legitimization by consultants has also been verified empirically. A recent study revealed the reasons for taking advantage of external management consultants to be confirmation and legitimization of restructuring decisions that have already been made, assurance by an expert, insight into the latest management methods, and induction of a placebo-effect (Fretschner et al., 1998). However, a critical appraisal reveals that most analyses are descriptive or rely on somewhat arbitrary or pragmatic categorization.

INTEGRATIVE THEORETICAL FRAMEWORK

The structure of our framework is based on the aspects of management decision making mentioned before and validates these by different theoretical perspectives. We propose to distinguish three economic functions. Management consultants support management by making resources like time and capacity as well as knowledge and information temporarily available. This group of economic functions will be referred to as *resource function*. Furthermore, management consultants fulfill primary functions when enforcing management decisions. On the one hand, the consultant's reputation can be used as a signal of a decision's quality, in particular in situations when conflicting goals are present. On the other hand, management can utilize consultants as representatives or even scapegoats, in order to prevent conflicts and to protect their own reputation. These aspects will be summarized as *enforcement function*. Last but not least, a rather indirect economic function emerges by management consultants' activities. That will be referred to as *mediator function*.

In order to explain the economic functions of management consulting, we suggest three levels for analysis. On a macro level the mediator function of consultants is apparent. Arguments of institutional theory are particularly helpful here. The main interrelation between consulting firms and clients is assigned to the intermediate level. Here especially the resource function is relevant and organizational economics seems useful for theoretically based analyses. At this level we deliberate three aspects in particular: (a) specialization, which is relevant because of the general knowledge generated by consulting companies, (b) coordination by providing external flexibility, and (c) focus as a consequence of discretely set goals as well as contracts. The third level of our framework integrates organizational phenomena on the individual level of decision making and enforcement. Cognitive and psychological findings, which are embedded in organizational theory, can be useful in providing comprehensive explanations for economic functions. An integration of these levels of perspective and analysis leads to a general framework, which opens up starting points for further differentiation as well.

Providing Resources

Management Consultants as Knowledge Providers. Within the transaction cost perspective (Williamson, 1979) consultancies will only create additional value for a client organization, if they provide non-specific, general knowledge to them. Such non-specific knowledge is beneficial for professional and problem-related issues, if it involves experiences made by others and/or enables comparisons. Permanent exposure to many different problems and situations in a number of different industries, can be considered the main characteristic and at the same time the unique advantage of consultants (Drucker, 1979).

The provision and accumulation of knowledge, which is not specific to any client firm, leads to specialization of a different kind for the management consultant firm. External consultants will be able to market only knowledge that promises an appropriate solution for individual organizations and at the same time can be used for serving different clients. Extending the transaction cost based reasoning, it becomes obvious that consulting companies will develop standardized concepts and meta-competencies for management problems and corresponding solutions (e.g. overhead-value-analysis by McKinsey or the well known BCG-Matrix). Further on, specialization in identifying management problems and in developing methodical solutions (economies of scope) associated with scale advantages due to repeated use of standardized methods (economies of scale) allow management consultancies to achieve a greater degree of efficiency than any single firm would be able to acquire (Canbäck, 1998). The less firm specific a management task seems to be, the more efficient is c.p. an external procurement strategy. The recent dominant view on core competencies supports this argument (Wooldridge, 1997).

Management Consultants as Flexible Resource. From the perspective of the client organization the option to buy management capacity and know-how temporarily is efficient for non-repetitive, occasional and unique tasks. It reduces the need to reserve human capital for any possible management need. Hence, for a client organization, management consulting companies represent a flexible resource to respond to tasks characterized by ad-hoc character and a high degree of uniqueness. Particularly large international management consulting companies may function as a resource pool. They are able to buffer irregular and stochastic changes in customer demand due to their bundling and balancing function.

That phenomenon is amplified by the general trade-off between standardization and flexibility. Due to economies of scale, organizations tend to develop routines and standards. Quite recently, internal management capacities have been reduced drastically, mainly because of increased external pressure put on management to improve productivity. While outsourcing of capacities often results in a better productivity ratio, as for instance sales per employee, corresponding cost of outsourcing contracts remain neglected. If managers' performance evaluation schemes are tied to such productivity measures it does not come as a surprise, that managers reduce organizational staff positions and instead employ external consulting companies. It may be seen also as a part of a general trend to externalize the workforce (Scott, 1998).

Management Consultants as Task- and Goal -Focused Agents. Utilizing external capacities may not only enhance a firm's flexibility. Little attention has been paid yet to incentive matters when

considering management consultants. Three lines of thought can be expressed. (1) One may assume that hiring a management consultant results in a higher degree of focus on the respective task. Transaction cost theory relates the existence of organizations to uncertain environments. In this case authority- and hierarchy-based systems may be more efficient, since external contracting is impossible or far more expensive. The draw-back is, however, that organizational incentive systems usually contain large implicit parts and cannot be adjusted to specific and especially to temporary goals fast and easily. Engaging an external consultant with a different incentive scheme may help to reach temporary goals without changing the systems in place for the employees of the firm. (2) Within an internal hierarchy, principals can change tasks and priorities of their employees permanently based on their power of command. As far as task fulfillment and performance are determined by and measured according to the consulting contract, a reduction of principal's propensity to ad-hoc deviations, interruptions and permanent changes of tasks could be expected. Thus, consultants should be c.p. more efficient than employees, who have to handle a larger spectrum of tasks that may change frequently and unforeseeably. (3) One may suppose, that consultants' goals correspond to a higher degree with corporate goals than those of employed managers. Theoretically, management consultants may have lesser potential for opportunism, if (a) they possess not as much discretion as managers, (b) no counteracting forces are at work and (c) the company is able to impose specific sanctions. Explicit contracts, time restricted cooperation, reputation effects and a higher intensity of competition between consulting firms should c.p. discipline consultants. Unfortunately, these assumptions may not hold in reality. First, there are clear indicators of extensive discretion especially for top management consultants, which enables them to pursue their individual, self-serving goals even if they are at odds with the goals of the client organization (Anonymous, 1996; Pinault, 2000). Second, the assumptions ignore the multi-level principal agent structure embedded in the example. If managers - which are (theoretically) accused of opportunistic behavior - mandate consultants, the positive effects outlined before may be moderated and agency problems may increase instead of decrease.

Decision Enforcement

Some organizational theorists stress that power structures and negotiation processes within organizations are main causes of and explanation for many managerial decisions (e.g. Pfeffer, 1981). This theoretical approach may also apply for consultant engagements.

Management Consultants as Certifier. Both the quality of management in general as well as decision making relies on the implementation of the decisions made. In order to convince powerful interest groups, explanation or rationalization of managerial decisions must correspond with prevalent patterns of perception and interpretation as well as the decision frames (Krogh & Grand, 1999). Additionally, it is important to recognize strategic management decisions to be usually ambiguous and heuristic. Applying the notion of search, experience and credence goods (Darbi & Karni, 1973; Nelson, 1970), management decisions can be classified as experience and credence goods. Therefore, the reputation of decision makers or supporters may serve as a indicator of decision's quality (substitute). In this respect, management consultants become means to enforce the favored alternative by providing an accepted, sometimes unquestionable reference. Thus the phenomenon of extremely high fees charged by top management consultant firms can be related to another explanation. From the client's perspective, the value of the

consulting service is not based on pure productivity of the work. Clients may be willing to pay more for a higher signaling quality, when facilitating the enforcement of their interests.

Consulting as a Symbolic Act – the “Placebo”-Function. Closely related to the significance of signals in conflict situations is the fact that purely symbolic actions have real consequences for human behavior (Pfeffer, 1981). The decision to hire an external consultant may signal concern about employees and about survival of the organization. Engaging consultants may also serve to mollify dissatisfied groups and thus prevents de-motivation and low performance or helps to reduce conflicts. Some authors compare this tactic to placebo medication.

Management Consultants as “Representatives”. Finally, in highly politicized decisions agents may be used or misused as representatives (Bonazzi, 1983). Since management consultants do not belong to the company, responsibility for certain decisions and their consequences can be attributed to them. In order to prevent a loss of personal reputation within the social community of the company, as well as a loss of personal market value, managers may hire consultants especially for risky, difficult or unpopular tasks and decisions such as lay-offs. If consultants fail or third parties complain about unfair treatment, insufficient consideration of their goals, or wrong decisions, managers may blame it on the consultants making them scapegoats. However, if consultants are successful, managers can at least claim to have hired the right consultants or they can even claim the success their own achievement.

Derivative Mediator Functions

The functions discussed so far, relate to direct consultant-client relationships. Additionally, as we have indicated above, economic effects deriving from the consulting industry as a population can be identified. These functions are the result of complex, reciprocal, and dynamic processes.

Selection Areas for Management Talent. A selective theory-based explanation of the growth and relevance of consulting companies focuses on the sophisticated recruitment and tournament-oriented career systems of consulting companies. Referring to institutional economics, it is argued that these systems are characterized by specific economic advantages in screening and sorting human capital. Additionally, the universal qualification top management consultant firms provide to their consultants, enables resigned consultants to adapt to and match the requirements of the management of other organizations quite easily.

Boundary Spanning. Besides providing methodological and related procedural knowledge, management consulting companies fulfill the important function of transferring and spreading knowledge between organizations and industries. General information on other industries, competitors, market structures, technological advancements etc. are at first non-specific and can be used repeatedly. Only through filtering, adapting, and interpreting provided information the general information becomes firm specific. Perceiving consulting companies as institutions that span boundaries between companies (Scott, 1998), lays ground for another explanation for the growth of the management consulting industry.

Knowledge Intermediation between Business Practice and Management Research. Management consulting firms also act as intermediaries between business research, and university education

and the practical application. On the one hand, by recruiting top university graduates management consulting firms have access to state-of-the-art theoretical management knowledge. The application of the real-option approach promoted by McKinsey's Strategy Metrics Initiative (Leslie & Michaels, 1997) and hence its popularization can serve as a recent example. On the other hand, management consultants are often much more exposed to current management problems and requirements than researchers. The articulation of practical problems can serve as a starting point for scientific research and theory building. The hypothesis of an economical intermediary function is supported by an increasing scientific acknowledgement of consultants periodicals (e.g. McKinsey Quarterly) and the acceptance of articles written by consultants in well-known management journals. Nevertheless, this knowledge transfer role is not undisputed, because of a large difference between the objectives and knowledge basis of practitioners, consultants, and scientists (e.g. Kieser, 2001). It is open to discussion, however, whether a complete knowledge transfer is intended by firms searching for consultants advice.

SUMMARY

Based on various works we comprehensively explored distinct forms of economic functions that management consultancies fulfill. The complexity of analyzing consultancy requires more than one theoretical perspective to identify, describe, and explain interdependent elements of social systems. To a large extent, the functions mentioned are interdependent and non-exclusive. Therefore we suggest three areas for further research. First, we encourage other authors to challenge and enhance our framework by integrating perspectives and organizational theories we might have neglected. Secondly, the arguments we offered have to be translated to propositions and hypotheses to enable empirical testing. Furthermore, as studies on cultural phenomena in the organizational environment show, accepted norms, beliefs and values influence decision making and enforcement due to interpretive considerations. Therefore this field of research could additionally provide interesting insights that improve our knowledge about the economic function of management consultants.

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