INTRODUCTION

Making a Career of Consulting

Soon after I began teaching strategy at the University of Oxford's Saïd Business School, one of the MBAs whom I supervised came to talk with me. The economic downturn in 2000 had left most of the business school students scrambling to find jobs when only a year before they would have been considering offers from several well-known employers. The student began by describing his work experience; he had served as a general manager both in his family business and also in another traditional company before he decided to pursue an MBA. The man, in his mid-twenties, explained that he was having a difficult time finding a job in either a management consulting firm or in an investment bank because neither group of professional service firms was hiring during the current recession. Did I have any suggestions or contacts that I could offer him?

My initial response was simple and reasonable, or so I thought. Given his work experience and the fact that he was so clearly a superb general manager, why wasn't he looking for a challenging job within an industrial company that would suit his newly acquired "Master of *Business Administration*" degree? The student smiled at me and indulged my naïveté by replying that if he had really wanted another job in industry, why would he have spent all that time and money to acquire an MBA? The MBA, after all, was the *de facto* qualification for an elite position within a professional service firm and, therefore, a job in general management was obviously a waste of the potential value of his hard-earned degree.

I soon recognized both how common this perspective is among business school students and how the faculties in business schools persist in deluding themselves that their central purpose is to train MBAs to enter large industrial corporations.[1] By the late 1990s, at a time when the career placement services within the leading business schools were mostly helping students to enter either management consulting or investment banking firms (to be fair, some students also wanted to work in high-technology startups, venture capital firms, and hedge funds), traditional management theorists like Peter Drucker no longer had any illusion that the faculties in business schools still believed that they could make management a "true profession."[2] Instead, business school degrees had come to certify that these quasi-professionals were qualified to advise corporate executives on their strategy (management consultants), their financial structure (investment bankers), or both (venture capitalists). Although business school faculty may originally have hoped to create a new "profession of business," by the end of the twentieth century, the leading professional service firms had first captured, and then redirected, the elite business schools to serve the specialized needs of their own quasi-professions.[3] Where the American reformer Louis Brandeis had once argued that business would ultimately become its own profession, now the self-regulated, business professionals saw their MBA as the most effective way to distance themselves from direct competition with the nonprofessionals who actually managed the large corporations.[4]

In 1999, just before the decade-long expansion in management consulting was about to crash, cultural critic Nicholas Lemann mused in *The New Yorker* about what he called an extraordinary "development" in the history of Western culture. As Lemann argued, the United States had decided, "in effect, to devote its top academic talent to the project of streamlining the operations of big business," by directing its best and brightest students into management consulting.[5] Just as perplexing, in Lemann's words, was the fact that "if the old disrepute of business in elite universities is now suddenly gone, then why shouldn't young graduates just go all the way, and work in actual companies instead of consulting firms and investment banks?"[6] Lemann's question cut to the heart of my exchange with the graduate student in Oxford: just how had it come to pass that nearly one-third of the top MBA graduates and one-sixth of all elite undergraduates (whether at Oxford or Yale) now began their working lives as management consultants?[7] What explained the remarkable dominance of the world's newest profession?

Nicholas Lemann's own answer to the question of why management consulting had come to assume such importance in American society was less theoretical than pragmatic. In Lemann's view, the best students were drawn to jobs in the elite consulting firms because these firms offered students, "that odd upper-meritocratic combination of love of competition, herd mentality, and aversion to risk."[8] Where law (in America) or accounting (in Britain) had once been the means further to burnish the credentials of those graduates who were uncertain of what to do next, management consulting now fulfilled that role. In other words, for those students who couldn't yet decide what to do with their lives, but did not want to appear directionless, management consulting promised the credentialed path to future glory.[9]

To be fair, however, students were following the advice of career surveys that showed that management consulting offered a relatively secure way to achieve corporate success. In August 1999, only two months before Lemann's critique appeared, *Fortune* magazine ran a feature comparing the relative success of General Electric and McKinsey & Company in training chief executive officers (CEOs) to lead other organizations. The "CEO Super Bowl," as *Fortune* named their imaginary competition, resulted in a tie for the stock performance of the five companies led by the alumni of the two institutions but *Fortune's* calculations also demonstrated that the partners at McKinsey & Company produced many more CEOs, and far more quickly, than the executives in General Electric, which was then the world's largest corporation.[10] The differences were even starker if one focused on the details of specific CEOs, for although General Electric had trained the future leaders of Allied Signal, Stanley Works, and Owens Corning, by 1999, former consultants from McKinsey ran IBM, Morgan Stanley, American Express, Delta Airlines, and Polaroid to name only the very best-known organizations.[11] As *Fortune's* charts illustrated, the total market capitalization of the five companies managed by CEOs who had started at General Electric was less than 15 percent of the value of the five companies controlled by former consultants from McKinsey & Company.[12] Not coincidentally, by 1997, surveys showed that in both America and Europe, management consulting had become the top career choice for graduates and that a position within McKinsey was considered the dream job on both continents.[13] By the end of the twentieth century, an entry-level position in a management consulting firm was not only a safe job to accept after completing a university degree, but a partnership within one of the elite management consulting firms had become the preferred path for promotion to the very highest executive positions throughout the world.[14]

Of course, neither Nicholas Lemann nor the journalists at *Fortune* argued that management consulting had always been so powerful a force in Western societies. Indeed, either implicit or explicit in the journalists' analysis was the question of just how this relatively new group of quasi-professionals – generally less well understood than other business professionals such as lawyers, accountants, and investment bankers – had come to command such prominence within such a short period of time. Less than forty years earlier, in 1962, the managing partners of the top management consulting firms had felt that it was necessary to explain to the MBAs at the Harvard Business School just why they would want to join one of the leading consulting firms and just what, more precisely, was actually involved in pursuing a career in management consulting.[15] As Marvin Bower, then the Managing Director of McKinsey & Company, explained in the Harvard Business School's *Career Guide*, "management consulting firms – which are rapidly emerging as members of one of the newer professions – help top management executives of businesses, governmental units, institutions, and other organizations solve their major management problems."[16] All of the other leading consultants who contributed to the 1962 Harvard *Career Guide* – Richard Paget, D. Ronald Daniel, Leonard Spacek, and Bruce Henderson – echoed Marvin Bower by declaring that this new profession would continue to grow rapidly in the years ahead.[17] For those who became consultants, whether in the 1960s or the 1990s, the future seemed particularly bright even if no one knew just how this had happened quite so quickly.

It was no coincidence that Marvin Bower of McKinsey & Company described management consulting as "one of the newer professions" when he addressed the MBAs at Harvard in 1962. In particular, Bower was a leading advocate of the ongoing professionalization of management consulting and professional status was a constant topic of concern as consultants gained economic and cultural status. Yet management consulting never achieved full professional status during the twentieth century. The *double entendre* in this book's title, "The World's Newest Profession," plays off both the longstanding perception that consulting is an emerging profession and also the widespread public apprehension that the advice proffered by consultants constituted little more than corporate pandering. Both elements, as I argue throughout this book, were long-standing concerns in the evolution of management consulting firms and in consultants' continuing quest for both autonomy and respect. In particular, as long as both insiders and outsiders to consulting accepted that the profession was still young, management consultants could dismiss any perceived ethical failings as symptomatic of the profession's adolescent development.

If immaturity shielded consultants from direct criticism, however, consulting's "newness" could not assuage the public's recurring concern over the particular role of consultants; a question of whether consultants primarily offered their clients legitimacy or some more tangible form of knowledge. The importance of legitimacy and knowledge varied from assignment to assignment and from decade to decade, with the two sometimes in harmony and sometimes in opposition. For example, in America during the 1930s and the 1990s, the legitimating function became consulting's most important role, often exceeding the importance of knowledge transfer, while in Europe, during the 1960s, legitimacy and knowledge transfer generally went hand in hand as consultants carried new organizational structures to European corporations. The oscillation of these two functions, as they varied in importance over time, continually shaped the historical development of management consulting during the twentieth century.

But before consultants could worry about their reputation or role, they first had to create markets for their services and to defend those new markets from rival professional groups. The historical explanation for the dominance of management consulting, as it turns out, was not to be found in the pragmatic choices of university graduates, but in a set of regulatory changes in America during the 1930s, the 1950s, and the 1980s that were bolstered by the strategic development of new markets by the leading management consulting firms. American antitrust regulation shielded early consultants from competition from rival professionals even as entrepreneurial firms created new lucrative practices by concentrating on particular market segments, like nonprofits or the state, or by installing specific organizational techniques, like the multidivisional form or information technology. This regulatory history helps to explain why most of the leading management consulting firms in the world are American in contrast to the other business professions, like law or accounting, where state regulation did not favor one geographic market over another. Remarkably, the regulatory history returned to haunt management consulting firms at the end of the twentieth century because corporate board members had come to rely so heavily on professionals to reduce their corporate liability. Throughout the twentieth century, state regulation, as much as institutional innovation, first shaped and then reshaped the evolutionary path of management consulting.

The historical answer to Nicholas Lemann's implicit question – "just how had the leading management consulting firms come to achieve such a dominant economic and cultural position?" – is the subject of this book. In the early twentieth century, before management consulting even existed, there was a need for management advice and a nascent professional setting in which that counsel was offered. The first chapter, then, is a "theory of management consulting" that is both consistent with modern economics and yet rooted in historical institutions. Before I can explain how consultants came to exert such enormous influence on the modern world, I must first answer the question of why management consulting firms even came to exist. We turn to that question now.

ONE

Economies of Knowledge

A Theory of Management Consulting

In 1930, *Business Week* introduced its readers to a new professional service: management consulting. As the writers at *Business Week* explained, the existing system of business professionals had become so complicated that, according to James McKinsey at the University of Chicago, a new type of professional was "increasing in numbers and influence . . . the advisor that tells business what other advisors to use and when."[1] Although *Business Week* would go on to chronicle the rise of management consulting over the next seventy years, consultants struggled to explain to the public what service they performed, particularly as the world's newest profession kept expanding faster than the wider American economy.

Since the 1930s, observers have repeatedly been surprised by the growth of management consulting.[2] In 1965, *Business Week* commented with astonishment that there was one consultant for every hundred salaried managers. By 1995, the ratio stood at one for every thirteen.[3] "Will the growth of consulting finally stop," people were prone to ask, "when every manager employs their own personal consultant?" The sheer number of consultants nowadays may be striking, but their relative increase is particularly interesting when one wonders, following Peter Drucker's lead: "Why management consultants" at all?[4] In other words, why should executives routinely employ outsiders to advise them on administrative issues about which they, presumably, are themselves the experts? Or, following the language of economists, why do executives employ external advisors to span the boundaries of the firm?

Analysts trying to explain the phenomenal growth of management consulting have traditionally tied the field's expansion to the overall growth in the American economy, the impact of international competition, and the complexities of modern management. Their interpretation is not wrong – consultants have prospered during periods of economic expansion and suffered during economic recessions.[5] But generalizations about increasing global competition and the complexity of management cannot fully explain the relative growth of consulting over other administrative roles. Consider, for example, a leading consultant's explanation of the growth of consulting: "You have to be bullish about consulting. It thrives on change and this is an era where change is accelerating."[6] Many consultants would have agreed with this explanation of the growth of consulting in 1999, but the statement was also true in 1969, when the consultant uttered those words. And a similar description would also have been true thirty years before that when, in 1939, Marvin Bower refounded McKinsey & Company. How else could McKinsey & Co.'s phenomenal growth be explained (an average 47 percent increase in profits per year between 1939 and 1944), if not through the accelerating need for consultants to help executives in an increasingly complex world?[7] As these examples suggest, any explanation of the growth in management consulting must be sensitive to exogenous changes in the economy and to the impact of global competition, but scholars cannot explain the remarkable run of management consulting solely through economic complexities and global change. Instead, in order to understand their growing influence on the national and international economy, we must first understand why consultants exist and how consultants outmaneuvered their professional rivals. Subsequent chapters in this book will build on this approach, charting the institutional impact of the rise of management consulting during the twentieth century. Before I describe the widespread influence of consultants, I must first set out why it is that outside advisors exist.

Peter Drucker's question, "Why management consultants?" echoes economist Ronald Coase's famous question, "Why are there firms?"[8] The two questions parallel one another because, at their heart, they challenge the traditional view of economists, "that firms might be envisaged as islands of planned coordination in a sea of market relations."[9] Because the two questions are so similar, it is not surprising that their explanations are also interconnected.[10] Ronald Coase's answer to his own question is that entrepreneurs create firms in order to reduce transaction costs (defined by economists as the cost of the administration of contracts and other relationships between separate firms). This partly helps to explain why executives are so willing to hire outside consultants.[11] As Coase argued, long before the widespread acceptance of management consultants, not only do firms routinely face the decision of whether to "make or buy" their physical goods, but "we can [also] imagine a system where all advice or knowledge [is] bought as required."[12] Like the process that drives manufacturers to buy materials from lower cost vendors, suppliers of management information enjoy substantial "economies of knowledge" that are, in turn, passed along to their customers.[13] Within the transaction cost framework, an executive decision on the margin to purchase advice from a consultant is no more outlandish than the decision to purchase machine tools rather than fabricate them internally.[14] The nature of the firm, it turns out, defines the nature of the consultant.[15]

The Utility of Outside Advisors

Administrators have employed outside advisors for thousands of years, but their counsel has traditionally been political, not