The Economics and Sociology of Management Consulting

Management consultancy is a key sector in the economic change toward a service and knowledge economy. This book explains the mechanisms of the management consulting market and the management of consulting firms from both economic and sociological perspectives. It also examines the strategies, marketing approaches, knowledge management, and human resource management techniques of consulting firms. After outlining the relationships between transaction cost economics, signaling theory, embeddedness theory, and sociological neoinstitutionalism, Thomas Armbrüster applies these theories to some central questions. Why does the consulting sector exist and grow? Which institutions connect supply and demand? And which factors influence the relationship between clients and consultants? By applying both economic and sociological approaches, the book explains the general economic changes of the past thirty years and sharpens the relationship between the academic disciplines.

Thomas Armbrüster is Professor of Business Administration in the Department of Management and Economics at Witten/Herdecke University, Germany.

The Economics and Sociology of Management Consulting

THOMAS ARMBRÜSTER

CAMBRIDGE
UNIVERSITY PRESS

CAMBRIDGE UNIVERSITY PRESS
Cambridge, New York, Melbourne, Madrid, Cape Town, Singapore, São Paulo

Cambridge University Press
The Edinburgh Building, Cambridge CB2 2RU, UK

Published in the United States of America by Cambridge University Press, New York

www.cambridge.org
Information on this title: www.cambridge.org/9780521857154

First published 2006

Printed in the United Kingdom at the University Press, Cambridge

A catalog record for this publication is available from the British Library

ISBN-13 978-0-521-85715-4 hardback
ISBN-10 0-521-85715-5 hardback

Contents

Figures

Cambridge University Press
978-0-521-85715-4 - The Economics and Sociology of Management Consulting
Thomas Armbruster
Frontmatter
More information

Tables

Preface and acknowledgments

THIS BOOK on management consulting is based on several sources of inspiration, and it is hard to say which the most important one has been. A first source was my own employment as a management consultant, first at a medium-sized information technology (IT) and organizational consultancy in Berlin, then at a small mergers and acquisitions (M&A) consulting firm in London, and eventually as a summer associate at a large strategy consultancy. The vicissitudes of these firms inspired my interest in management consulting as an academic topic, and after completing my PhD thesis on a different subject I started doing research on the advice sector. Without personal involvement in the consulting sphere and the insights gained there, I would have been unable to write the book.

A second source was my journey between academic disciplines and exposure to the ongoing discussion between economics and sociology. As an undergraduate and graduate student in management and industrial engineering, I attended lectures and tutorials in micro- and macroeconomics. I was disappointed by them and felt that daily newspapers and weekly magazines taught me more about the economy than the models I learned at university. I felt that these models, and thus economics as an academic discipline, were mere skeletons that contributed little to the explanation of ongoing events in the real world. Courses such as organizational behavior provided much more stimulation for me, and I finished my first degree by focusing on behavioral aspects without economic modeling.

In the course of my PhD thesis I came to be familiar with sociology in general, and with the British, critical tradition of economic sociology in particular. At the time, I perceived sociology as a relief. After all, academics were able to see the world as it is rather than as some models assumed it would be, and the application of sociology to management consultancy matched some of my experiences as a consultant. During and shortly after finishing my PhD thesis I was interested in the critical tradition of sociology and applied these ways of thinking to management consultancy.

At some point, however, I felt that many approaches to consultancy in the critical tradition of sociology overdid it. The denial of prudent and informed calculation on the clients' side, and the preoccupation with what I came to consider oversocialized views, drove me back to look at market mechanisms and cost considerations as outlined in institutional economics and US-based economic sociology. Books such as Swedberg's (1990) interviews with economists and sociologists, and the tension between these two disciplines, became my fascination and motivated me to look at consultancy along this line. I relearned institutional economics autodidactically as far as possible and enjoyed comparing it to economic sociology.

The list of sources of inspiration would be incomplete if I did not mention the people with whom I had many discussions about consultancy and who influenced my thinking. In the earliest stage of my research I benefitted from many conversations and a first joint conference paper with Raimund Schmolze, a friend for many years. Later on, Johannes Glückler and Matthias Kipping became the most important colleagues on the consultancy topic. Matthias was the head of a research team with the EU-funded project 'The Creation of European Management Practices' (CEMP). When I joined the team, Matthias had already published widely on the history of management consultancy. He introduced me to the literature and we started publishing together. A revised version of a common article by us has become chapter 6 of the present book.

Johannes drew my attention to embeddedness theory, and after this discovery we dived into US-based economic sociology and published a paper together, which I have shortened and revised to become chapter 3 of this book. In the meantime, he has published subsequent research on consultancy based on embeddedness theory (Glückler 2004, 2005, 2006), in which he has extended the notion of reputation networks to a geography of reputation. I am grateful to both Johannes and Matthias for our frequent discussions on consultancy, for the time we spent together writing papers, and for their permission to use revised versions of co-authored articles as chapters of this book.

In the organizational behavior section at the University of Mannheim I could develop many ideas, and did most of the writing. Its director, Alfred Kieser, gave me the freedom to co-assign topics

for diploma theses, and I had the pleasure of supervising highly talented graduate students, some of whose results have been integrated in this book. Christoph Barchewitz wrote an excellent piece on the marketing of consulting services, which we published as a German-language paperback and on which chapter 7 of this book draws. Judith Eichner wrote on careers and women in consultancy, and her interviews with female consultants nurtured a section of chapter 9. Sebastian Wind wrote a fine piece on internal versus external consultancy and his interviews informed chapter 5. I am thankful for and proud of having cooperated with them.

I also benefitted a great deal from visiting stays at the Scandinavian Consortium for Organization Research at Stanford University, and at the Department of Economics and Business of the University Pompeu Fabra, Barcelona. In these institutions I presented papers, discussed ideas, and learned a lot from colleagues and their comments. At Stanford I could also conduct interviews with clients and consultants in the Silicon Valley and San Francisco. A grant from the Stiegler Foundation in Mannheim enabled my visiting stay at Stanford; the MBA program at Pompeu Fabra hosted my stay in Barcelona. The support of these institutions is gratefully acknowledged.

A previous version of the manuscript was accepted at the Department of Economics and Management of the Technical University of Berlin as a formal qualification for full professorships at German-language universities (*habilitation*). I am grateful to the dean and faculty members for the uncomplicated procedure, especially to Diether Gebert and Hans Gemünden, who were important advisors. Diether Gebert was my most important mentor over many years; his support involved many more issues than just research.

As the final manuscript was taking shape, Henning Piezunka, Johannes Glückler, Achim Oberg, Christoph Barchewitz, and Sebastian Wind read it, or large parts of it. They provided additional ideas and literature sources, and they helped to clarify and sharpen my arguments. Katharina Mol edited the manuscript patiently and accurately. Chris Harrison, Katy Plowright, Lynn Dunlop and Paula Parish of Cambridge University Press steered the work through the review and production processes. I am grateful to all of them, as much as to the fifty consultants and clients in Germany and the United States who were interviewed in the context of this book.

Regarding the use of revised versions of articles as chapters in this book, my thanks go not only to the above-mentioned co-authors but also to the publishers for their permissions. Chapter 3 is a shortened and revised version of 'Bridging uncertainty in management consulting', by Johannes Glückler and Thomas Armbrüster, *Organization Studies*, 24/2, pp. 269–97, by permission of Sage Publications Ltd. Chapter 6 is a revised version of 'Strategy consulting at the crossroads', by Thomas Armbrüster and Matthias Kipping, *International Studies of Management and Organization*, 32/4, pp. 19–42, by permission of M. E. Sharpe, Inc. Chapter 7 draws on 'Marketing instruments of management-consulting firms: an empirical study', by Thomas Armbrüster and Christoph Barchewitz, *Academy of Management Best Paper Proceedings* 2004, Management Consulting Division, pp. E1–E6. Chapter 9 is a revised and expanded version of 'Rationality and its symbols: signaling effects and subjectification in management consulting', by Thomas Armbrüster, *Journal of Management Studies*, 41/8, pp. 1247–69, by permission of Blackwell Publishing Ltd. Figures 2.1 and 4.1 are reprinted with permission of Kennedy Information, Inc., Peterborough, NH 03458, United States.

A few more words on the relationship between economics and sociology in connection with this book are in order. To take up Akerlof's (interview with Akerlof in Swedberg 1990: 70) notion of the interplay between economics and sociology, A + B does not always equal C but often just remains A + B. That is, trying to use both economics and sociology on the same topic does not always lead to an integrated perspective, but often simply remains economics plus sociology or sociology plus economics. The perspectives may complement each other and add up to a more comprehensive view, but they do not always amalgamate. I think this is true, but it is not a tragedy. The results of using both economics and sociology come in different shades of integration, and can in any case be used to cross-check each other. For example, regarding the question of why the consulting sector has grown so rapidly over the past three decades, economic and sociological explanations complement each other but do not necessarily merge (see chapter 2). There are several reasons why the consulting market has grown, some of which can be best described in economic terms and others in sociological terms, and there is no need to marry them at gunpoint. Discussing both economic and sociological mechanisms leads to a more comprehensive view than just discussing one viewpoint. In other words, A + B is more than A or B alone, even if they do not merge to C.

As regards other topics of consultancy, such as the mechanisms that connect supply and demand, or human resource management (chapters 3 and 9), there is more room for interweaving the two disciplines. With regard to market mechanisms, chapter 3 discusses the role of trust between consultants and long-term clients, and it is a matter of terminology and empirical research, rather than academic discipline, how much calculativeness such a relationship entails and to what extent the term "trust" applies. Moreover, sociological insights often shed light on the limits of economic efficiency, and are thus indispensable for a full understanding of market mechanisms. With regard to human resource management, I aim to demonstrate that an interweaving of economic and sociological insights leads to a better account of personnel selection and career discrimination. My intention is to show that we can learn most about an industry or market if we do not tie ourselves to a single discipline but use insights from other disciplines to question, check, or test our assumptions, methods, and results. I consider this, rather than a merger of disciplines, as the essence of scientific progress, and outline this in chapters 1 and 10 from the viewpoint of critical rationalism.

I limit the scope to two theories of each discipline: transaction cost theory and signaling theory represent the economic approach, and sociological neoinstitutionalism and embeddedness theory the sociological one. These are four central theories to deal with the increased role of knowledge and uncertainty in the economy, of which management consultancy represents a central phenomenon. In comparison to other knowledge industries, such as biotechnology, management consultancy is less research-intensive and more customer-driven, and it brings about intangible results. Only the results of IT consulting are more tangible, and the results of financial consulting are often measurable. In general, however, consulting services represent intangible and hard to evaluate resources, and involve information asymmetries between economic actors as well as uncertainties about service quality, actor behavior, and business transactions. This highlights the questions of how clients gain quality certainty and how supply and demand meet, and transaction cost economics and embeddedness theory suggest themselves as representatives of economic and sociological perspectives. Moreover, consultancy represents a market of symbolic resources and has an institutionalized market stratification. Thus it is beset with phenomena external to the immediate exchange relationship between clients and consultants, and signaling theory and sociological neoinstitutionalism deal with these phenomena explicitly. While further theories could have been added, the selection of transaction cost economics, embeddedness theory, signaling theory, and sociological neoinstitutionalism was based on a tradeoff between redundancies and gains of omitting one theory or taking a fifth on board.

In the future, an application of game theory to management consultancy may sharpen the insights gained by the theories used here. This is not only due to game theory's modeling capacities but, first and foremost, due to its capability to take up arguments from different strands. In a few sections in the book I mention game theory in passing, but, at this point of the debate on consultancy, taking game theory fully on board would have overloaded the approach. Transaction cost economics, signaling theory, embeddedness theory and sociological neoinstitutionalism all make specific and irreplaceable contributions to the current state of scholarly writing on consultancy.

Chapter 1 outlines these four theories and their relationships to each other. After this, the book is divided into three parts. Part I looks at the mechanisms of the consulting market. By "mechanisms" I mean those institutions, such as trust, power, reputation, and price, that connect supply and demand and that determine the relationship between buyer and seller. These institutions are results of the features of consulting services, especially their intangible character and quality uncertainty. Hence Part I focuses on the questions of why consulting firms exist as independent firms and why the sector grows (chapter 2), which procedures connect supply and demand (chapter 3), which factors generate power between clients and consultants (chapter 4), and in which cases internal consultancies accompany or compete with external advice (chapter 5). Interviews with consultants and clients have been integrated as far as this seemed useful for illustrating or comparing the theories.

Part II seeks to explain the drivers of managing consulting firms. By "drivers" I mean the circumstances of strategy, marketing, organization, and human resource management which lead to decisions of senior consultants and which shape the fortunes of firms. Part II relies on Part I in that it refers to the market mechanisms outlined there and explains the management of consulting firms on their basis. The individual sections then look at the strategies of large providers (chapter 6), at the marketing of consulting services (chapter 7), at organizational governance and knowledge management (chapter 8), and at human resource management in the form of personnel selection and promotion mechanisms (chapter 9). Like Part I, it keeps the presentation of empirical material at a minimum and focuses on the comparison of theories. The concluding Part III summarizes the insights gained from the multidisciplinary perspective, puts them in the context of past and ongoing shifts to a knowledge economy, and discusses the relationship between economics and sociology on the basis of critical rationalism (chapter 10).

If the details of one theory or a particular aspect of the market or of managing a consulting firm had been in the foreground, then each topic – such as the consulting industry's growth, firm strategies, or personnel selection and promotion policies – would have been worth a full book. For example, an analysis of selection and promotion policies in management consultancy could usefully have been expanded to a monograph on personnel economics (see Pudack 2004 for a useful example, in German, based on signaling theory). However, the intention of this book is a different one. It seeks to provide a theory-guided overview of consulting market mechanisms and firm management. The book limits the degree of detail for each theory and gives center stage to a comparison of theories, seeking to enhance our knowledge on individual topics and phenomena.

For each subject I select an economic perspective as the point of departure, and complement, criticize or adjust it from the viewpoint of at least one sociological theory. I put a particular question in the foreground (e.g. why does consultancy grow? Why have strategy consulting firms moved less into IT consulting than accounting firms? Why do consulting firms select personnel by case studies rather than assessment centers?) and use the theories as different or complementary tools of explanation. This specialization on topics rather than theory or method represents a phenomenon-oriented rather than paradigm-driven work. Inevitably, this comes with the risk of being sketchy or eclectic. It is a hazard we must bear if we want to reap the benefits of a theory-comparative approach.

I hope that this book attracts not only scholars of management consulting, but also a broader audience of scholars interested in the economic shifts to a knowledge economy and in the relationship between economics and sociology. The literature on the knowledge economy often refers to knowledge workers as a general phenomenon, but tends to abstract from differences between them. Hence this book seeks to specify management consultancy as a part and a result of the considerable changes toward a knowledge and service economy. If we can sensibly explain why management consulting – as a pivotal sector of these changes – has grown, how supply and demand in such a market meet, why consulting firms are managed the way they are, and how careers in such firms develop, then we contribute to an encompassing understanding of economic and social developments that affect countless professional and private lives.