

Impact of management consulting
Perspectives on value creation, performance evaluation,
and governance of the client-consultant relationship

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Gutachter der schriftlichen Promotionsleistung:
Prof. Dr. Roland Kirstein
Prof. Dr. Marko Sarstedt

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Preface

Discussions about the added value by consultants can leave all parties involved in and effected by consulting projects puzzled. While consulting companies are obviously interested in claiming substantial positive effects of their work, several critical authors have characterized consultants as overpaid quacksalvers who sell their clients useless pieces of advice. Not surprisingly, the critical attitude towards consultants is occasionally expressed on client site. Critical client managers may ask questions such as ‘What are we paying for?’, ‘What is your impact?’, ‘What will be the return on our investment?’, ‘Who is responsible in case a project fails?’ – questions which are in most cases difficult to answer.

Having worked as a consultant for several years in three different companies – ranging from a 30-employee local boutique player to a world-wide giant with over 400,000 employees – prior to pursuing a PhD, my personal interest in the consulting industry comes natural. I have been very lucky to have had the opportunity to spend more than two years of working academically in order to unravel the concept of value of consulting services and to bring together the results by means of this dissertation. For this, I am deeply indebted and thankful to a number of persons.

First of all, to Prof. Dr. Roland Kirstein for accepting me as PhD candidate and for supervising my thesis work. Many interesting thoughts have been sparked in numerous discussions with him which have had a great influence in shaping this dissertation. Moreover, I have also received highly valuable feedback by faculty members Dr. Annette Kirstein, Michael Karas, Matthias Peiß, Julia Felischak, and Mariia Shkolnykova. Furthermore, I am very thankful to Prof. Dr. Marko Sarstedt for agreeing to be the second reviewer of this thesis.

Outside of the university in Magdeburg, I would like to thank my friends Philipp Letzgus and Tim Sadler for several fruitful discussions around several aspects covered in this book. Moreover, I would like to thank Dr. Marc Baaij whose course on Strategic Management Consulting I attended in 2010/2011 at the Rotterdam School of Management and who thereby introduced me to thinking about consultants’ work and impact from an academic point of view

What has enabled me to pursue a PhD has been the support by my employer, OC&C Strategy Consultants GmbH (EY-Parthenon as of 2018). The possibility to go on a PhD leave while being funded by the company and being able to work from my desk in the Hamburg office has been a great starting condition for writing my dissertation.

Last but not least, I would like to thank my wife, Elizabeth Jöcker, my family, and my friends for their support during the time of working on my PhD.

If one person stands out in motivating me to work academically, this would be my grandfather, Klaus Schaefer. I am convinced he would have been an outstanding scholar. It was mostly due to the difficult circumstances in post-war Germany in the mid- and late 1940s that he did not have the opportunity to attend a university and pursue an academic career. Being thankful that I was given the opportunity, I dedicate this book to him.

Table of contents

List of figures and tables.....	V
List of abbreviations.....	VI
List of variables.....	VII
1. Introduction.....	1
2. Consulting: Literature Review and Synthesis	5
2.1 General background on consulting.....	5
2.1.1 Definitions, boundaries and characteristics of consulting	5
2.1.2 Development of the consulting industry	13
2.1.3 Criticism faced by consultants	19
2.2 Client organization and the relationship with consultants.....	21
2.2.1 Reasons to use consulting services	21
2.2.2 Roles within the client organization	25
2.2.3 Combined view: client-consultant relationship.....	27
2.3 Procurement of consulting services, contracts and fees.....	32
2.3.1 Procurement process for consultancy projects.....	32
2.3.2 Contract structure for consultancy projects.....	42
2.3.3 Costs of consultancy projects	44
2.4 Impacts of consulting.....	57
2.4.1 Measurements for project results and success factors.....	58
2.4.2 Consultancy impacts beyond the context of projects.....	71
3. Empirical research	74
3.1 Methodology	74
3.2 Empirical findings	78
3.2.1 Trends.....	79
3.2.2 Criticism towards consultants	80
3.2.3 Procurement and tendering	81
3.2.4 Contingency fees.....	86
3.2.5 Success factors and measurements	91
3.2.6 Emerging topic 1: Optional consulting contract.....	93
3.2.7 Emerging topic 2: Third party monitoring	93
3.3 Discussion of results.....	98
4. Temporal divisibility of fees	101
4.1 Relevant context in consulting literature.....	101
4.2 Theoretical background.....	102

4.3	The basic model.....	104
4.4	The model with a partial pre-payment	107
4.4.1	The NEV case.....	109
4.4.2	The case of initial board proposal by M alone.....	111
4.5	Summary of results.....	112
4.6	Implications for future research	113
5.	Monitoring of consulting projects.....	115
5.1	Theoretical background.....	116
5.2	Choice of monitor	118
5.3	Model of Bayesian enforcement for consulting projects.....	123
5.3.1	The consultants' choice.....	125
5.3.2	The project sponsor's choice.....	126
5.3.3	Equilibrium analysis	128
5.3.4	Implications for choice of monitor.....	130
5.4	Summary of results.....	131
5.5	Implications for future research	132
6.	Conclusion and outlook.....	135
	List of references.....	140

List of figures and tables

Figure 1: Classification of consulting services 7

Figure 2: Phases of the consulting process 9

Figure 3: Consultants' roles in a project context24

Figure 4: Summary of hiring reasons.....25

Figure 5: Agency relationships in a project context.....31

Figure 6: Purchasing process of consulting services33

Figure 7: Scenarios for hiring decisions with respect to consultants and M's interest40

Figure 8: Set-up under terminable consultancy contracts with hiring manager as ultimate client.....44

Figure 9: Assessment of contingency pay agreements by perspective55

Figure 10: Selected lists of success factors, sorted by primary locus.....61

Figure 11: Success dimensions according to Klein.....62

Figure 12: Dimensions of engagement success according to Gable.....63

Figure 13: Factors influencing the determination of net project value69

Figure 14: Basic game tree106

Figure 15: Extended game with pay-in-part option.....108

Figure 16: Inspection Game between Sponsor and Consultant118

Figure 17: Possible diagnosis skill levels of player i.....122

Figure 18: Conditional probabilities for S's believe in truthfulness of signal obtained124

Figure 19: Bayesian enforcement game124

Figure 20: Best response of project sponsor128

Table 1: Summary of empirical study by Fleischer.....57

Table 2: Sample sizes of selected empirical studies77

Table 3: Overview interview partners.....78

Table 4: Summary table interviews with consultants.....97

Table 5: Summary table interviews with clients.....97

List of abbreviations

APP	Act of Public Procurement
BCG	The Boston Consulting Group
BDU	German consultants' association; <i>Bund Deutscher Unternehmensberater</i>
CMC	Certified management consultant
EY	Ernst & Young
FMCG	Fast moving consumer goods
FTE	Full time equivalent
GDP	Gross domestic product
HR	Human resources
ICT	Information and communication technology
IROC	Idiots rights out of college
KPI	Key performance indicator
M&A	Mergers and acquisitions
NEV	Negative expected value
PEV	Positive expected value
p-i-p	Pay in part
pr	Probability
PwC	PricewaterhouseCoopers
ROC	Receiver operating characteristic
ROI	Return on investment
RQ	Research question
USD	US Dollar
WTP	Willingness to pay

List of variables¹

M	Manager
E	Opposing player of M (e.g. rest of the enterprise / employee representative)
U_M	Utility of player M
U_E	Utility of player E
F	Consulting fee
f	Function determining consulting fee
x	Project outcome
e	Effort exerted by consultants
θ	Random component
Y	Effect on E's payoff due to following M's proposal
λ	M's share in company's earnings or expenses
D	Board of directors
ω	Probability that board follows M's proposal
σ	Probability that board sanctions M, given rejection of proposal
Ψ	M's disutility due to being sanctioned
N	(Non-cash) transaction cost, indicating M's preference for earlier solution
Z	Savings due to cut in employee benefits based on consultants' recommendation
ω_c	Probability that board follows M's proposal, with consultants' engagement
σ_c	Probability that board punishes M, given rejection of proposal, with engagement
π	Fraction of consulting fee payable at Stage 0
S	Project sponsor
C	Consultant
$-\Gamma$	Monitoring cost for S
$-P$	Damage suffered by C, resulting from being caught
B	C's benefit from shirking
$-X$	Damage suffered by S due to shirking C
d	Decision by C to deliver project in accordance with agreements (good) or to cheat (bad)
g	'Good' performance by consultants
γ	Probability that C chooses 'good' performance
b	'Bad' behavior by consultants
δ	Probability that S chooses to monitor
T	Third party monitor
ρ_i	Probability of player i's observes 'good' performance by C, given that d = g
φ_i	Probability of player i's observes 'good' performance by C, given that d = b
σ_i	Reported signal by player i
η_i	Probability of player i's reported signal being 'good', given that 'good' performance has been observed
ϑ_i	Probability of player i's reported signal being 'good', given that 'bad' performance has been observed
r_i	Probability of player i's reported signal being 'good', given that d = g
w_i	Probability of player i's reported signal being 'good', given that d = b
j	Judgement by S, having obtained a signal by player i
α	Probability that judgement by S is 'bad' given that received signal was 'good'
β	Probability that judgement by S is 'bad' given that received signal was 'bad'
μ	S' believe that C has actually chosen 'good' given that received signal was 'good'

¹ Sorted by order of appearance in document.

v	S' believe that C has actually chosen 'good' given that received signal was 'bad'
G	S' benefit from correctly sanctioning a non-compliant C
-L	S' loss from correctly sanctioning a compliant C
K	Term to abbreviate notation, $K = \frac{B}{P(r_i - w_i)}$
Π_j	Payoff term of player j, $j \in (S, C)$.

1. Introduction

In both popular and academic contributions about the consulting industry, the most controversial topic appears to be the impact and value creation by consulting services. How can it be measured? Who is impacted by consulting services? In which way?

According to Sturdy (2011: p. 527) “we do not currently have an adequate basis on which to make claims about the impact of management consultancy.” This statement is rather surprising given the growth and size of the consulting industry – with an estimated market size of more than USD 390 bn (Klarner et al., 2013) – and the growing body of academic literature dealing with consulting services. The goal of this dissertation is to improve the understanding of the effects of management consulting on the most relevant stakeholders, means to measure value creation, and the governance of the relationship between client organizations – consuming consulting services – and consultants². Thereby, the academic discussion on these issues is advanced. In order to be able to do so, four main research questions are scrutinized. These are presented below, followed by a description of the structure in which they are examined in the course of the dissertation.

RQ 1: How can the value of management consulting projects be conceptualized?

Determining the value created by consulting projects requires clarity about a number of factors, such as whose perspective among various stakeholders is chosen, which time horizon is selected, which objectives are to be fulfilled, and which measurement scale is to be used. Moreover, in order to determine the net value of a project, all types of costs need to be recognized and taken into account. In discussing costs, special emphasis is put on contingency fees³, which are reported to be increasingly common in the field (Fleischer et al., 2014) despite the fact that outcomes of consulting projects, on which fees are contingent, are in many cases very difficult to measure (Glückler and Armbrüster, 2003).

The discussion of benefits and costs of consulting in this dissertation draws on several streams of literature. Apart from basic literature on consultancy (e.g. Schein, 1988, 1997; Canback, 1998, 1999; Kipping and Clark, 2012), it will further be referred to literature on agency theory (e.g. Jensen and Meckling, 1976; Shapiro, 2005), pricing (e.g. Kotler and Keller, 2006), human

² *Nota bene*: important terms commonly used to describe the interaction between management consultants and their clients, including a description of the distinction between *management consulting* and other types of consulting, are presented in Chapter 2.

³ The terms ‘contingency fees’, ‘contingent fees’, and ‘success-based fees’ will be used synonymously.

1. Introduction

resources (e.g. Shaw and Gupta, 2015; Mitra et al., 2016) and purchasing (e.g. van Weele, 2005; van der Valk and Rozemeijer, 2009).

In order to contrast the literature-based discussion with the current situation in the industry and in order to identify emerging topics which have thus far not received enough academic attention, an empirical study has been conducted as part of the dissertation. The motivation behind the empirical research is to answer to following question:

RQ 2: To which degree are predictions of the literature concerning the relation between clients and consultants and the governance of this relation in line with statements by practitioners and which aspects have not yet been regarded from an academic point of view?

A total of 17 interviews with insiders from the field have been conducted and the findings are contrasted with the body of literature. As “the empirical research on [...] consulting services is in an early stage“ (Sieweke et al., 2012: p. 124), which is mainly due to the fact that access to consulting companies and their project partners is usually difficult to achieve (Mohe, 2011), the information obtained from the conducted interviews can help to broaden the research base.

In terms of topics which have not been previously covered in the body of academic literature, two were of special interest. The first aspect is the existence of what is referred to as ‘optional consulting contract’. Under this contract, a consulting company offers a certain amount of time of its professionals to its clients against a pre-payment. This capacity can be retrieved over a certain period of time in the form of a consulting project. In case no such project is initiated, the pre-paid fees are sunk. Agreeing to such a contract model may appear counter-intuitive from a client’s point of view. However, it may be beneficial for individuals within the client organization to enter in such a contract. Under which conditions this is the case remains to be discussed. The hypothesis is that such a contract can be used strategically by individual actors in a client organization to their advantage over others. Thus, the question to be answered can be formulated as:

RQ 3: Can a divisible, pay-in-part consulting contract be a device to change the balance of power between intra-firm shareholders?

The second aspect which has thus far not been dealt with in the literature is the provision of external monitoring services for consulting projects. The goal of such a monitoring is to create a performance rating for the consultants’ work which, in turn, may be used in order to determine

1. Introduction

whether and to which degree contingent fees need to be paid by the client organization. Such a monitoring, as has been claimed by the provider of such services in the respective interview, can induce consultants to put forward the amount of effort which has been contractually agreed upon.

From the point of view of a project sponsor⁴, being faced with the offered services by an external monitoring specialist, an important question will likely be:

RQ 4: Under which conditions should a third party monitor be engaged in a project setting?

Research questions 3 and 4 will be answered primarily using game theoretic modelling – an approach that has been hardly used in the discussion around management consulting as of yet.

This dissertation is structured as follows. Chapter 2 lays out the theoretical background, including the definitions, characteristics and boundaries of consulting services, as well as the industry's history and development, and an overview of the main points of criticism faced by consultants. Moreover, Chapter 2 discusses the relationship between clients and consultants, the procurement of consulting services, along with the respective contracts and fee agreements. The literature-based chapter concludes with a summary on the effects of management consulting projects (answering to RQ 1) as well as beyond the direct project context.

After describing the methodology used for the empirical study, Chapter 3 presents the obtained results from the series of interviews and contrasts them with the current state of the literature (in response to RQ 2). This leads to the identification of research gaps which are taken into account in RQ 3 and 4.

Chapter 4 is devoted to analyzing the concept of a partial prepayment and especially on the effect of the balance of power within the client organization (answering to RQ 3). As will be shown, it may be the case, that individual decision makers can improve their position within their organization by agreeing to such a contract with management consultants. By describing the conditions under which this is the case, the model offers a possible explanation for the existence of 'optional consulting contracts'.

⁴ I.e. the individual within a client organization initiating a consulting project.

1. Introduction

In Chapter 5, the newly observed offering of external monitoring services for consulting projects is scrutinized. Answering to Research Question 4, it is examined if and under which conditions a project sponsor ought to decide to hire a third party monitor instead of choosing alternative options. Chapter 6 summarizes the findings and conclusions.

2. Consulting: Literature review and synthesis

This chapter is devoted to providing a thorough overview on the consulting profession and industry (Section 2.1), the interaction between the organizations sourcing consulting services and consultants in general (Section 2.2) as well as the governance of the relationship in particular (Section 2.3). Section 2.4 sums up the discussion on the impacts of consulting.

2.1 General background on consulting

In order to build a basis for the discussion about consultants, their interaction with clients, and the respective impact of their work, this section is designed to familiarize the reader with the relevant background knowledge. This includes a discussion about how to define the term “consulting” as well as factors which characterize consulting services (2.2.1). In order to further deepen the reader’s understanding, the history, status quo and an outlook for the consulting industry are discussed (2.2.2). The section concludes with a review of common criticism expressed towards consultants (2.2.3), hinting at doubts about the value which consultants add by means of their work – a discussion which will be further detailed in later sections.

2.1.1 Definitions, boundaries and characteristics of consulting

In his 2011 paper, Andrew Sturdy points out that “in order to assess the impact of management consultancy, it is important to clarify its nature and boundaries” (Sturdy, 2011: p. 523). While a comprehensive definition of the subject under scrutiny is without a doubt very useful, there is no commonly accepted answer to the question of how to define management consulting (Gross and Poor, 2008; Ajmal et al., 2009; Baaij, 2014).

The fact that the task of finding a precise and generally accepted definition of business consultancy has been repeatedly referred to as “problematic” (e.g. Kipping and Clark, 2012: p. 2) in the literature is mostly explained by the lack of regulation and standardization with respect to the industry. As the profession and the term “management consultant” are not protected by law, basically anybody can label themselves *consultant* (Greiner and Ennsfellner, 2010). An attempt by the German consultants’ association, BDU, to protect the term *Unternehmensberater* by law and relate it to some standards, failed in 1997 (Gross, 1999), meaning that this ambiguity prevails. Glückler and Armbrüster (2003: p. 272) have argued that this lack of standardization has also been driven by large consulting companies as they “have resisted efforts to introduce uniform labeling and professional status measures”.

2. Consulting: Literature review and synthesis

Despite the lack of a definition which is unanimously agreed upon, it is worthwhile reviewing several opinions on how to define the profession. Business consultancy, according to Greiner and Metzger (1983: p. 7), can be defined as:

[...] an advisory service contracted for and provided to organisations by specially trained and qualified persons who assist, in an objective and independent manner, the client organisation to identify management problems, analyse such problems, recommend solutions to these problems and help when requested in the implementation of solutions.

This view appears to be largely accepted until the present day. The definition which this dissertation adheres to has been offered by Baaij (2014: p. 36) and shares the aforementioned elements:

Management consultancy is a knowledge-intensive service which independent business professionals provide to managers of organizations, and which consists of objective advice on management's decisions regarding the solutions to the client organization's problems and opportunities [narrow definition], and may, in some cases, also consist of assistance with the management's tasks regarding the implementation of these solutions [broad definition].

Beyond this definition, a number of elements from other authors' definitions ought to be taken into account. With respect to solving problems of a client organization, Law's definition (2009: p. 63) emphasizes that consultants impact their client organizations "through the application of knowledge, techniques and assets". March (1991) points out that the recipient of consultancy services may not be the client organization as a whole but possibly only certain individuals – an issue which will be discussed in more detail in Section 2.2.

In order to keep this work in focus, it is important to constrain the definition of consultants. As Randall (2006: p. 1) put it: "Consultants, it seems, are everywhere: management consultants, tax consultants, security consultants, technology consultants, health consultants, personnel consultants, transport consultants. Even consultants have consultants."

The focus of this dissertation lies on management consultants who may be referred to as 'consultants' for the sake of brevity. The terms 'business consultants' or 'advisor' may also be used to refer to this group of professionals. 'The consultancy' will be referring to the consulting company. A more detailed look into the structures within consultancies will be taken later in

2. Consulting: Literature review and synthesis

this section. By discussing the work and impacts of these companies, the focus lies on incorporated consulting companies rather than freelancers and, in line with the definitions above, external service providers rather than internal consulting units.⁵

The literature offers a number of different classifications of consulting services. Arguably the most typical classifications are similar to the grouping offered by Fink (2014), as depicted below. Speaking in this terminology, this work focusses on the middle path in the graph below.

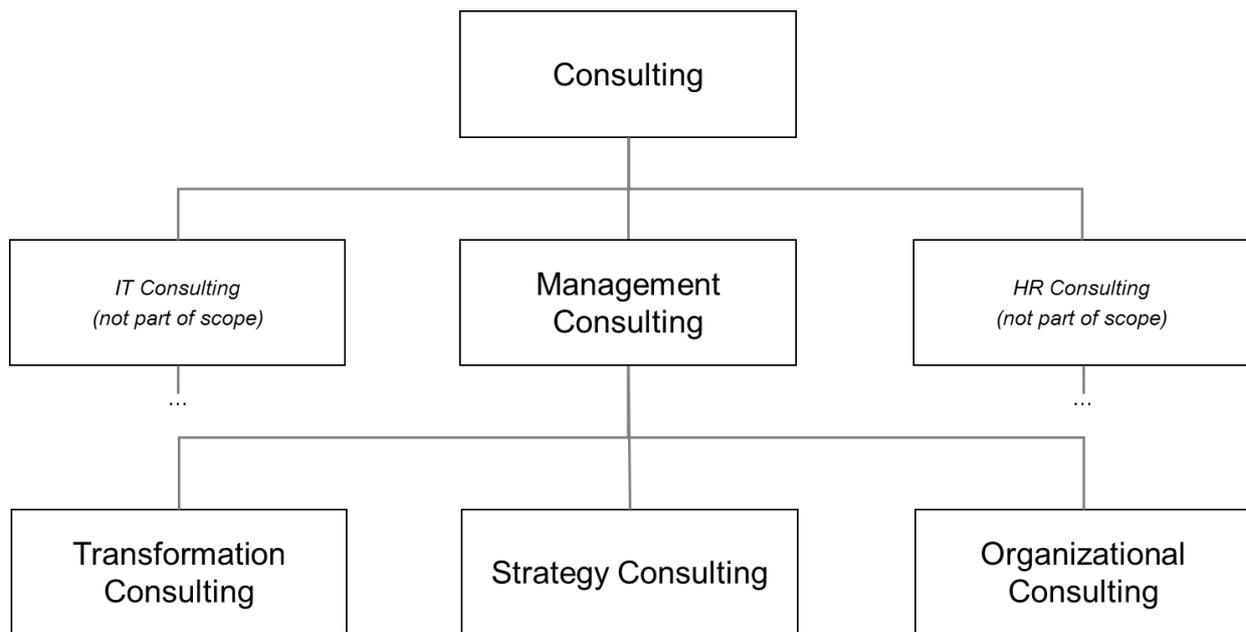


Figure 1: Classification of consulting services; Source: Author's adaptation of Fink (2014: p. 4)

Nevertheless, it needs to be pointed out that projects performed by consulting companies may well include elements of two or more types of consulting (e.g. strategic and organizational advice in one project) which is why some authors warn that strict distinctions “would be artificial and largely pointless” (Glückler and Armbrüster 2003, p. 274; In similar vein: McLachlin 1999; Armbrüster and Kipping 2002).

Largely independent of the type of projects offered, consulting companies fall under what Maister (1982) refers to as professional service firms. In line with the definitions provided above, what these companies sell to their customers is basically knowledge (Macdonald, 2006), for limited amount of time (Baaij, 2014) being an “outsider” to the client organization (Sturdy, 2011: p. 527).

⁵ However, due to several shared characteristics, some of the findings presented may be generalizable and thus apply for freelancers or internal consulting units as well.

2. Consulting: Literature review and synthesis

Thus, the product which consultants sell, displays basic characteristics of services in being intangible and perishable (Clark, 1993). Even though the outcomes are usually delivered in the form of written reports, what is often regarded to be more important is the verbal component, as “consulting is first and foremost a linguistic activity” (Clegg et al., 2004: p. 36; see also Czarniawska, 2013). Furthermore, the service is heterogeneous (van der Valk and Rozemeijer, 2009), meaning that it cannot easily be compared or reproduced and it depends on interaction between consultants and the respective client organization (Clark, 1995).

With respect to the interaction between consultants and clients, several authors emphasize that consultancy services are usually not passively consumed by the client organization but that the results are rather the product of a co-creation between the involved parties (e.g. Ernst and Kieser, 2002; Haverila et al., 2011). Moreover, the results of the collaboration are, in most cases, confidential (Glückler and Armbrüster, 2003) as they may be vital strategic decisions for the client organization. While the above characteristics are rather straightforward, they are nevertheless important to be kept in mind when discussing issues like value creation and valuation thereof in later sections. For example, the service characteristics are likely to lead to information asymmetries between client and consultant which gives rise to a discussion by which mechanisms best to overcome them. This will be dealt with in the following sections.

In order to further deepen the understanding of the work and impacts of business consultants, it is useful to look at the sequence of action of consultancy projects in general. When looking at phases of a consulting assignment, the general terminology used by Schweizer et al. (2009) proves to be suitable, dividing the process into ex-ante, ex-interim and ex-post steps.

Numerous authors have described the different steps and stages taking place around consulting projects, of which some are presented as follows. Schmidt et al. (2005) describe four steps, namely (1) Knowledge building, (2) Project setup, (3) Strategy development, and (4) Strategy implementation. It is worth pointing out that the implementation phase is not always part of the consultancy project and may lie more strongly in the hand of the client (Klarner et al., 2013). De Caluwé and Stoppelenburg (2004), drawing on Kubr (1996) and Block (1999), use five phases: (1) Entry phase, (2) Diagnosis phase, (3) Solution development phase, (4) Implementation phase, (5) Evaluation or extension phase.

Fleischer et al. (2014) also propose four phases: (1) Acquisition and task-setting, (2) Data analyses and creation of concept, (3) Implementation of concept, (4) Evaluation and measurement. An even more fine-grained approach is offered by Sieweke et al. (2012) with

2. Consulting: Literature review and synthesis

seven phases in the process of working with consultants: (1) Definition of the contract assignment, (2) Selection of qualified consultancies, (3) Contract negotiation, (4) Project steering, (5) Project documentation, (6) Project evaluation, and (7) Coordinating consulting projects within the company. The seventh element here is a more general back-office operation in client organizations, performed e.g. in the respective purchasing departments.

Focusing on the steps taken during a management consulting project, Wiebes et al. (2007) use (1) Preparation phase, (2) Analysis phase, (3) Decision-making phase, and (4) Implementation phase to describe the work of a consulting team.

In order to provide an overview, *Figure 2* below summarizes the process descriptions presented above. It needs to be pointed out that this list is not necessarily complete, nor is it the case that all elements are present in all consulting assignments. Moreover, as will be discussed in Section 2.4, project evaluations, do not exclusively take place after projects end. This aspect of project evaluation further is an essential element of the model presented in Chapter 5.

Ex-ante	Ex-interim	Ex-post
<ul style="list-style-type: none"> ■ Problem awareness / definition ■ Invitation to pitch ■ Evaluation of proposed concept(s) ■ Supplier selection ■ Contracting ■ Resource planning / team assignment 	<ul style="list-style-type: none"> ■ Data collection ■ Data analysis / diagnosis ■ Project steering ■ Concept / solution development ■ Decision making ■ Implementation 	<ul style="list-style-type: none"> ■ Project follow-up ■ Project evaluation ■ Renegotiation

Figure 2: Phases of the consulting process

The remainder of this section will be devoted to provide a deeper understanding of consulting companies themselves. The detailed view within the consultancy firms is needed in order to be able to alleviate the common simplification of referring to 'the consultant' as single person or entity instead of a multi-layer construct. This is a necessary basis for later discussions, e.g. on motivational issues concerning individuals within a consulting company. Moreover, knowledge of the typical hierarchy within consulting companies is important to interpret the quotes and statements given by interviewees, as presented in Chapter 3, against the background of their positions within the respective consulting firms.

Whereas project phases may be grouped according to a sequence of steps taken, internally, consulting companies are oftentimes organized along axes. This organization is commonly

2. Consulting: Literature review and synthesis

done by region, industry focus or function (e.g. marketing, strategy, finance, operations, and increasingly big-data teams) (cf. Risch, 2014).

The majority of consultancies are organized as private partnerships (Baaij, 2014) with a few exceptions, mostly concerning bigger players, being listed in stock exchanges. In these partnerships, profits are split between equity partners, which is in line with an observation by Alchian and Demsetz (1972: p. 786), namely that “profit sharing seems largely limited to partnerships with a relatively small number of active partners.”

Looking more deeply into consulting companies and understanding some HR-related aspects is especially relevant as “consulting firms' success depends on their ability to attract and maintain a workforce as the most valuable asset and the main source of competitiveness” (Mompalmer et al., 2015: p. 1462) or, as Maister (1982: p. 15) put it, these firms are “the ultimate embodiment of that familiar phrase ‘our assets are our people’”.

The typical consultancy is, somewhat similar to other professional service firms, organized in a pyramid structure. While the exact labels of positions differ between companies, there are essentially three layers which can be found: Juniors, Managers and Seniors. Juniors tend to be occupied with technical tasks such as carrying out analyses, conducting interviews, or designing slides for presentations. Managers are in charge of the actual project on client site, supervising the Juniors' work and engaging in day-to-day communication with the client team. Seniors, usually called ‘Partners’, may be involved very little in actual project work. They may only be present for important presentations which the team has prepared. However, partners are typically in charge of keeping up client relations also beyond single projects (Maister, 1982). Thereby, they bring in business for the company in a role as “rainmakers” (Lazear, 1998; p.: 315).

Of the revenues obtained by Seniors, the major proportion goes out to pay employees' salaries and bonuses. After cost of overhead, other expenses, and financing investments, the remainder is left to be distributed as profits among the partners. Key to the profitability is largely the ability of the consultancy to leverage skills and expertise of senior employees with the work hours put in by Juniors, who receive a comparatively lower wage (Maister, 1982). In general, the firm's goal is to have as many hours as possible of the total hours worked in the company billed to a client – the so-called “staff utilization rate” (Connell and Zalan, 2012: p. 2681). Even if employees work on non-billable tasks, many of these are indirectly aimed at generating future revenues such as by R&D efforts to generate new products and services or the publication of studies, insights and books which may be regarded as marketing materials (cf. Sturdy, 2011).

2. Consulting: Literature review and synthesis

Naturally, the mentioned pyramid is thinner at the top (Senior level) than it is at the bottom (Junior level). Even though Juniors have the possibility to eventually become Seniors over the course of their career, many drop out along the way. This principle is commonly referred to as “up or out’ promotion policy” (Kitay and Wright, 2004: p. 11). Reportedly, around 90 percent of professional employees leave the firm before completing ten years in a consulting company (Greiner and Ennsfellner, 2010), many of them already in early years of the consulting career, leading to churn rates of close to 20 percent p.a. (Töpper, 2014). While these numbers may appear high, they are deeply embedded in the business model.

Employees that either leave the consultancies voluntarily or which are forced to leave as they cannot advance to the next higher career level, the so-called alumni, are argued to be a very important source of future business for the consulting company. These individuals are likely to pursue management positions in other industries after their time as consultant (Wright et al., 2012) and have a tendency to turn to their former employers in search for advice (Kipping, 1999). This may be one of the main reasons why consulting companies undertake great efforts to foster their alumni networks. The numbers of members in these network groups grow constantly. For example, BCG’s alumni network is said to approach 20,000 (The Boston Consulting Group, 2015) and of McKinsey’s close to 25,000 alumni, over 230 are CEOs of companies with over a billion dollar annual revenues. Moreover, over 20 percent of these McKinsey alumni have started their own companies (Baaij, 2014). However, while these individuals may be likely to hire their former colleagues, they are also rather demanding as they know which results they can expect from consulting assignments (Geffroy and Schulz, 2015). The way that consulting companies may have an indirect impact on the economy is discussed in Subsection 2.4.2.

On the hiring side, consulting companies undertake great efforts to attract top talents, which is referred to as “war for talent” (Richter and Niewiem, 2004: p. 18). Many consultancies name the search for skilled staff as one of their most important challenges (BDU, 2016).

Consulting companies usually look for employees whose grades are in the top ten percent of their class, e.g. at business schools (Töpper, 2014). In order to achieve this, the screening and recruiting process as well as working environment are designed to only attract top performers (Clark, 2003). Thus, the selection, monitoring and training of employees requires heavy investments by the consultancies (Greiner and Ennsfellner, 2010).

2. Consulting: Literature review and synthesis

Besides the investment in attracting and educating employees, funds of consultancies are arguably wisely spent on creating pleasant conditions for their employees to work in, as there is a proven relationship between the working environment and the success of service firms (cf. Höck et al., 2011).

Qualities in employees which consulting companies look for include analytical excellence and creativity (Fink, 2014), strong communication skills (cf. Clegg et al., 2004) as well as the willingness and ability to work in an international context, which may include high flexibility in terms of geographic working location (Faust, 2014). Increasingly, also skills necessary for digital transformation and big data projects, including the handling of required tools, are demanded by employers in the industry (BDU, 2016).

From the potential employees' perspective, there are several points making jobs in consulting attractive, but clearly also a number of downsides. In their empirical study, Kakabadse et al. (2006: p. 472) have summarized five main points which consultants have mentioned that make their job attractive:

- (1) *Lack of routine and boredom;*
- (2) *Contact with clients*
- (3) *Contribution to organisational welfare*
- (4) *Intellectual challenge, and*
- (5) *Transfer of knowledge clients / consultants.*

Adding to these points, Baaij (2014: p. xiii) lists a number reasons for young professionals to join a consultancy:

- (1) *Steep learning curve*
- (2) *Superior earnings compared to most other sectors*
- (3) *Offering faster career opportunities*
- (4) *Profession with high status*
- (5) *Consultants perceived as powerful.*

Career opportunities clearly do not only refer to options within the consulting company but also outside. This is due to active outplacement done by many consultancies and the demand for ex-consultants for management positions in other industries (Maister, 1982), as pointed out above.

2. Consulting: Literature review and synthesis

In terms of negative aspects about the consulting profession, adding to abovementioned the travel-related stress, the empirical results by Kakabadse et al. (2006: p. 475) suggest seven main points:

- (1) *Long hours*
- (2) *Uncertainty*
- (3) *Bureaucracy*
- (4) *Lack of top-management support*
- (5) *Current trend of “assessment”*
- (6) *Role ambiguity; and*
- (7) *Dealing with criticisms.*

The above has laid out the definition of management consulting which is relevant for the following parts of the dissertation, the nature of the service provided by management consultants, the sequence of basic steps taken in the interaction between consultants and client organizations in a given project as well as the characteristics of a consulting firm and the roles and characteristics of the individuals working in a consulting firm. All of these aspects are required as a basis for understanding the discussions in later chapters. Before turning the criticism commonly faced by consultants in in Subsection 2.1.3, the next section will present the history and development of the consulting industry which lays the ground for later discussions, e.g. in Chapter 3.

2.1.2 Development of the consulting industry

While in today's business world consultancy companies are highly influential players, a century ago, they have been almost non-existent. This section will present the beginnings, the subsequent development, and the status quo of the industry as well as trends which are expected to shape its future. Whereas understanding the roots of the industry adds to the comprehension of the nature of the consulting services, the status quo shows the relevance of the consulting industry e.g. indicated by its current share of GDP in certain geographies. Furthermore, future trends – e.g. with respect to the interaction and balance of power between client and consultant side – are important to understand discussions in the following chapters.

History

The first appearances of management consultants were seen in the United States in the late 19th and early 20th century, by founders whose names are still today well-known in the consulting industry. In 1886, Arthur D. Little founded his company, Edwin Booz followed in 1914, and in 1926 James McKinsey started his firm, which was soon joined by one of his first

2. Consulting: Literature review and synthesis

consultants, Andrew Thomas Kearney (Canback, 1998; Gross and Poor, 2008; A.T. Kearney, 2014).

Driven by the aforementioned pioneers, among others, the industry experienced pre-World War II growth. While, according to McKenna (1995), there were around 100 companies in the market by 1930, ten years later this number had quadrupled. It was also in the 1930s that James McKinsey formulated the first set of guidelines for new consultants to follow when completing a project (McKenna, 1995), which may be regarded as an important step in the professionalization of the business. After McKinsey's death in 1937, some of his early employees around Marvin Bower re-founded the company in 1939 as McKinsey & Company, on which the partnership is based until the present day (Geffroy and Schulz, 2015).

In the second half of the 20th century, US consultancy companies started to expand internationally, opening offices in Europe in the late 1950s and 1960s. It was around that time, that Bruce Henderson left the consulting firm of Arthur D. Little to found the Boston Consulting Group in 1963, from which, in turn, 10 years later a group of partners around Bill Bain went on to start Bain & Company, another internationally leading management consulting company (McKenna, 1995; Canback, 1998; Bain & Company, 2015). Yet, even at that point in time the industry, it is argued, "was still in its infancy" (Canback, 1998: p. 4) and it was mainly a US-driven business. European management consulting markets are stated to have evolved into differentiated markets with powerful local players in a period between 1975 and the fall of the iron curtain (Kipping, 1999). For example, one of the most prominent European consulting firms, Roland Berger, was the first European company to join the Association of Consulting Management Engineers (ACME) in 1980 (Roland Berger, 2016).

The late 1980s and especially the 1990s marked a period of "immense growth" (Glückler and Armbrüster, 2003: p. 269) of the consultancy industry. This development is made clear by the change in ratio of consultants to managers. While it was 1:100 in 1965, it rose to one consultant per 13 managers in 1995 (Clark et al., 2013).

The 80s and 90s of the last century were also the time of significant changes in the market. Being traditionally strongly involved in strategy development, consultants were facing stronger demands towards implementation assistance (e.g. Hrebiniak, 2006; Sturdy, 2011). Moreover, being attracted by the high growth rates in this high-margin industry, also IT companies, such as IBM, and accounting companies were entering and strongly expanding their consulting businesses (Kipping, 2002; Armbrüster and Kipping, 2002; Lander et al., 2013). Further, towards the turn of the century, also former internal consultancy branches of corporate

2. Consulting: Literature review and synthesis

companies have entered the open market, offering their services to external clients (Glückler and Armbrüster, 2003).

For the accounting firms involved in consulting, the new century started off with some major changes due to the Sarbanes-Oxley Act from 2002 which prohibited them from multidisciplinary mandates. This act was largely triggered by the 2001 Enron scandal, in which the accounting company Arthur Andersen was regarded to have willingly overlooked fraudulent accounting due to a conflict of interest because of very close business relationships with Enron, including a substantial consulting mandate (Abelson and Glater, 2002; Greenwood and Suddaby, 2006).

Also specialized consulting firms faced changing market conditions at the first decade of the new century as growth rates were decreasing and structural changes were taking place (Richter and Niewiem, 2004; Buono, 2011), which are described below.

Whereas the increasing competition by specialized consulting providers (Connell and Zalan, 2012), freelancers and market research companies (Petch and Wheals, 2013) – executing tasks that were traditionally performed and billed by consultancies – have certainly contributed to the pressures in the market, the most prominent driver is to be identified at the clients' end (Schmidt et al., 2005). While some authors argue that clients were getting overwhelmed and tired of consultants in their organization, thus experiencing “consultancy fatigue” (Gilbert, 1998: p. 340), the greater part of the changes lies in the fact that clients were increasingly experienced in working with consultants. The client professionalization, “defined as adopting an effective and efficient approach to dealing with consultancy” (Höner and Mohe, 2009: p. 299) means that more experienced clients have a clearer picture of what they can demand from consultants in which time span and at which price. This has led to shorter, more targeted projects and increasing price pressure (Fink, 2013).

Moreover, the “demystification” (Werr and Perner, 2007: p. 110) of consultants resulted in a lowered esteem of the profession. For example, as insights presented by consultants were eye-opening in earlier decades, they were now readily available on the internet. Another point which has changed is that, due to a certain degree of commodification of consulting services, consultants have started to be increasingly sourced by purchasing departments (Sieweke et al., 2012). In fact, since the turn of the century, there are even companies who consult clients of consultancies on which consultant to choose. The sourcing of consulting services will be discussed in more detail in Section 2.3.

2. Consulting: Literature review and synthesis

Despite the increasing client sophistication and competitive pressure, the consultancy industry kept on growing substantially in the 2000's (Mohe and Seidl, 2011), just at lower rates. While the business in core markets may have been maturing, consulting companies have for example experienced high growth rates in emerging economies such as India (Gross and Poor, 2008). They have also extended their client portfolio to workers unions, clubs, churches, NGOs and the like (Macdonald, 2006; Mühlberger, 2016). In order to broaden the portfolio of services, consulting companies have moreover built analytics units and acquired analytics companies to compete in the field of big data analyses (Schlenk, 2015; Periscope, 2015).

Apart from consultancies with a specialist proposition, several players have engaged in mergers and acquisitions, arguably to obtain a critical mass and to improve cost efficiency (Momparler et al., 2015; Palass, 2016). Many takeovers in the consulting sector have also been completed with the Big Four accounting companies on the buying end. After the withdrawal from many consulting activities in the early 2000's, the accounting giants have recently undertaken large efforts to re-strengthen their consulting propositions.

The takeovers include Deloitte buying Monitor (Prasad, 2012), PwC acquiring Booz & Company (Schatz, 2015), and EY taking over OC&C's Benelux operations (EY, 2016). These mayor accounting players have further taken over a considerable number of specialized consulting firms (Lambrecht, 2015). Accenture has for example spent approximately USD 2.5 bn on acquisitions between 2012 and 2015 (Palass, 2016).

Status Quo

As discussed above, the boundaries of what the literature regards as consulting are not fully consistent, thus leading to problems in comparing estimations on the overall market size for consulting services. In 2010, Greiner and Ennsfellner estimated the global market to amount to USD 200 bn, for 2012, Klarner et al. (2013) refer to a market size of over USD 390 bn⁶. Kipping and Clark (2012) use an estimate of USD 350 bn for all types of consulting and USD 150 bn for business consulting.

In any case, the consulting industry may be regarded as "highly fragmented" (Law, 2009: p. 63). This is true in terms of geographies as well as market concentration of the consulting companies. According to Gross and Poor (2008), 49% of consulting revenues are generated in North America, 33% in Europe, as well as 10% in the Asia-Pacific region, leaving 8% for the rest of the world. Within Europe, more than three quarters of the management consulting

⁶ Besides different market definition the differences in years of reference may further explain the discrepancies between the respective values.

2. Consulting: Literature review and synthesis

revenues are generated in the four biggest markets, namely Germany (33%), United Kingdom (22%), Spain (12%), and France (10%). Germany is not only the biggest economy in Europe, the amount spent on management consulting services relative to the GDP is also the highest in Europe, with a value of 1.15% in 2011⁷ (FEACO, 2012).

While the majority of consulting companies are small enterprises of ten or less employees, the market is dominated by comparatively few big firms (Baaij, 2014). The three biggest management consulting companies – McKinsey, The Boston Consulting Group, and Bain & Company – were reported to have combined revenues of USD 10 bn in 2011 (McGinn, 2013). By 2015, McKinsey alone was estimated to have generated USD 8.4 bn in revenues, up from USD 6.6 bn in 2012 (Freitag and Student, 2015). The picture in the German market is largely similar. According to the German consultants' association, there are 15,425 consulting companies in Germany, of which 375 have reported € 15 mn or more in revenues in 2015. The combined revenues of these 375 consultancies make up more than half of the overall market (BDU, 2016).

In terms of clients using consulting services, the biggest parts are assigned to the public sector (21%), financial services (20%), healthcare (10%), manufacturing (8%), energy, communications and media, and retail (all roughly 7%) (Baaij, 2014). These figures, of course, also depend on the respective geography. According to recent figures, 10 percent of consulting revenues in Germany are done in the public sector – in the United States even as much as 30 percent (Neuscheler, 2016). Again, a word of caution ought to be expressed with respect to sometimes inconsistent definitions used for different sources. Nevertheless, it is clear that consultancy services are widely used in all major parts of the economy⁸.

Despite the wide-spread use of consulting services, some well-known companies have established a reputation of having a strict policy of not using consulting services. These include General Electric, Procter & Gamble, and Continental AG (Ernst, 2002; Faust, 2014)⁹.

⁷ No causality implied.

⁸ At least in the core geographies, as discussed above.

⁹ The question whether companies who use consulting services perform significantly better or worse than those who do not, as well as the caveats of existing approaches taken to scrutinize this question, will be discussed in Section 2.4.

2. Consulting: Literature review and synthesis

Future outlook

While reporting on past developments is relatively easy, predicting the future is clearly more challenging and less reliable. This is why I do not put an emphasis on the review of such contributions. Still, some key trends are repeatedly mentioned in the literature which ought to be mentioned at this point.

In terms of overall market growth for the short to medium term, several sources provide forecasts between 5% and 10% per annum (e.g. Gross and Poor, 2008; Sommer, 2014; BDU, 2016). The fact that these growth rates are lower than in the phase of rapid expansion, as discussed above, should not be surprising, given that the industry is maturing (Sturdy, 2011).

Summarizing the respective comments in the literature, the future of the consulting industry appears to be mainly influenced by four forces, which have already been shaping the field in the recent past: (A) Client sophistication, (B) Digitalization, (C) Market consolidation, (D) Battle for talent¹⁰. These trends will also be reflected in later sections of the dissertation, e.g. when contrasted with opinions of practitioners.

The process of professionalization of clients' sourcing activities with respect to consulting services is expected to continue. This also includes clients pushing more strongly for fee agreements which are contingent on the consultants' performance and results (cf. Christensen et al., 2013).

A strong influence on the nature of consultants' work is clearly exerted by developments in information and communication technology (ICT). Articles about the future of consulting work often include discussions of the influences of Big Data, Smart Data and Cloud Computing (e.g. Heuer, 2014; BDU, 2016; Martin-Jung, 2016).

Acquiring the resources – both in terms of hardware and software as well as know-how – in order to create a credible and competitive offer regarding big data computation may require companies to invest heavily. Thus, this is one of the factors contributing to an expected future consolidation of the industry (Christensen et al., 2013; Palass, 2016; Höhmann and Leitl, 2017). The aforementioned pressures of companies from other industries such as accounting will further re-shape the face of the industry.

Lastly, while consulting companies are set out to continue to grow, the industry is claimed to have lost its appeal towards highly talented young professionals (Werle, 2015). In order to

¹⁰ These developments are not necessarily mutually exclusive but may rather influence one another.

2. Consulting: Literature review and synthesis

close the potential gap between decreasing supplies in the 'input market' and increasing demand in the 'output market', consultancies have several options. They may for example increase salaries, shift their focus more strongly towards attracting older employees, offer part-time models, or make use of freelancers, expert networks or crowd-sourcing platforms (Geffroy and Schulz, 2015; Zwior, 2016).

2.1.3 Criticism towards consultants

In order to understand the debate about value creation – or the lack thereof – by consultants, one ought to be familiar with common criticism towards the profession. Especially as a basis for the discussion in later sections about potential safeguards against consultants' (agents) deviation from clients' (principals) interests it is worthwhile to be aware of common accusations faced by consultants.

The public suspiciousness appears to be shaped by statements in popular culture like "How management consultants steal your watch and then tell you the time" (Kihn, 2005)¹¹ or descriptions of consultants' activities as being intended to "take the [client's] money and run" (Kitay and Wright, 2004: p. 15). In its most extreme forms, the antipathy against consultants may even be at the edge of causing violence. As Mohe (2011: p. 261) reports, "police protection was necessary to safeguard the celebration of the 40-year company anniversary of McKinsey Germany against resentful demonstrators".

In cases of flawed, harmful or unethical activities by consultants, which cause obvious detrimental effects for the client organizations (cf. O'Shea and Madigan, 1998), the criticism would apparently be well justified. Such examples include the abovementioned case of Enron and the bankruptcy of Swissair (Fleischer, 2010). For most of the other accusations, the border between justified critique and prejudices is more blurry.

These common accusations fall mainly in four categories, namely (1) lack of value creation and especially lack of responsibility for the implementation of recommendations; (2) an exclusive focus on securing follow-up business instead of solving clients' problems; (3) selling partner capacities but having projects executed by inexperienced juniors; and (4) impression management – blowing up rather trivial advice by use of jargon. The following paragraphs will briefly discuss these points.

¹¹ Subtitle of the popular book by the title *House of Lies* by Kihn, on which also a successful TV series with the same title is based.

2. Consulting: Literature review and synthesis

The perception of consultants delivering a report, charging the client and taking off without being accountable for actual results is driven by the fact that, in many cases, consultancy assignments end after the strategy development phase and do not continue during the implementation phase (cf. Subsection 2.1.1). Especially if the recommendations given by the consultants are appealing to a top management team but are unsuitable to convince the organization at large, the projects' effect may be very limited (Maister, 2008).

Accusing consultants of being extensively focused on their own commercial success, Bloch (1999: p. 115) writes: "As soon as consultants secure one contract, they are thinking about the next one". In order to extend current projects or to generate new project assignments, consultants are said to undertake considerable efforts to make themselves indispensable and thus creating a (perceived) dependence on them for the managers (e.g. Beer and Eisenstat, 2000; Ernst and Kieser, 2002). Further efforts are reported in creating and promoting fads and suggesting managers that their respective companies are left behind if they do not hire consultants in order to be 'fashionable' (Huczynski, 1993; Fincham, 1999)¹².

As has been discussed in Subsection 2.1.2, employees of consulting companies are often young professionals whose first job after graduating from universities is in the consulting industry. Given that consultants are often hired in order to supply companies with outside know-how, sending inexperienced employees without the required expertise is likely to give rise to client suspicion (Jang and Lee, 1998). These "IROCs – Idiots Right out Of College", as Faust (2014: p. 12) refers to them, are criticized to receive training on the job, "at the expense of clients" (Greiner and Ennsfellner 2010: p. 72).

The last major category of criticism fits the phrase that consultants sell "old wine in new bottles" (Baaij, 2014: p. 332). This refers to selling rather standardized solutions 're-packaged' as customized offer (Kitay and Wright, 2004). In order to be able to do so, consultants are said to make use of complicated jargon, referred to as "consultobabble" (Williams, 2003: p. 134) and to be sleek in bluffing when required (Herles, 2013). This effort to manage a good impression (Clark 1995; Clark and Salaman, 1998) is summarized in Bloch's (1999: p. 116) provocative statement: "They may give you poor advice, but they will look good while they do it!"

In essence, the main types of criticism, as listed above, appear to display doubt about whether or not consultants are worth the fees which they are charging their clients and thus about the value of the services provided by consultants. That in mind, providing a conceptualization of the impact of consulting, as provided in Section 2.4, should be in the interest of both,

¹² For more on phases on fads and fashions in management see also Furnham (2004).

2. Consulting: Literature review and synthesis

consultants and clients, in order to be able to have a ground on which to discuss the worth of consulting projects.

2.2 Client organization and the relationship with consultants

Having laid out the most important characteristics about management consulting in general, the industry's growth and importance as well as the common points of criticism above, this section turns to the organizations actually consuming consulting services as well as the interaction with consultants.

First, reasons for why a company – or members within it – typically engage consultants are presented below. Second, the roles of the members within the client organization are provided, laying the ground for discussions in Chapters 4 and 5. Third, the combined view on the interaction and relationship between the client organization and consultants is laid out.

2.2.1 Reasons to use consulting services

In order to be able to discuss the impact which consultants have later in this chapter, an important step to be taken in this subsection is to look at the question for which reasons consultants are engaged. After a brief discussion of general hiring reasons, the major part of this section will review the corresponding role titles which commentators have assigned to consultants in different contexts, generally defined by the purpose clients engaged them for. While this subsection discusses why consultants are hired, Section 2.3 will deal with the questions how a decision for a certain consultancy is made and how the respective contracting works.

When companies consider hiring an external consultant versus finding a solution to a given problem without consultants, they are essentially facing a make or buy decision (Fincham, 1999). Thus, when a certain task is performed frequently, when the particular individuals or teams working on it are specifically important for the organization in order to perform the task and when delegating the task to an external provider would involve a considerable level of uncertainty, companies are expected to use internal resources or to vertically integrate instead of working with external consulting firms (Canback, 1999; Glückler and Armbrüster, 2003). In this sense, consultants can be regarded as providers of specialist skills and knowledge for non-standard assignments. In-house consulting units may be situated in the middle of such a spectrum of possible solutions as they are external to a given department but are still readily available within the organization.

2. Consulting: Literature review and synthesis

In line with the definitions discussed in Section 2.1, what consultants offer to their clients are basically expertise and knowledge along with the methodology and 'tools' to approach problems, to develop possible solutions, and to communicate them in a structured way (Canback, 1998). Clients, when hiring consultants, look for their expertise and also value the merits of consultants' outsider position, enabling them to open new perspectives without the risk of overlooking options due to *Betriebsblindheit*¹³ (Drucker, 1979; Macdonald, 2006; Fleischer, 2010).

While the definitions of consulting services discussed above already provide a good idea of why consultants are employed by their clients in general, it is worthwhile reviewing the hiring reasons in more detail. The literature offers a long list of descriptions of roles the consultants may take in the course of their projects. These labels may not be fully mutually exclusive but they provide a useful basis for later discussions on motives of individual stakeholders on the client side behind engaging consultants.

One of the first classifications of consultants' roles is provided by Schein (1988), describing how consultants are employed for locating, understanding and solving a given problem. In Schein's terminology, a consultant acts as an *expert* in bringing in expertise in order to solve a problem which has already been identified by the respective client organization. If a problem has not been located at the beginning of a project, the consultant may draw on previous experience in order to be able to recommend a cure, acting as a *doctor*. Similar terminology is provided by (Clegg et al., 2004) as *medical practitioner* or by Kakabadse et al. (2006), speaking of a *therapist*. In case a consultant is teaching the client the process and methodology to identify and solve a given problem, this is referred to as *facilitator* (Schein, 1988).

One of the roles which is reported to be increasingly demanded – and which may be regarded as response to the first point of common criticism discussed above – is to support clients in the implementation process instead of simply delivering a report and ending the project. Thus, in that way, consultants act as *implementer* (Schmidt et al., 2005). In general, if the clients' personnel resources are insufficient to take on a given task but it does not seem appropriate to hire permanent employees, consultants are also simply regarded as a form of *temporary labor* (e.g. Alvesson, 1993; Sturdy, 2011; Kitay and Wright, 2004). Contracting consultancy resources for a limited amount of time may not only apply for human labor but also in the case of big data computation capacities not available at the client (Christensen et al., 2013). Another resource consultants may contribute is their network, e.g. in foreign markets for projects supporting the client's internationalization (Faust, 2014).

¹³ I.e. being myopic with respect to certain problems due to embeddedness in a given company.

2. Consulting: Literature review and synthesis

Since a consultancy project is usually initiated to bring along changes within the organization and the consultant can both trigger and facilitate such changes (Sturdy, 2011; Wright et al., 2012), the role of consultants in such a context is described as being *agents of change* (Kakabadse et al., 2006). In facilitating changes, the consultant does not necessarily have to bring in creative ideas. Consultants can be valuable by re-phrasing existing knowledge, enabling organizational learning through their communication skills (Armbrüster, 2006; Czarniawska, 2013), thus acting as *knowledge brokers* (Canato and Giangreco, 2011). Further, consultants have been described as *parasites* (Clegg et al., 2004; cf. Sturdy et al., 2004) in a client organization who disrupt existing routines and who are thereby forcing the client firm to react to these “perturbations” (Mohe and Seidl 2011: p. 3). This forced reaction may lead the client organization to discover and develop new solutions and innovations on its own. Moreover, consultants may also act as impartial third party in the case of intra-firm disputes, leading to a settlement between conflicting parties and thus acting as a *mediator* (cf. Fleischer, 2010).

As the party hiring the consultant is usually not the client organization as such but a particular decision maker (Macdonald, 2006; Fink, 2014)¹⁴, acting on behalf of this organization, several roles in which a consultant has an impact ought to be examined at an inter-personal and less formal level. In a challenging business world with many uncertainties, consultants may provide a respective manager with re-assurance and act as *uncertainty alleviators* (Sturdy, 1997; Sturdy et al., 2013; Faust, 2014). Related to this, consultants can support managers by reducing the vast amount of strategic choices and thus to reduce complexity (Ernst and Kieser, 2002). Especially at top management level, showing uncertainty towards lower levels in the hierarchy or versus competing managers may be perceived as weakness (Johansson, 2004). Being able to turn to a trusted consultant in such a situation leaves the advisor to provide *emotional help* (Lundberg and Young, 2001).

As one might argue, the most informal roles of consultants in a project context are present if a certain decision has already been made when the consultancy project starts. In such cases having the consultants – who ideally enjoy a good reputation – on board adds credibility to the pre-made decisions, putting the consultants in a role of a *legitimator* (Ernst and Kieser, 2002; Glückler and Armbrüster, 2003). If such decisions are detrimental to certain stakeholders and the consultants are the ones who are supposed to be blamed, their role would be comparable to a *scapegoat* (Kitay and Wright, 2004; Sturdy, 2011; Paust, 2012). In some cases, it is argued, consultants may also be hired by a certain manager to foster this manager’s personal

¹⁴ The procurement of consulting services will be discussed in detail in Subsection 2.3.1.

2. Consulting: Literature review and synthesis

Besides the explicit roles attributed to consultants, the common hiring reasons can further be summarized, as is done in *Figure 4*. In general, consultants are either engaged because (1) they can bring skills to the table which are not readily available at the client organization, or (2) because the available resources at the client organization are not sufficient and need to be enhanced with external capacity. Moreover, (3) informal hiring can be assumed to be done in order to improve the position of an individual or a group of individuals within the organization. Again, a combination of the three main classes of hiring reasons is possible or even likely.

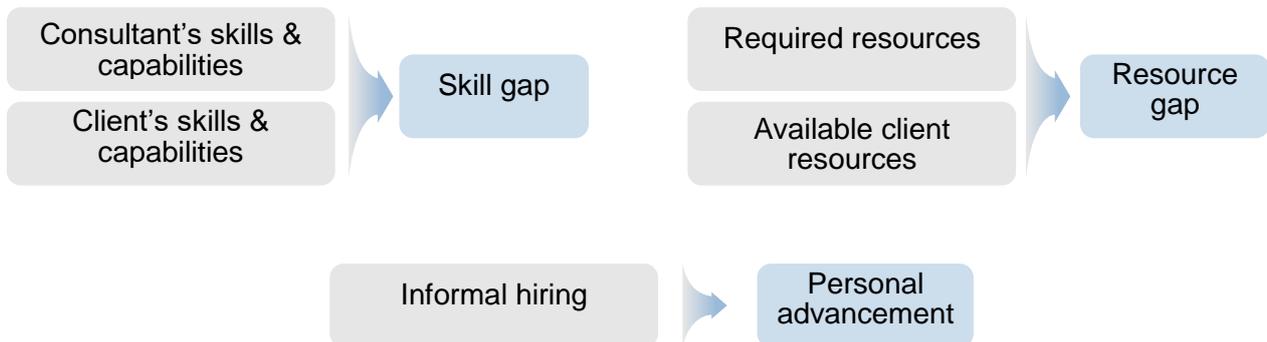


Figure 4: Summary of hiring reasons

2.2.2 Roles within the client organization

In general, consultants work with and for different individuals within each client firm (Appelbaum and Steed, 2005; Alvesson et al., 2009). The client of consulting services may thus not be a homogenous corporation but rather an individual or a set of persons within the client firm. Again, knowledge about roles of certain groups or individuals within a client organization facilitates the understanding of considerations in later sections. This subsection will present the role descriptions of client individuals as presented in the literature, before the next subsection will analyze the interactions of clients and consultants.

When looking at client roles, it is important to recognize that the classical “portraits of clients as victims, marionettes or passive consumers of consulting services” (Höner und Mohe 2009: p. 299) are hardly providing a complete and accurate picture. Rather, within client companies, there are several individuals with different interactions with and attitude towards external consultants. In order to describe these sorts of clients, Schein (1997, p. 1f.) introduces six types:

2. Consulting: Literature review and synthesis

- (1) *Contact Clients* – The individual(s) who first contact the consultant with a request, question, or issue.
- (2) *Intermediate Clients* – The individuals or groups that get involved in various interviews, meetings, and other activities as the project evolves.
- (3) *Primary Clients* – The individual(s) who ultimately "own" the problem or issue being worked on; they are typically also the ones who pay the consulting bills or whose budget covers the consultation project.
- (4) *Unwitting Clients* – Members of the organization or client system above, below, and in lateral relationships to the primary clients who will be affected by interventions but who are not aware that they will be impacted.
- (5) *Indirect Clients* – Members of the organization who are aware that they will be affected by the interventions but who are unknown to the consultant and who may feel either positively or negatively about these effects.
- (6) *Ultimate Clients* – The community, the total organization, an occupational group, or any other group that the consultant cares about and whose welfare must be considered in any intervention that the consultant makes.

In largely similar vein, Alvesson et al. (2009: p. 255) propose four types of individuals:

[...] the passive consumer, receiving suggestions, analysis and other forms of consulting input; the supervisor, actively directing and controlling consultancy work; the co-worker, cooperating (and / or conflicting) with the consultant in the consultancy process; or the judge, assessing the outcome of the work of the consultant and controlling him / her through feedback and / or a promise (or threat) about re-purchase.

The considerations to follow in the next sections and chapters will refer several times to the role of a 'project sponsor'. This person is, closely related to Schein's "primary client" – the person who initiates consulting projects and who is usually the addressee of final presentations – without necessarily having to be actively involved in actual project work.

Schein (1997) further discusses six different levels of consultation on which advisors and clients interact, ranging from a bilateral level – a consultant only giving advice to a single

2. Consulting: Literature review and synthesis

manager, much like a personal coach – to an inter-organizational level – consulting two or more firms, e.g. in the process of forming joint ventures or strategic alliances. The most typical levels for management consultants to work are either at an organizational level – such as defining long term strategic options for the company – or at an inter-group level – for example helping to organize the collaboration and responsibilities between departments or subsidiaries.

To be complete, one differentiation needs to be added to the above mentioned client groups, namely one between individuals or groups who work actively with consultants and those who are not involved in or affected by a project (Czarniawska and Mazza, 2003; Alvesson et al., 2009) – these are even more remote than the “unwitting client” proposed by Schein (1997).

The role definitions will be needed in the discussion laid out in Section 2.4 about which stakeholder is impacted in which way by consulting projects. In general, it needs to be emphasized that the individual employees within an organization may well have interests which are divergent from those of the company as a whole (Höner and Mohe, 2009). A more detailed look at goal divergences will be taken in the following subsection, in Section 2.3 as well as in Chapters 4 and 5.

2.2.3 Combined view: client-consultant relationship

Having discussed the roles of consultants and clients above, this part shall combine the two sides. As Appelbaum and Steed (2005: p. 71) formulate it: “consultant engagements beyond simply purchasing expertise require the development of a relationship between the consultant and the client.” The economic problems potentially present in this relationship stand at the core of this dissertation and will be central to the following sections and chapters. As a basis for these, this subsection will present the characteristics of the relationship. As will be shown, the client-consultant relationship may more correctly be understood as set of sub-relationships which will be summarized in a concluding graphical representation.

Strictly speaking, the relation between the provider (consultant) and the user (client) of consulting services can be described as principal-agent relationship¹⁵. In their canonical paper, Jensen and Meckling (1976: p. 308) define an agency relationship as:

¹⁵ As mentioned, the result of a consulting project will likely be the result of team work between members of the client organization and the consulting firm. Nevertheless, consultants are agents to the project sponsor.

2. Consulting: Literature review and synthesis

[...] a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent.

Keeping in mind that the two parties usually engage in a co-production (cf. Section 2.1.2) and that the client's role should not solely be regarded as passive and submissive (cf. Subsection 2.2.2), it becomes clear that the interaction we are regarding is "bidirectional" (Bronnenmayer et al., 2016: p. 5) and "reciprocal" (Glückler and Armbrüster, 2003: p. 277). It may further be "deeply embedded in complex social ties" (Kitay and Wright, 2004: p. 2) and the balance of power between the sides is not necessarily fixed (Fincham, 1999). Kakabadse et al. (2006: p. 425) emphasize that "the relationship existing between consultants and clients is much more than professional, and involves a psychological dimension that must be taken into account when exploring the relationship existing between both parties."

Mohe and Seidl (2011: p. 4), in reviewing previous contributions on the client-consultant relationship, state that the relationship has been scrutinized from the perspectives of "role theory, agency theory, social network theory, rites theory, situated learning theory and the theories of otherness and parasites" as well as the theory of social systems. Many of the labels reviewed in the previous subsections can be attributed to role theory but authors of other approaches have also been taken into account (e.g. Clegg et al. (2004) comparing the consultants' presence in the client organization to that of *parasites* in an organism). One approach which I will add to this list is applying elements of game theory in Chapters 4 and 5.

Obviously, the representation of "the client" and "the consultant" as single persons or homogenous groups has some merits for analysis of the relationship as it helps to keep matters simple and traceable. However, as mentioned in the previous section, the interests of individual actors may differ from those of their respective organization. This is why several authors have specified the view on the client-consultant relationship, putting primary emphasis on the manager who hires consultants and the advisor (e.g. Macdonald, 2006). In this sense, the matter may be referred to as manager-consultant relationship.

The focus on hiring managers as key decision makers in the context of consulting projects helps to make the discussion easier to comprehend. As a matter of fact, the descriptions of more latent roles of consultants, as discussed in Subsection 2.2.1, only make sense in the context of a specific manager being impacted. Further, the top tier management consultancies, in their own presentation on websites and in booklets, depict themselves as being committed

2. Consulting: Literature review and synthesis

to working with and supporting individual managers in the client organizations (Kitay and Wright, 2004; Bäcklund and Werr, 2008).

Nevertheless, in order to paint a realistic picture, it is important to also pay attention to other employees and interest groups within the client firm. Especially for projects above certain budget thresholds, the CEO, chairperson or board of directors either need to be informed about consulting projects or their approval is required in order to be able to conduct the respective projects (Fleischer, 2010). The workforce, possibly represented by a work council, is another important group to be taken into account as they are very likely to be affected by the outcome of consulting projects. Oftentimes, the reputation of consultants among the general workforce is rather negative, fearing worsening work conditions or layoffs (Faust, 2014; Geffroy and Schulz, 2015). Employees may be able to sabotage projects and can thus prevent them from being successful (Bäcklund and Werr, 2008). Therefore, all stakeholders in the client organization ought to be taken into consideration when analyzing the interaction of consultants and “the client”. This is also true for analyses in later chapters.

An intra-firm group of particular interest may be professionals in sourcing departments (more detailed discussion to follow in Subsection 2.3.1). Whereas in the majority of cases managers are responsible for engaging and managing consultants, in the course of increasing client professionalization, the purchasing department is more commonly involved in dealing with consultants. In discussing the client-consultant relationship, Sieweke et al. (2012: p. 123) suggest to scrutinize a “service triad” between managers, consultants and purchasing professionals as a more realistic setting in this context. According to a recent study, around one third among the 500 largest companies in Germany, for example, directs the responsibility of dealing with consulting engagements to specialized departments instead of having the respective managers directly in charge (Geffroy and Schulz, 2015).

With respect to agency relationships, it needs to be emphasized that not only consultants are agents to the clients but that several agency relationships exist within the client company. The board of directors supervises on behalf of the shareholders, the top management is, in this sense, agent to the board. To the middle managers, top managers are principals while the middle managers themselves are principals to the employees in their respective departments (Höner and Mohe, 2009).

To add to the perspective of Höner and Mohe (2009), it is important to point out that also the team executing the project on behalf of the consulting company is not necessarily a homogenous body but consists itself of individuals with their own interests and potential

2. Consulting: Literature review and synthesis

conflicts (Clegg et al., 2004; Sturdy et al., 2013). Within the team of consultants, there is another set of principal-agent relationships which should not be omitted when trying to correctly depict the set of relationships in the context of consulting projects.

In order to clarify the potential conflict of interests, one can take the example of a project manager of a consulting company working at a given project. The consulting firm and the client company will have a contract, making the consultants the client's agents. The team of consultants, led by the project manager, on the other hand are agents of the consultancy's partner in delivering the project work. Thus, the project manager is the "agent's agent" in the sense of Fincham (2002: p. 67) whose interests also possibly diverge from those of the consultancy or the respective partner of the consulting firm, implying another set of potential agency problems.

The conflicts of interest between members of the client team and those of the consulting team can be made more comprehensible by means of a small example. While the client's satisfaction with a consulting project can be assumed to be increasing in both the reduction in the number of problems (which is why consultants may be hired) and the general quality of the consultants' work, the consultancy's project manager may be incentivized based on the quality of the work delivered, as well as on the generation of follow-up business by means of further projects to be conducted in the future. These future projects are likely to depend on the number of 'new' problems discovered within the client organization (during the phase of the consultants' presence) which can lead to new project engagements. Bluntly speaking, if problems are thoroughly solved, this may cost future job opportunities for the consultancy.

The potential conflict between solving client problems and the consultants' own commercial objectives has been pointed at by several commentators (cf. Ernst, 2002). This discussion is also reflected in point (2) of the main criticisms discussed in Subsection 2.1.3.

Extending a representation of Höner and Mohe (2009: p. 301), *Figure 5* below proposes a set of principal-agent relationships relevant in order to understand the mechanisms in consulting projects. An understanding of these relationships will be the basis for the game-theoretic models presented in later chapters.

2. Consulting: Literature review and synthesis

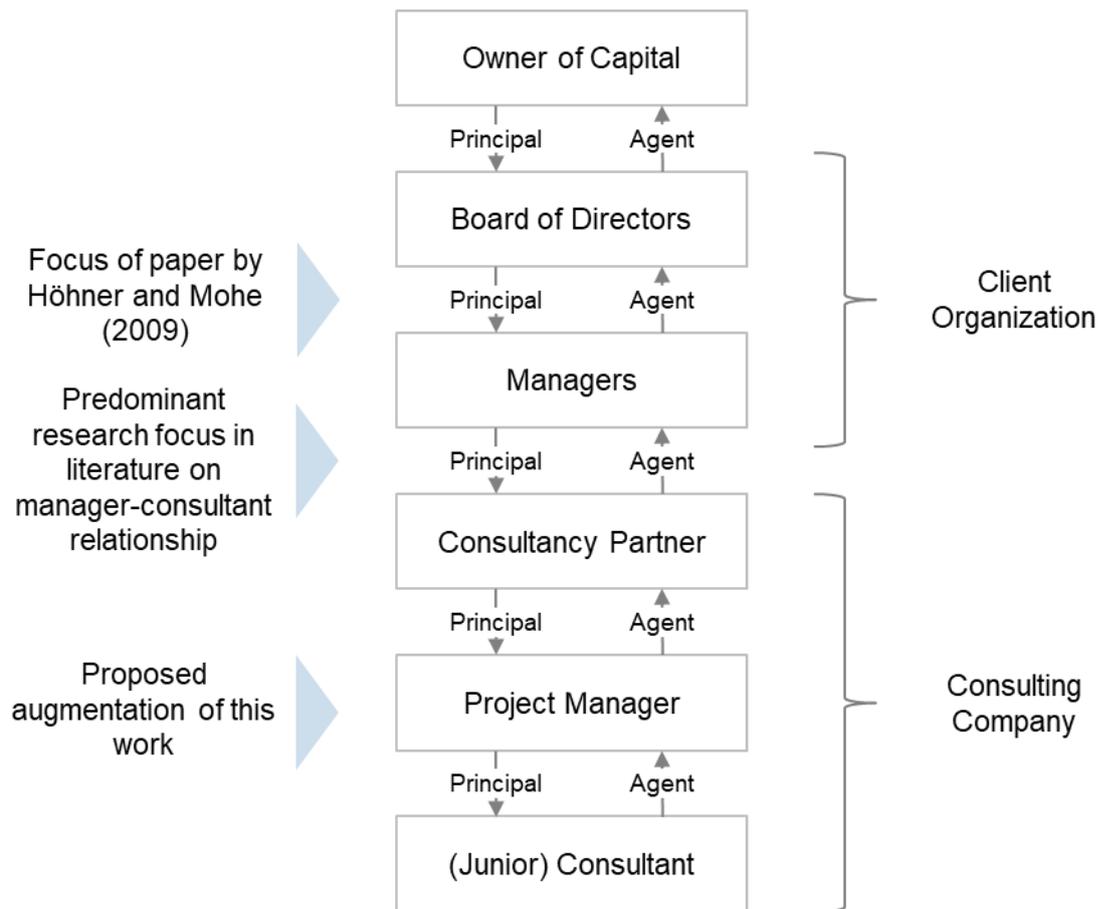


Figure 5: Agency relationships in a project context; Source: Author's extension of Höhner and Mohe (2009: p. 301)¹⁶

One aspect worth pointing out is the changing involvement of the aforementioned parties over the course of a project. While the consultancy partner and the project sponsor (usually a member of the top management team) are heavily involved in the course of contract negotiations and final decision making, the project managers and (junior) consultants as well as the client company's project team are active during the analysis phase and the possible implementation phase of the project (Fleischer et al., 2014).

In the end of the discussion about client-consultant interaction, it ought to be pointed out that some authors conceptualize a consulting project as taking place outside of the client organization as well as outside of the consulting organization. The interaction of the client staff being designated for the project and the consulting team working on the specific project has been referred to as "contract system" (Mohe and Seidl, 2011: p. 3) or "liminal space" (Czarniawska and Mazza, 2003: p. 267) by these authors.

¹⁶ Augmentation of existing graph by Höhner and Mohe (2009), no strictly decreasing knowledge or externalities upwards implied.

2. Consulting: Literature review and synthesis

2.3 Procurement of consulting services, contracts and fees

Having laid out the characteristics of consulting services in general the properties client organizations consuming these services as well as the roles in the interaction between the two sides involved in consulting projects in the previous sections, this section will deal with the governance of the relationship. This is done according to the chronological order of a typical management consulting project. First of all, the project needs to be defined and initiated, which can be described as procurement process (2.3.1), eventually ending in agreement on a contract (2.3.2). As soon as the consulting firm has started to work for the client organization, there will be costs in the form of consulting fees and other costs (2.3.3). These elements will lay the basis to combine views on costs and impacts of consulting services in the subsequent section.

2.3.1 Procurement process for consultancy projects

Whereas in 2.2.1 reasons for why consultants may be hired by client organizations were laid out, this subsection will scrutinize the procurement process leading to consulting projects.

When reviewing the sourcing of consulting services, Werr and Perner (2007: p. 100) “observe thus a tension between what are generally regarded as rational and effective purchasing procedures and [...] actual purchasing of management consultants”. Even more drastic, the two authors state in an earlier comment: “the way in which management consultants are purchased and managed is far from efficient” (Werr and Perner, 2005: p. B5).

This conclusion is especially surprising as the “purchase of these services [like consulting] has become a substantial element in a firm’s total acquisition of external resources” (van der Valk and Rozemeijer, 2009: p. 3). Describing how consulting services are sourced, according to which decision criteria, and by whom is the purpose of this subsection.

Obviously, before consulting companies are engaged by their clients, the involved parties need to be aware of each other. Fleischer (2010) suggests three modes of first contact: by the consultant, by the client, or by a third party. In case the consultant approaches the client, the client firm may not be aware of a certain problem it may be facing or a certain development to which the current business model may need to be adjusted. When clients approach a consulting company, they are usually aware of a certain problem and are looking for support in order to solve it. In this case, the description of the consultant’s role as *expert* described in Section 2.2 may be suitable. Thirdly, if the contact between client and consultant firms is the

2. Consulting: Literature review and synthesis

result of an introduction by an external party, this is usually a recommendation in the sense of Glückler and Armbrüster's (2003: p. 269) "networked reputation", to be discussed below.

The case of an open call for proposals by a client organization, as it is especially common for public clients, can be classified as the second of the three modes. While the client company may be unaware of a particular consultancy, by which it may be approached, it is nevertheless aware of a problem and creates the basis for a later collaboration.

In order to describe the sourcing process for professional services, authors in most cases propose models of about five to ten steps (e.g. van Weele (2005), van der Valk and Rozemeijer, 2009). These descriptions typically consist of a pre-contractual phase in which needs are expressed, a supplier is selected – possibly in several rounds, and contract terms are negotiated. After a contract is signed, which in itself is more a point in time than a phase, starts the phase of managing the collaboration in accordance with the contract. Controlling for contract fulfillment requires evaluation which can be implicit or explicit. To depict such a process, I present a model which is an adaptation of van der Valk and Rozemeijer (2009) who themselves have extended a process description by van Weele (2005). Clearly, not all of these phases are necessarily present in all projects, nor are they typically equally pronounced.

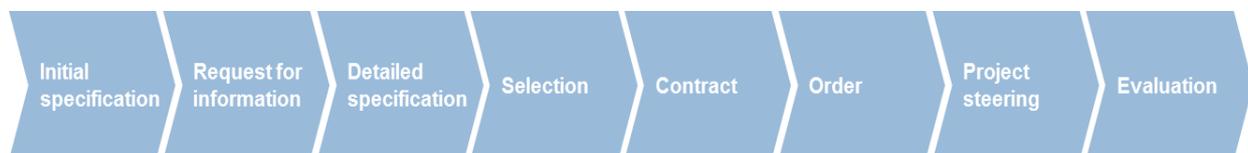


Figure 6: Purchasing process of consulting services; Source: Author's adaptation of van der Valk and Rozemeijer (2009: p. 7)

With respect to specification, van der Valk and Rozemeijer (2009: p. 6) differentiate between four methods – input, throughput, output, and outcome specification:

When the buying company specifies the service as a consultant with a certain degree and level of experience for a certain period of time, they use an input specification. When they specify a process of regular meetings with the consultant aimed at redeveloping the purchasing strategy, this is referred to as a throughput specification. When the specification is to attain an improved purchasing strategy, it is an output specification. Finally, when quantifying the final objective, for example as 10 percent savings on contracts with partner suppliers, the buying company uses an outcome specification.

2. Consulting: Literature review and synthesis

The process of consultants replying to these specifications, attempting to convince the potential client to choose them to carry out the respective project is usually referred to as 'pitch'. As will be discussed below, by far not all projects follow an official and extensive pitch process.

In many cases, managers may simply turn to a consulting company with which they have previously been satisfied to sign a contract for new projects (Haverila et al., 2011). This is reflected in reality. For instance, BCG claims that over 30 percent of its customers have been part of the client base for over ten years (The Boston Consulting Group, 2015) which must be a result of a number of projects, given the relatively short average duration of consulting engagements.

Apart from catering personal relationships, awarding projects to previous business partners can be economically cost efficient. According to Baaij (2014: p. 12) agreeing on repeat business "is attractive to both parties as it saves on search cost for clients and acquisition costs for consultants."

In case several possible consulting companies are feasible as service providers, the contracting decision may be based on different selection criteria. An empirical study by Day and Barksdale (1992: p. 86), investigating the selection process of providers of professional services, suggests that there are four main dimensions of such criteria:

- (1) *Perceived experience, expertise, and competence of the provider;*
- (2) *The provider's understanding of the client's needs and interests;*
- (3) *The provider's relationship and communication skills;*
- (4) *The likelihood of the provider conforming to contractual and administrative requirements.*

Glückler and Armbrüster (2003: p. 286) suggest that there is a sequence of factors influencing assignment decisions, namely:

- (1) *Public reputation;*
- (2) *Experience-based trust;*
- (3) *Networked reputation; and*
- (4) *Competitive price.*

In reviewing a number of existing studies on decision criteria for consulting projects in Germany, Glückler und Armbrüster (2003) find out that of these factors "neither price nor measurable quality, but rather experience-based trust and a mechanism we label 'networked

2. Consulting: Literature review and synthesis

reputation” are the drivers in the decision for assignments between competing consultancies. This is in line with argumentation by Clark and Salaman (1998).

Relying on reputation in one’s network or on public reputation, especially in the absence of own previous experience, can alleviate the fear of misconduct by the consultant. Obviously, having a good reputation can be an “incentive not to cheat” (Granovetter, 1985: p. 490) as rebuilding a damaged reputation would be costly. Thus, also a selection based on reputation leads to reduced transaction costs (Sieweke et al., 2012), again, due to a lesser need to invest in safeguards.

Following this discussion, the question arises of how intensively clients of consulting services actually search for potential providers and how many of these candidates are invited to deliver their pitch presentations. While this question is certainly difficult to answer in general, as the ‘typical client’ company does not exist, there is some indication for a rather low search intensity.

McLachlin (1999) quotes a study, according to which in 1990, 68 percent of client companies have never talked to a second consultant and 83 percent do not solicit a second bid prior to signing a contract. Still in 2000, roughly 25 percent of client companies stated not to conduct any form of market screening before deciding for a consultancy (Glückler and Armbrüster 2003). What the development of these numbers already hints at, is, that also the procurement process is subject to the increasing client sophistication, as discussed in Section 2.2. As companies work with consultants more often and the accumulated amount spent on consulting services increases, the question of whether and if so, how, procurement of these services can be made more efficient.

While the trust-based decision criteria may be a means to reduce transaction costs, as discussed above, one should not overlook the potential opportunity costs (Pemer et al., 2014). These opportunity costs can occur as chances to find service firms who either deliver better quality and / or do so at lower prices are clearly decreased by limiting the search to very few providers or continuing with the present one.

Indeed, research indicates that when trying to source more cost-efficiently, services on average display even a greater savings potential than materials or commodities (cf. van der Valk and Rozemeijer, 2009). In order to improve the purchasing of professional services, organizations can take a number of measures. The most prominent ones are (1) formalization, meaning the establishment of rules and guidelines for sourcing, which may include mandatory checklists, (2) centralization, meaning that instead of individual decision makers, purchasing

2. Consulting: Literature review and synthesis

is organized centrally, in most cases by the sourcing department, and (3) establishment of framework agreements, meaning that potential suppliers are required to fulfill a number of criteria in order to be eligible for a cooperation and requiring them to deliver according to agreed terms, for instance with respect to quality, price, and termination periods. Such agreements could be regarded as formalization with respect to external partners. It ought to be pointed out that these factors are not necessarily mutually exclusive. In a highly formalized environment (1), it may be required to turn to a central purchasing department (2) for selecting a service provider, which might have to be listed in a pool of preferred suppliers with whom an outline agreement has been signed (3).

Especially in cases where the top management team is responsible for making assignment decisions for consulting services, it might be the case that the board of directors may set up and control the policies for the appointment of consultants (Höner and Mohe, 2009). In general, in an organizational context, “[f]ormalization represents the degree to which rules define roles, authority relations, communications, norms and sanctions, and procedures” (Jaworski and Kohli, 1993: p. 56).

In line with the above, according to Perner et al. (2014), the predominant reasons for formalizing sourcing procedures have to do with cost reductions. Following the authors, adhering to common procedures is aimed at reducing search costs, selection costs, contracting costs, and monitoring costs. Moreover, with clear guidelines which everybody in the client organization needs to follow, the company appears more homogenous which is argued to increase the bargaining power, and thus, potentially leading to improved terms and conditions.

In the underlying empirical study among 76 Swedish companies, Perner et al. (2014) attempted to determine which characteristics drive the elements of purchasing formalization. The results indicated that the larger the organization is, the more likely it is to have formulated policies for dealing with service providers. Further, the more often the respective organization contracted such service companies, the higher was the likelihood of having outline agreements in place.

The internal sourcing regulations of an organization may require that purchasing professionals are involved in the process. This involvement can be of different degrees of intensity. Werr and Perner (2007: p. 101) describe it as:

[...] evolutionary, passing the levels of transactional orientation (focusing on the clerical tasks), commercial orientation (requesting and comparing different tenders, negotiating),

2. Consulting: Literature review and synthesis

coordination of purchasing (gaining control over and coordinating demand, managing the supplier base), internal integration (cross functional involvement, supplier development), external integration (focus on the entire supply chain) and, finally, value chain integration (working with the supply chain from the end customer's perspective).

To classify organizations' approaches according to the degree of involvement of the sourcing departments, it is suggested to differentiate between decentralized and centralized approaches. In the former, individual managers are in charge of dealing with consultants with no or almost no involvement of purchasing professionals. In the latter, the sourcing department is heavily involved in the interaction with consultants, being responsible for the selection and contracting of these. Configurations in between are referred to as "hybrid approach" (Sieweke et al., 2012: p. 123).

A centralized unit dealing with professional services is not necessarily limited to sourcing service providers. Höner and Mohe (2009: p. 307) differentiate between a "central office for the purchasing of consulting service" and a "central project office". The latter is involved along the entire process up to an evaluation of the respective project.

Delegating the responsibility for sourcing of consulting services to purchasing departments can, once again, be motivated by a struggle for cost-efficiency. If sourcing professionals are experienced in negotiating about conditions due to frequent interactions with consultancies, they are assumed to be better qualified to do so than other individuals in the organization, e.g. than managers (van der Valk and Rozemeijer, 2009). Furthermore, the goal may also be "to control managers and consultants by establishing a corporate relationship (i.e. between the client company and a management consultancy), as opposed to a personal relationship (i.e. between an individual manager and a consultant)" (Sieweke et al., 2012: p. 126). This aspect will be discussed in more detail at the end of this subsection.

Whatever the motivation behind it may be, it is clear that the share of companies using purchasing departments to deal with consulting engagements has increased significantly since the turn of the century (Werr and Perner, 2007). The same developments are visible with respect to preferred supplier agreements. An empirical study by Sieweke et al. (2012) reported that 44 percent of interviewed client companies have such frame agreements in place. This value is roughly in line with the results by Perner et al. (2014), reporting around 40 percent.

However, despite the increasing use of instruments like preferred supplier programs, their merits are controversial. For instance, Perner et al. (2014) did not find a positive relation

2. Consulting: Literature review and synthesis

between the establishment of outline agreements with preferred suppliers and the companies' abilities to purchase services. Sieweke et al. (2012: p. 131) reported that, regarding the "selection criteria when purchasing consultancies, we found no differences between companies with and without PSPs for consulting services."

Moreover, given the fact that, according to the aforementioned studies the number of consultancies in such supplier pools can be as low as three, the risk of myopic sourcing from a very small set of possible suppliers is evident. As mentioned before, thereby, the availability for cheaper or better providers in the market may be overlooked, leading to opportunity costs.

In another study, Lindberg and Edenius (2006) investigate the changes in public procurement of consulting services in Sweden following the introduction of the Act of Public Procurement (APP). The authors state that the "grand thought of the APP is to foster 'grand business practice'" (p. 1) by adhering to the sourcing regulation which, for example, requires tendering to be open to consultancies from all over the European Union above certain threshold values. The benefits from free competition among consultancies should, for instance, be expected to enable a better price-performance ratio.

The attitude of the respondents in their study, however, was highly critical towards the directive. Interviewees' stated that following the regulation was "extremely resource-demanding" and "bureaucratic and costly" (p. 5) so that they attempted to either "work around" or "ignore" it (p. 3). It was further argued that standardizing the requirements of management consulting projects in a way that it would fit a general sourcing directive was virtually impossible.

Adding to the critique towards sourcing regulation, Ernst (2002) suspects that formalized selection procedures are in many cases used to legitimize pre-specified decision. A differentiated view is offered by Werr and Perner (2007: p. 111). They conclude that

[...] a preoccupation of purchasing professionals with cost-related aspects and a focus on "measurable" aspects of the service. An increased focus on formal criteria, for example, for the choice of consultants, may shift the focus towards measurable variables such as price and time, while more intangible aspects, such as the consultants' cultural fit, the manager's trust in the consultant or reputation, become downplayed. In regard to consulting services that are well understood and fairly standardized, such a shift may increase service quality and the price/performance relation. In regard to other, less well-understood services, it may however be detrimental to the quality of the services purchased.

2. Consulting: Literature review and synthesis

Hence, one should not expect to find a 'one size fits all' solution for the question of how much power ought to be given to procurement departments. This may be part of the reason why the trend of shifting responsibility towards sourcing departments may be slowing down. In a recent study about trends in the German consulting market, the German consultants' association, BDU, reported that the majority of polled consultants, 72%, agreed with the statement that the actual departments¹⁷ regain influence in the selection decision for consultants (BDU, 2016: p. 18).

Apparently, there is a tradeoff between giving an individual manager or a procurement professional the authority to make the supplier decision for consulting projects. Managers may have a better understanding of how the consultants are going to fit to the team which is supposed to work with them, as pointed out by Werr and Perner (2007), and may also be better qualified to judge the specific professional expertise of the potential consultants. However, several authors have cautioned that managers' hiring decisions are prone to cater their own agenda more than the organization's (e.g. Bloch, 1999; Macdonald, 2006; Höner and Mohe, 2009). This may also explain the particular resistance by managers against the involvement of sourcing departments, apart from their general opposition towards loss of power (Werr and Perner, 2007).

Procurement professionals, on the other hand, may be able to usefully bundle requests for proposals towards consultancies and they are more likely to be aware of the previous corporate relationship with certain consulting companies, allowing for potential discounts on subsequent projects. Moreover, as mentioned above, it is argued that the specialized sourcing staff is generally more experienced in negotiating (van der Valk and Rozemeijer, 2009).

By means of a simple graphical representation, it can be shown why it may be beneficial for a given client enterprise not to grant the responsibility to take the hiring decision for consultants to an involved manager. The example is situated in a two player-setting consisting of a manager, M, on the one hand and the rest of the client company, or enterprise, E on the other hand. This player E could, depending on the context, for instance be interpreted as employee representative, as manager of a competing division or department, or as sourcing professional. At a given point in time, the status quo is denoted by point '0' below. This point represents the respective utility levels of the players M and E are denoted by $U_M(0)$ and $U_E(0)$ in *Figure 7* below¹⁸.

¹⁷ German: *Fachabteilung* as opposed to the sourcing department, *Einkaufsabteilung*

¹⁸ For the sake of simplicity, the curvature of the respective utility curves of players M and E is not described. Both players are assumed to be utility maximizing individuals.

2. Consulting: Literature review and synthesis

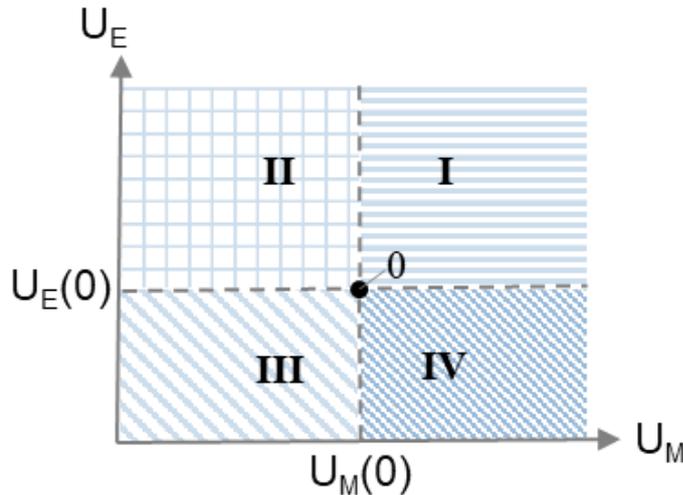


Figure 7: Scenarios for hiring decisions with respect to consultants and M's interest

Assuming that consultants may be hired for a project, the utility levels of the involved parties, M and E, are assumed to change. In case, net of consulting costs, the position of both players improves, i.e. the combination of utility levels would shift in north-eastern direction, carrying out the project would be in the interest of both. This is represented by area I in Figure 7. If M is making the decision on hiring consultants, these would be hired in this situation without a conflict arising.

Analogously, if both M and E would be worse off due to consulting project – represented by the area labeled by III above – a rational, utility-maximizing M would decide not to hire consultants and thereby not hurt E.

What is more critical, are the cases represented by the areas II and IV in the above figure. Both describe possible problems resulting from M's interests being in conflict with E's. In the former, M can be assumed to hire consultants despite harming E. If, as in the latter case, a solution offered by a given consulting company would harm M's personal position and M is aware of this beforehand, no project would be started with these advisors.

According to Bloch (1999: p. 115), consultants “need to please the people who sign the contracts, often the very individuals who should be most subject to scrutiny.” In similar vein, Randall (2006: p. 1) asks “when was the last time a consultancy firm moved into a company, analysed its flaws, and then recommended that the [...] management should be fired?” In the light of the argumentation above, the statements by Bloch (1999) and Randall (2006) need to be looked at from a different perspective. It may be the case that consultants exist that would indeed identify that part of the client company's problem lies in its management. However, in case M is making the respective supplier decision, such consultants whose recommendations

2. Consulting: Literature review and synthesis

would lead to a result west of the initial situation, would not be employed¹⁹. If the board of directors instructs the purchasing department to select a consultancy, this problem may be prevented.

However, it should not be taken for granted that buyers are free of their own agenda and preferences, as many articles on sourcing of professional services appear to assume implicitly. Thus, the proposed positive effect of taking responsibility from managers and shifting it towards the sourcing department may be overstated. As Ferguson (1996) points out:

Several studies of industrial buyer behavior have indicated that the fear of making a wrong decision is a major underlying consideration in vendor selection. An industrial buyer is often willing to pay a higher price to avoid the possible criticism, discipline, or termination that might result from a bad decision.

A final aspect worth discussing with respect to the procurement of consulting services are the pitch processes. Schmidt et al. (2005: p. 40) caution that “Strategy consultants who prepare for a beauty contest must make up-front investments and take the risk that clients will enjoy a free lunch as they shop for knowledge”. Indeed, if client companies invite a number of consultants to present their ideas, aspiring to be reimbursed for their up-front investment in the form of a project and none of the consulting companies ends up winning the pitch, this may constitute such a ‘free lunch’.

If the risk of a market failure was significantly high, in a sense that no consulting companies would submit proposals due to fear of giving away knowledge and effort for free, mechanisms against client misbehavior could be implemented. This could, for instance, be done in the form of a mandatory compensation paid by the client organization to all consultancies participating in a pitch.

However, Macdonald (2006) argues that consultants are experienced enough not to give away too much valuable knowledge before being officially hired. This may explain why such safeguard mechanisms, to the author’s knowledge, are not observed in the market.

Nevertheless, according to a recent study, around two thirds of consultants complain that even if they end up winning a project, they have to present intermediate results for free while they would have billed the analyses to the clients a few years ago (Werle, 2015). This is also an indicator of intensifying competition in general and, in particular, of increasing price pressure

¹⁹ That is, given that M is sufficiently informed about the project’s outcomes.

2. Consulting: Literature review and synthesis

as mentioned in Subsection 2.1.2. Prices, being part of the costs of consulting projects will be discussed in more detail in below in Subsection 2.3.3 after regarding contracts between consultancies and their clients in general in the next subsection.

2.3.2 Contract structure for consultancy projects

Following a chronological logic, after tendering for potential service providers and negotiating about project details, a contract is closed between the client organization and the consulting company which is to be engaged. These contracts are the subject of this subsection. Generally speaking, by doing so, I answer a call for further research by Kakabadse et al. (2006: 492) who state that research on “contract specification in consulting would benefit to both clients and business consultants.”

Basically, contracts between the client organization and the consulting firm can be of two types: either a contract of employment²⁰ or a contract of services²¹. In the former case, the consulting company is compensated for the time its employees spend on working on a given project. In the latter, the service provider is not remunerated for the incurred efforts but for agreed upon results (Fleischer, 2010). The contract of employment is by far more commonly observed. Fees which are contingent on results are, thus far, not the rule but rather the exception. However, as contingency fees are increasingly observed, they will be discussed in more detail in the next subsection.

Independent of whether the contract between the two parties is based on time and expenses or on results, it can be argued that it will hardly be complete. This fact is generally attributed to transaction costs incurred in formulating complete contracts (cf. Williamson, 1985). Instead of using contracts that cover all possible outcomes and situations, implicit agreements between the contracting parties are used (Klein, 1996). According to Akerlof (1970: p. 500) such “informal unwritten guarantees are preconditions for trade and production.”

As in many other areas of business, this also holds true for contracts dealing with consulting and may be especially pronounced in this industry. Since consulting engagements are oftentimes set up in order to solve non-standard tasks (cf. Section 2.1), Werr and Perner (2007: p. 100) point out that “in practice, contracting is generally rather informal and emergent, with the trust-based psychological contract being far more important than the legal contract.”

²⁰ German: *Dienstvertrag*, stipulated in §§ 611 ff. BGB.

²¹ German: *Werkvertrag*, stipulated in §§ 631 ff. BGB.

2. Consulting: Literature review and synthesis

Prior to turning to costs in general and fees of consultants in particular below, one aspect of contracts between consultants and clients will be regarded in more detail – namely the terminability of such contracts. Terminability of contracts can be expected to play an important role in regulating the relationship between the contracting parties. As Klein and Leffler (1981: p. 616) argue,

Transactors are assumed to rely [...] on the threat of termination of the business relationship for enforcement of contractual promises. This assumption is most realistic for contractual terms concerning difficult-to-measure product characteristics such as the "taste" of a hamburger.

Arguably, and as will be discussed in more detail in Section 2.4, the results of consulting projects are in most cases difficult to measure. Indeed, consulting contracts are usually readily terminable by the client company (Fleischer et al., 2014). This fact should in general be in the client's interest. If the client organization – or, to be more precise, key decision makers within it – should not be satisfied with the consultants' performance, having the option to dismiss the service provider can function as a safeguard against paying extensive fees.

One thought, however, should be added against the background of the discussion in Subsection 2.3.1. In case an individual manager is in charge of supervising a consulting project and is further in a position to dismiss consultants at will, it is unlikely that consultants could effectively communicate that they believe that the management is part of the organization's problem. If the contract were non-terminable, the consulting team could communicate to the board of directors rather freely about the management's deficiencies. This is most likely not the case under a contract which is terminable by the management and the board of directors ought to be aware of this problem. Yet, in reality, it appears that this risk is more likely mitigated by engaging sourcing departments, as discussed above, than by using long-term non-terminable contracts.

The predominance of terminable contracts may further be explained by intra-consultancy agency relationships. As presented in Subsection 2.2.3, the (junior) team actively executing project tasks should be considered to consist of agents to the (senior) partner who closes the project deal and who is claimant to the residual profits generated by it.

The project team is usually remunerated by a fixed wage and a bonus payment, depending on personal performance. Moreover, under the common 'up or out' scheme, the chance of making it to the next career level is also determined by performance (cf. Maister, 1982).

2. Consulting: Literature review and synthesis

In case the client firm should not be satisfied with the work done by the consulting team and decide to terminate the contract as a result, this would serve as a strong signal to the consultancy's partner without incurring monitoring cost (cf. Jensen and Meckling, 1976). Such a negative signal would likely dampen the individual consultants' earnings and career perspectives within the firm. Thus, one can argue that the threat of contract termination spurs motivation of the active team members involved in the project – a factor which may not be as strong under a non-terminable contract. This situation is laid out in *Figure 8* below.

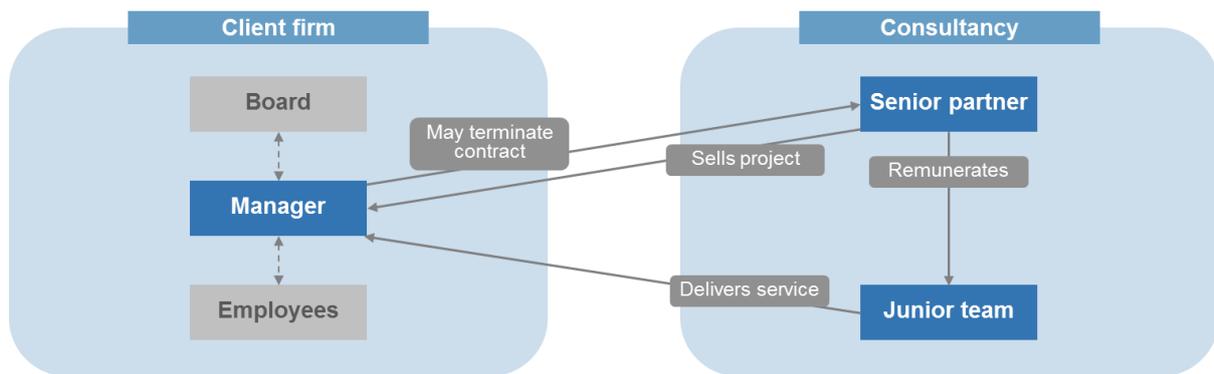


Figure 8: Set-up under terminable consultancy contracts with hiring manager as ultimate client

The consultancy's partner is likely to benefit from a motivated and hard-working project team as their efforts are related to client satisfaction and are likely to enhance the consulting firm's reputation which is an important factor in selling future projects (Glückler and Armbrüster, 2003; see also Subsection 2.3.1). The stream of income of future projects, can be assumed to be more important to the partner than to the team. This is because the juniors' compensation does either not depend, or at least less so, on the number of projects sold than for the partner. Moreover, given the rather short average number of years of working for a consulting company, long-term goals such as enhanced reputation of the firm may not be a highly relevant motivator for junior consultants.

2.3.3 Costs of consultancy projects

This subsection deals with the costs of consulting projects – starting with a broad look at costs in general, looking into consultancy fees in more detail, and putting a focus on contingency pricing in the end of the subsection.

2. Consulting: Literature review and synthesis

At first sight, the costs of hiring consultants may appear to be equivalent to the fees charged by consultants. Yet, more factors ought to be regarded. Phillips and Phillips (2011: p. 38) suggest the following cost aspects to be relevant in consulting projects:

- *The cost of initial analysis and assessment connected to the consulting project*
- *The cost to develop consulting solutions*
- *The cost to acquire technology, equipment, and external services*
- *The cost of materials and supplies used in the project*
- *The cost for the use of facilities and support expenses*
- *The cost for the time of all stakeholders involved in the project*
- *The cost of application and implementation of the project*
- *The cost of maintenance and monitoring*
- *The costs of administration and overhead for the consulting project allocated in some convenient way*
- *The cost of evaluation and reporting*

It is important to point out that this list does not state who bears these costs. While the development of solutions may be primarily carried out by consultants, who later bill their clients for the related expenses, the cost of monitoring will usually be incurred by the client company. In general, one can assume that most costs on the side of the consultants will be passed on to the client in the form of their fee.

In addition to the factors listed above, unintended externalities beyond the project context could be regarded as costs resulting from engaging consultants. For example, a consultants-led outsourcing project may result in a loss of crucial in-house knowledge or decreased employee motivation (Ernst and Kieser, 2012). Moreover, if a company is relying heavily on consulting services, own capabilities may not be developed. Thus, opportunity costs due to foregoing possible benefits from having these capabilities in-house are incurred (Solomon, 1997; Faust, 2014). Furthermore, in case confidential client information is misused by consultants (cf. Glückler and Armbrüster, 2003) the effects may also be regarded as costly. In order to keep the discussion somewhat comprehensible, these rather abstract costs are not regarded in detail for the moment.

Apart from externalities, one can basically group the costs resulting from a consulting project which client organizations face in three classes. First of all, there are direct expenses, which are payable in the form of the consulting fee. Secondly, there are indirect costs which include

2. Consulting: Literature review and synthesis

the time and effort of involved staff on the end of the client firm, rent, materials, etc. A third class, as has been argued, can be regarded as agency costs.

These agency costs are present due to the characteristics of the interaction between the involved stakeholders, as discussed in the previous sections. Given the relatively nontransparent market for consulting services and the aforementioned difficulties in observing the contributions of the respective parties to the project, several authors have emphasized the considerable uncertainty present in the context of consulting projects (Glückler and Armbrüster, 2003; Sturdy et al., 2013).

In theory, agency costs can occur for several reasons. According to Shapiro (2005: p. 281), these include:

[...] the costs of recruitment, adverse selection, specifying and discerning preferences, providing incentives, moral hazard, shirking, stealing, self-dealing, corruption, monitoring and policing, self-regulation, bonding and insurance, agents who oversee agents who oversee agents, as well as failures in these costly corrective devices.

In virtually all agency relationships, some of these sources of agency costs will be relevant. Rather than eliminating them altogether, a principal can choose to incur one (or several) costs in order to prevent having to face others. For example, investments in monitoring can be used to mitigate the risk of shirking by the agent.

In the context of management consulting, the literature offers mainly three levers by which agency problems can be moderated: (1) trust, (2) regulation, and (3) contingency fees. Trust, according to the commentators, can result from a long-standing business relationship between client organization and consultancy, including numerous joint projects (e.g. Sturdy et al., 2013). Moreover, trust can come from recommendations from trusted sources, such as peer managers in other companies, which Glückler and Armbrüster (2003: p. 269) refer to as “networked reputation”, as has been mentioned in Subsection 2.3.1. More generally, trust in a consultancy can further result from a general reputation either of a specific partner or the overall brand (Glückler and Armbrüster, 2003).

While regulation, certification and standards are used in many other industries to bridge uncertainties of principals with respect to potential suppliers – for which such certificates can be the source of a competitive advantage (Terlaak and King, 2006) – these measures are largely absent in the consulting industry (cf. Section 2.1). For instance, only approximately

2. Consulting: Literature review and synthesis

1-2% of all professionals have obtained the title Certified Management Consultant (CMC) (Law, 2009; Greiner and Ennsfellner, 2010).

Thirdly, fees contingent on results are suggested to align the interests of client and consulting firms (Clark, 1993). This option will be discussed in more detail below. Before turning the special case of contingency fees, pricing in consulting in general will be reviewed.

As mentioned in Subsection 2.3.1, Glückler and Armbrüster (2003) do not find price to be an overly important criterion for clients in deciding for a consulting company. Apart from their empirical study, they also quote several studies from the 1990's (e.g. Clark, 1995) which support the argument that price is an unimportant factor in the competition between professional service firms. Nevertheless, the authors also recognize that "price becomes increasingly important as uncertainty in the consultant–client interaction decreases" (Glückler and Armbrüster, 2003: p. 288).

Therefore, it seems reasonable to assume that the increasing importance of price is driven by the process of client sophistication which was discussed in Section 2.1. Richter and Niewiem (2004) suggest that clients' demand for consulting services becomes more elastic with respect to price as these clients become more experienced in dealing with consultants.

This development from earlier phases, as quoted by Glückler and Armbrüster (2003), to more recent times is underlined by the findings of Momparler et al. (2015). In their work, they call "price [...] the main factor in clients' contracting decision" (Momparler et al. 2015: p. 1458).

Due to this more pronounced role of pricing of consulting services, the remainder of this section addresses several important aspects of pricing in this context. First, pricing strategies and price setting methods will be briefly reviewed. Later, the main focus will lie on the discussion of output-contingent pricing which has become increasingly important also for consulting companies.

Price-setting methods

In general, many different methods for price-setting exist and have been discussed in the literature. The six most commonly used approaches are summarized by Kotler and Keller (2006: p. 444 ff.): (1) Mark-up pricing, adding a standard mark-up factor on the costs incurred in producing a good or delivering a service; (2) Target-return pricing, determining an end price which delivers a desired rate of return on (specific) investments incurred in order to develop and market a certain product; (3) Perceived value pricing, adjusting prices to the value which

2. Consulting: Literature review and synthesis

consumers attach to it, ultimately depending on the consumers' willingness to pay; (4) Value pricing, attempting to win loyal, repeat customers by offering low-margin products; (5) Going-rate pricing, basing the prices of offered goods and services on benchmarked prices in the relevant set of competitors; and (6) Auction-type pricing, leaving the final sales price for a good or service to be determined by the highest bid by potential customers.

Obviously, several of these price-setting methods are comparably inadequate in order to set the price for a professional service such as consulting. Dealing more specifically with pricing in the consulting industry, Owusu-Manu et al. (2012) list four major methods used by consultants: (1) Time and expense, meaning that the rate per time unit of the professional staff times the respective billable time incurred plus additional expenses (e.g. travel costs) are charged; (2) Results-based fees, depending upon reaching specified goals; (3) Fixed price, representing a total fee billed irrespective of incurred efforts or results, and (4) Risk and reward related pricing, adjusting a time-based or fixed fees upward in case of target achievement or downward in case goals are missed.

The first type is the most commonly used in the consulting industry and in this sense, consultants' "output is calculated in person-per-day units" (Czarniawska and Mazza, 2003: p. 274). According to a recent article, the rates per day charged by market leader McKinsey in Germany are as follows: € 10.800 for a partner, € 7.900 for a junior partner and € 3.000 for a senior consultant (Freitag and Student, 2015).

One should notice that higher prices charged for an hour or a day of professional staff do not have to decrease the chances of a consulting company to win a given project. Following the basic idea expressed by Klein and Leffler (1981), high prices may be a signal of high capability and a means to assure performance as contracted. Several authors (e.g. Glückler and Armbrüster, 2003; Owusu-Manu et al., 2012; Christensen et al., 2013) have emphasized that high prices are perceived as indicator of quality and that the esteem of top-tier brands is even fueled by elevated price levels.

Pointing in the same direction, Arnaud (1998: p. 478) states that clients may feel like guinea pigs in case they are obtain the consultants' advice for free or at a low rate.

Apart from potentially making clients feel insecure about the quality of recommendations they are receiving at a reduced rate, consultants should be even more worried about not setting unfavorable precedents by charging low fees. As in almost all industries, having once offered

2. Consulting: Literature review and synthesis

their work cheaply, consultants will face great difficulty in successfully demanding higher fees in subsequent projects (Connell and Zalan, 2012).

Contingency pricing²²

As mentioned above, contingency fees have been proposed as a means of solving principal-agent problems inherent in the client-consultant relationship. Given that the capabilities of a consulting team are often not known to the client organization and that the actual efforts incurred by the consultants are usually not easy to monitor, variable pricing appears to be a reasonable candidate to align the interests of the two contracting parties. This is in line with the description offered by Moe (1984: p. 763):

[...] general principal-agent models of hierarchical control have shown that, under a range of conditions, the principal's optimal incentive structure for the agent is one in which the latter receives some share of the residual in payment for his efforts, thus giving him a direct stake in the outcome.

Hence, an output-contingent pricing agreement may first of all only attract consulting companies who are confident to have sufficient resources to reach a given target and secondly ensure that the consultants are motivated to put in the required efforts to reach it. Before discussing the relevant aspects of variable pricing in the specific context of the consulting industry, the following representation will be used to demonstrate the general properties of a contingency fee agreement. It is an adaptation of one offered by Rickman (1994) in discussing the remuneration of lawyers.

The representation uses a number of variables:

- F – Fee to be paid to the consulting company, possibly determined by $f(x, e, \theta)$
- x – Produced outcome, depending itself on factors e and θ , so $x(e, \theta)$
- e – Effort exerted by consultants, e.g. amount of time put in by professional staff
- θ – Random component

If the fee, F , to be paid to the consultants should not be a fixed fee, it can be made dependent on (a) output or (b) input. The random variable, θ , meaning that the client “cannot be sure how much of the ultimate outcome is due to the [consultants’] effort” (Rickman, 1994: p. 36), will

²² For the sake of brevity and in line with the literature on consulting pricing, output-contingent fees (i.e. depending on results) will be referred to as ‘contingency fees’ in the following while input-contingent will be referred to as ‘time and expenses’.

2. Consulting: Literature review and synthesis

eventually be relevant for the final payoff of the consultant, especially in the output-based scheme. The two schemes look as follows:

- (a) Input-based pay: the amount of fees collected by the consultants depend on the amount of effort put in, i.e. $F = f(e)$, $\frac{df}{de} > 0$
- (b) Output-based pay: the consulting company receives a fee determined by $F = f(x)$, the client company claims the residual, i.e. $x - f(x)$

In general, the structure of a fee is determined before the start of a given project. In this sense, it clearly relates to the discussion of project specifications in Subsection 2.3.1. In the terminology of van der Valk and Rozemeijer (2009), projects with input and throughput specifications will more likely result in the former remuneration scheme, output and outcome specifications in the latter.

The aforementioned price-setting methods according to Owusu-Manu et al. (2012) can also be directly related to the representation by Rickman (1994). Variant (a) is similar to a time-based fee, to which relevant expenses may be added, variant (b) is results-based. A fixed fee may be interpreted as special version of the input-based pay in a sense that $f(e) = f$ for $e > 0$. A fee structure taking into account risks and rewards can be regarded as hybrid between (a) and (b). In the terminology of Shapiro (2005: p. 270), the two types are referred to as “behavior-oriented” and “outcome-oriented” compensation.

Having established the theoretical possibilities of output-contingent pricing, the main question is how well such remuneration models actually work in aligning the interests of principal and agent and to which degree so under different circumstances.

Cumulative evidence from the area of human resources (HR) shows that, in general, financial incentives, e.g. in the form of variable bonuses, positively influence performance while not affecting intrinsic motivation negatively (Shaw and Gupta, 2015). Dealing with intra-firm incentives, the researchers point out that incentives need to be well-designed in order to be effective.

First of all, incentives need to lie above certain threshold values relative to the fixed component in order to have a noticeable effect on employee’s performance. A recent meta-study by Mitra et al. (2016) suggests that a lower bound of somewhere between 5 and 8 percent increase in compensation is needed to observe these effects. Secondly, the incentives have to be tied to relevant performance indicators in order to function as intended. Shaw and Gupta (2015: p.

2. Consulting: Literature review and synthesis

288) sum up that “unless the performance appraisal system is thoroughly examined for validity, tying financial incentives to them is likely to lead to undesired behaviors such as impression-management and politics.”

Outside of this intra-firm context, a number of studies, such as the abovementioned work by Rickman (1994) have analyzed the effects of different compensation schemes on the incentives of lawyers. While the results are certainly not unisonous, it is clear that the choice of payment scheme will influence the relationship between lawyers and clients in several dimensions. The most relevant ones are risk-sharing, conveyance of information and incentives (Bebchuk and Guzman, 1996).

With respect to risk-sharing due to working with a contingent contract, Helland and Tabarrok (2003) assert that net utility is created for the clients in case they are more risk averse than their lawyers. Moreover, these authors find that, compared to hourly fees, contingency fees discourage low-quality suits and reduce the average time to settlement.

For lawyers, a contingency fee scheme usually means that the lawyer will receive a fraction of a settlement amount or a final trial reward while bearing all litigation cost. As Polinsky and Rubinfeld (2003: p. 165) point out, this may lead to undesired effects as “the lawyer may have an insufficient incentive to bring the case, may spend too little time working on it if it is brought, and may encourage a settlement when the client would be better off going to trial.” Therefore, it is suggested to develop a modified contingency fee scheme under which the lawyer bears the same percentage of the costs and of the benefits to be obtained from a settlement of trial reward.

Coming back to the area of consulting, it is essential to note that while many useful parallels between the compensation of lawyers and consultants can be drawn, some key differences exist. The most important one, as one could argue, is the difference in realizing whether or not a given collaboration has been successful. In legal disputes, either by settlement or court decision, the result is usually evident at a certain point in time as is the payoff of the involved parties²³. As will be discussed in more detail in the next section, outcomes are less clear in most consulting projects. This may be the reason why such variable compensation models are only applied in a minority of projects.

²³ The possibility of appeal trials may render the outcomes uncertain as they may not be final – nevertheless, at least at the court of ultimate resort, results will be final.

2. Consulting: Literature review and synthesis

Estimates of which share of consulting projects are actually charged with a fee that carries a variable component are surprisingly scarce and may differ depending on the respective studies' focus. According to Christensen et al. (2013) the value lies just under 10 percent. What is clear from a review of the relevant literature is that the industry is facing a trend towards success-based fees (Baaij, 2014; Fleischer et al., 2014; Student, 2016). While in the early 1990s, consultants' associations referred to success fees as frivolous and unethical (Kubr, 1996), nowadays, some client companies such as the Lufthansa make it a prerequisite for consulting projects that at least part of the fee is goal-dependent (Fleischer, 2010). This trend towards more variable components in consulting projects is also expected to continue (Christensen et al., 2013).

In a perfect world, output-contingency fees "could be the ideal way of remunerating and motivating consultants: the consultant is not paid for spending time at the client's offices, or for writing reports, but for achieving bottom-line results. [...] The client pays only if the results are real and measurable" (Kubr, 1996: p. 564f.). However, the situation in reality is obviously not 'perfect' which is why it is necessary to analyze possible effects from the clients' as well as the consultants' perspective in order to judge whether or not such a remuneration model should be proposed.

From a client's point of view, the expected effect of implementing a success fee scheme can clearly be assumed to motivate consultants to put in the required efforts and resources to reach the respective project's goals. This point has already been made above.

Moreover, several authors propose that contingency pay of consultants may also function as insurance against a number of risks involved. First of all, if the consulting company participates in the downside risk in case a project does not turn out to be a success (Fleischer et al., 2014). Secondly – and related to the motivational aspect – such a compensation scheme is also regarded as safeguard against opportunistic behavior by the consulting company (Schweizer et al., 2009). Thirdly, following the trend of variable compensation models for consultants may also deflect the risk of being criticized for not sufficiently managing suppliers of professional services. Such criticism may for instance come from shareholders or superiors in corporations when arguing about a company's or a division's expenditures.

On the side of consulting companies, accepting or even pushing variable compensation models has been argued to be essentially a marketing device (Schweizer et al., 2009). By agreeing to such a model, consultants express confidence in their capabilities and effectiveness which is underlined by the willingness to take a stake in the client's risks.

2. Consulting: Literature review and synthesis

Moreover, consultants can signal not to be afraid to be evaluated and measured against the promises made during the tendering phase.

A point which, to the best knowledge of the author, has not yet been mentioned in the literature is that variable pricing contracts may provide a valuable point of contact for the consultancy with key decision makers in the client organization. In general, the results on which a success fee may depend oftentimes only become visible a certain time after the project ends (cf. Fleischer, 2010). In order to determine the final amount payable, discussions between the project sponsor on the client side and the partner on the side of the consulting company may be necessary. In case these parties meet, it provides the partner of the consulting company with a valuable opportunity to not only discuss the past project but to also talk about topics which may lead to follow-up projects. A rough idea of how valuable such touch points are can be obtained by a recent statement of a consulting partner quoted by Student (2016). According to this article, the mobile phone number of a CEO of a stock listed company is valued at around € 100,000, not including possible revenues from projects.

According to Ernst (2002), the post project evaluation of consulting projects, which is usually a prerequisite of contingency agreements, can further be a safeguard for consulting companies against later criticism and possible recourse claims²⁴. Once the client organization agrees to pay a certain percentage of the variable component, it implicitly acknowledges that the agreed upon service has been delivered by the consulting company.

While not being part of contingency pay agreements, an important positive side effect has been pointed out by Fleischer (2010). In order to agree on measurements on which a variable compensation may be based (see Section 2.4 for a discussion on commonly used measurement scales) client representatives and consultants have to agree on project goals and deliverables before the start of it. This may appear to be trivial but diverging opinions on the actual objectives and desired results are listed among the key reasons for project failures (e.g. Schaffer 1997). The improved coordination is likely to benefit both parties.

Besides these possible advantages of using a contingency pay model over more classical options, such as time and expense, several possible disadvantages and undesired effects may exist.

²⁴ Ernst (2002) did not specifically mention variable fee agreements – the argument, resulting from post project evaluations, is valid nevertheless.

2. Consulting: Literature review and synthesis

For clients, a major risk in incentivizing consultants via such success-based fees may carry the risk of shifting towards short-term, easily quantifiable goals (Mohe, 2005; Ernst and Kieser, 2012). If this happens, long-term objectives could be disregarded leading to detrimental effects.

Related to this, when the focus of the project team is set in a way such that there is a strict focus on reaching pre-specified targets, the client organization may further forego the opportunity to benefit from improvement levers which consultants might only discover in the course of the project (Fleischer, 2010). In this sense, a narrow and clearly specified scope carries a possible opportunity cost.

Specifically in M&A projects, fee structures are oftentimes designed in a way such that the consulting company receives significantly more fees in case the bidding company, which the consultants are advising, stays longer in the process and even more so if a transaction eventually takes place (Connell and Zalan, 2012). The potential conflict of interest is rather evident in this case. Instead of providing an honest evaluation of the attractiveness of the target company, consulting companies may be inclined to phrase their assessments overly positive in order to increase the chances to receive higher revenues.

On the consultants' end, Schweizer et al. (2009) point out that clients may only agree to a variable compensation scheme if they know that chances of actually reaching the targets are relatively low. As clients are likely better informed about the preconditions, this is a risk of adverse selection. Similarly, in M&A projects, clients may push for variable compensation in case no actual interest to buy a target exists but consultants should provide them with research and insights at a comparably low price (Connell and Zalan, 2012).

Overall, the more complex the measurements underlying a success fee agreement are, the higher are the respective measuring costs (Fleischer et al., 2014). Despite possibly being more accurate and thus also fairer, the incurred efforts in measuring and debating which fraction of the success component is due should not be underestimated.

The following graph summarizes the listed arguments on contingency pay of consulting companies. Whether or not their implementation is worthwhile for a given project clearly depends on how pronounced the factors are in the specific situation.

2. Consulting: Literature review and synthesis

	Client	Consultant
Opportunities / Advantages	<ul style="list-style-type: none"> ■ Providing motivation ■ Obtaining insurance against risks 	<ul style="list-style-type: none"> ■ Signalling confidence ■ Creating additional point of contact ■ Protecting against retrospective criticism
	Ensuring coordination	
Threats / Disadvantages	<ul style="list-style-type: none"> ■ Shifting focus to short-term results ■ Foregoing benefits from restricted scope ■ Providing malincentives [in M&A valuation] 	<ul style="list-style-type: none"> ■ Facing risk of adverse selection
	Incurring measurement costs	

Figure 9: Assessment of contingency pay agreements by perspective

In general, a decision for or against a contingency compensation model can be made along a number of axes: (a) Measurability / Attributability, (b) Information asymmetry, (c) Trust, and (d) Number of repetitions.

All other things equal, the better a result can be measured and the better it is attributable to the efforts of the consultants (i.e. the smaller θ in the example above), the more adequate is a choice for contingency fees.

In line with the discussion on incentive alignment against the background of agency theory, it is clear that the greater the information asymmetry between the responsible client representative and the consultants and the lower the degree of trust, the more likely it will be that incentive-compatible pay will be chosen. Lastly, the higher the chances that the two parties will meet again, which is similar to the probability to engage in a multi-round game in game theoretic modelling, the lower is the need to implement such motivational measures as variable pay schemes.

As will be clear from the discussion in Section 2.4 below, the measurability of effects differs highly by type of project. Results may be comparatively easy to quantify in cost reduction projects and a lot more difficult in projects aiming to design a long-term strategy. In M&A projects, according to Connell and Zalan (2012: p. 2682) contingency fees are in many cases calculated using the “Lehman formula”. Applying this formula, the “advisors' fees are estimated on the basis of a sliding scale of between 1% and 5% of the value of different portions of the transaction,” meaning that the higher the transaction value, the higher is the fee received by

2. Consulting: Literature review and synthesis

consultants in case that the transaction takes place. Under such a model, the abovementioned caveat from possible malincentives applies as consultants may be inclined to push for a deal to be closed in order to be rewarded – even if the transaction may be suboptimal for the consultants' client.

Against the background of theory summarized above, it is rather surprising that only very little academic attention has been devoted to scrutinizing which models are used in reality in consulting projects and under which circumstances so. To the best of the author's knowledge, there exists only one comprehensive study which was the basis of the dissertation by Fleischer (2010) and which further constitutes the basis for an article by Fleischer et al. (2014). The empirical research conducted in the course of this dissertation presented in Chapter 3, aims to broaden the research base. In the following, the main results of the work of Fleischer are summarized.

In her work, Fleischer conducted six case studies in projects where a contingency pay agreement had been in place. Where possible, she interviewed client representatives as well as consultants involved in these projects.

The study's key findings included that in all examined cases a relatively low number of criteria – a maximum of three (see *Table 1* below) – had been employed in order to determine whether the projects were considered to be successful. Thus, in conducting these measurements, no elaborated models were observed. Moreover, in none of the cases have there been attempts to isolate the consultants' contribution to success or failure of the projects. In five out of the six scrutinized cases, the use of variable compensation has been suggested by the client organization.

Furthermore, Fleischer et al. (2014) found no link between the competitive situation with respect to the projects (i.e. number of companies involved in the pitch process) and the use of contingency fees²⁵. In addition, the authors doubt the plausibility of an incentive effect on the consulting team actually working on a project (cf. Subsection 2.2.3).

Probably the most surprising finding has been that, according to Fleischer et al. (2014: p. 238), "there is not necessarily any link between the results of measuring success and the amount of the success fee paid." Following the authors' explanation, this is mainly due to the fact that the individuals eventually negotiating for the amount due, i.e. the project sponsor and the partner

²⁵ The informative value of this finding may, however, be questioned as the sample only includes cases in which contingency fees were used.

2. Consulting: Literature review and synthesis

of the consultancy, are detached from the actual project work. Their personal relationship, according to the study, is more relevant for the fraction of the success component paid than the actual measurement results. It is mainly due to this result that the summarizing assessment of Fleischer (2010) is that the use of contingency pay connected to a project evaluation is not advisable.

	1	2	3	4	5	6
Industry	Construction	Home & garden appliances	Automotive	Engineering	Automotive	Retail
Number of measurement criteria	2	1	2	1	3	1
Criteria used to determine payable variable comp.	<ul style="list-style-type: none"> ■ Satisfaction ■ Degree of implementation 	<ul style="list-style-type: none"> ■ Cost savings 	<ul style="list-style-type: none"> ■ Satisfaction ■ Target earnings increase 	<ul style="list-style-type: none"> ■ Cost savings 	<ul style="list-style-type: none"> ■ Inventory levels ■ Headcount ■ Specific freight cost 	<ul style="list-style-type: none"> ■ Amount of supplier kickbacks

Table 1: Summary of empirical study by Fleischer; Source: Summary of Fleischer (2010: p. 194) and Fleischer et al. (2014: p. 234)

Keeping in mind the scarcity of empirical data on contingency pricing in general and the somewhat unexpected conclusions by Fleischer (2010), a particular emphasis of the empirical study conducted in the course of this dissertation project was put on contingency pricing as the insights and opinions from the field can help improve the understanding of the underlying mechanisms. The findings are presented in Chapter 3. Prior to discussing these, the following section will focus on the impacts of consulting projects.

2.4 Impacts of consulting

The broad range of criticism as summarized in the beginning of Chapter 2 – especially the first mentioned aspect of an absence of added value in return for the oftentimes high consultancy fees paid – gives an idea of how uncertain commentators as well as clients of consultants are of the extent to which the advisors add value.

Correctly measuring the effects of consulting projects and the contributions of the team of consultants is definitely a complicated and complex task due to a number of reasons to be laid

2. Consulting: Literature review and synthesis

out below. While I clearly agree with the view that determining consultants' impacts is highly challenging, I believe that a structured approach to the problem can help to gain insights and improve the understanding of the topic. To do so, this section is organized as follows.

First, the existing literature on measurements for the value added and successfulness of consulting projects is reviewed, including a short summary of success factors for consulting projects which have been proposed by the literature. In combination with the insights obtained in the previous sections, the findings will be synthesized into a conceptual model for the determination of project value. This is followed by a summary of the few studies attempting to determine the effects of consulting interventions.

In a second step, concluding this literature-based chapter, the view on impacts of consulting is broadened beyond the determination of the impacts of a single project to discuss the effects of consulting on an industry-level as well as on society at large.

2.4.1 Measurements for project results and success factors

The purpose of this section is to review the controversial discussion around the question of when consulting projects are considered as 'successful' and how the value created by these projects may be measured.

The term 'value' has been used since the thirteenth century to express the worth of something. While around the seventeenth century, it was used largely equivalent to the price of a good or service, today the term 'value' is more connected to a personal appreciation than to a monetary unit (Owusu-Manu et al., 2012) which is important to be kept in mind when considering impact and value of management consulting projects.

In the debate about the value of consulting services, one view is almost commonly agreed on by the commentators: that assessing the quality and value is very difficult (Clark, 1993; Glückler and Armbrüster, 2003; Mohe, 2011). Some even claim that it is virtually impossible (Ernst, 2002; Ernst and Kieser, 2002; Sturdy, 2011). With respect to the uncertain outcomes of consultancy projects, Law (2009: p. 64) provokingly states that:

[...] when it comes to consulting, otherwise sane people are quite happy to play an organizational version of Russian Roulette.

2. Consulting: Literature review and synthesis

So what makes the valuation of consulting services so difficult? First of all, the characteristics of the service, as discussed in Section 2.1. As it usually is a co-production between client team and consultancy team, it is very difficult to isolate and attribute the individual contributions. The problem of isolating factors further exists with respect to external influences, possibly referred to as 'noise term', such as macroeconomic developments which cannot be influenced by the involved actors. When assessing the effects of a consulting project, one also faces the difficulty of setting a suitable time span to undertake measurement efforts. Another obstacle to a correct valuation of a consulting project is usually a lack of a control group in order to estimate what would have happened without the respective project (Kipping and Engwall, 2003; Ernst and Kieser, 2002; Schweizer et al., 2009; Ernst and Kieser, 2012; Fleischer et al., 2014).

The last major obstacle to effectively evaluating consulting projects is a bias of the individuals being in charge of the assessment (Kipping and Engwall, 2003). Ernst and Kieser (2002) have argued that neither the consultants nor the client representatives have an honest interest in conducting a correct assessment, largely because of their embeddedness in the project context. The personal interest makes it desirable from a manager's perspective to celebrate successful projects as own achievement, possibly not disclosing that consultants were involved, while project failures may be attributed to faulty advice from the consultants (Baaij, 2014). On the other hand, consultants will be tempted to talk about being successful due to their influence while blaming the client organization for unsuccessful projects, e.g. due to lack of effective implementation (Geffroy and Schulz, 2015). This tendency to relate success to personal efforts while blaming external factors for unsuccessful endeavors is certainly not a phenomenon exclusive to the consulting context. It is well known and described by psychologists contributing to attribution theory (Ernst, 2002). Thus, success and failure are subject to personal interpretation.

Despite all these obstacles to measuring success of consultancy projects, the pressure on hiring managers as well as consultants to prove the effects (Baaij, 2014) and consequently also the efforts to measure these have been increasing. The remainder of this section will (a) discuss success factors for projects as proposed by the literature, (b) review possible measurement approaches and scales, and (c) present (claimed) results of measurements.

Success factors

While the effects of consulting projects are difficult to measure, several authors have investigated which factors make successful projects more likely – however 'success' may be defined. It needs to be pointed out that the authors remain rather vague on how and from whose perspective 'success' ought to be measured.

2. Consulting: Literature review and synthesis

Below, I summarize the lists of success factors provided by McLachlin (1999), Appelbaum and Steed (2005), and Bronnenmayer et al. (2016). While a considerable number of such lists by other authors exists (e.g. Jang and Lee, 1998; or non-success factors such as the “fatal flaws” by Schaffer, 1997: p. 44), these three examples incorporate the proposed factors sufficiently well.

In general, these factors can either be attributed to the client side, the consultant side or to the space of collaboration as depicted in *Figure 10*. An alternative grouping of these factors could have followed the classification suggested by Kubr (1996: p. 18), sorting into a “technical dimension” and a “human dimension”.

While a solution developed for a client firm may be optimal in theory, there are very low chances of it getting implemented without convincing the relevant decision makers (cf. Ernst, 2002). As one could argue, in proposing a second-best solution, consultants may help the client firm in case the chances of a preferable recommendation getting accepted by the organization are too low. Being able to judge such a situation for the benefit of the client company can also be part of the consultants’ competences (as listed by Applebaum and Steed, 2005).

It should be emphasized that the success factors attributed to the interaction between clients and consultants working on the project in a joint team depend on the ability to translate and adapt the competences they have to the specific project situation (cf. Klarner et al., 2013). Managing the interactions of all participants is part of project management. Referring in general to “the planning, controlling and monitoring of projects” (Bronnenmayer et al., 2016: p. 11) successful project management includes clear assignment of roles and responsibilities to prevent conflict (Müller et al., 2008).

In order to contrast the success factors proposed by the aforementioned authors with a current view of practitioners, a discussion on success factors has been included in the empirical study which is presented in Chapter 3.

2. Consulting: Literature review and synthesis

	McLachlin (1999)	Appelbaum and Steed (2005)	Bronnenmayer et al. (2016)
Client	<ul style="list-style-type: none"> ■ Client involvement and readiness to change ■ Client control 	<ul style="list-style-type: none"> ■ Clear and well communicated expectations and outcomes ■ Visible executive support ■ Client readiness 	<ul style="list-style-type: none"> ■ Provided resources ■ Top management support
Interaction	<ul style="list-style-type: none"> ■ Clear agreement concerning requirements and expectations ■ Good fit 	<ul style="list-style-type: none"> ■ Emphasis on client results vs consultant deliverables ■ [Goals] defined in terms of incremental success ■ Real partnership ■ Inclusion of the consultants through the implementation phase 	<ul style="list-style-type: none"> ■ Common vision ■ Intensity of collaboration ■ Trust ■ Project Management
Consultant	<ul style="list-style-type: none"> ■ Consultant integrity ■ Consultant competence 	<ul style="list-style-type: none"> ■ Competent consultants ■ Up-front investment in learning the client environment 	<ul style="list-style-type: none"> ■ Consultant expertise

Figure 10: Selected lists of success factors, sorted by primary locus; Source: Adaptation of McLachlin (1999: p. 394), Applebaum and Steed (2005: p. 77), and Bronnenmayer et al. (2016: p. 23)

Measurement approaches

In an ideal world, clear measurement criteria are agreed upon before a project starts (Sieweke et al., 2012), are clearly quantifiable (Ernst and Kieser, 2012) and the degree of fulfillment of the criteria can effortlessly be obtained after the project ends (Schweizer et al., 2009). Moreover, the performance of the consulting team, leading to the result, can be readily isolated (Ernst and Kieser, 2012) and the outcome of the next best scenario without consultants is obvious and can be deducted to obtain the added value of the project (Fincham, 1999). Unfortunately, these conditions are effectively non-existent in real world settings.

Evaluation of consulting projects is probably the easiest, when clients and consultants agree on unambiguous bottom line criteria. In such cases, profits are to be increased by traceable cost reductions or increases in sales (Haverila et al., 2011). However, bottom line effects are not the only quantifiable indicators that can be used for the evaluation of projects. Such criteria may for instance be a reduction in employee sick days, enhanced employee satisfaction, reduced process time, improved website conversion rates or customer satisfaction scores (received by the client), as well as increased brand awareness (Phillips and Phillips, 2011; Ernst and Kieser, 2012; Baaij, 2014).

In the case of M&A projects, the objective which is to be fulfilled and which may therefore be used as a proxy for measuring success is simply whether or not a transaction takes place (Connell and Zalan, 2012). Further 'basic' criteria may simply include whether a project has

2. Consulting: Literature review and synthesis

been finalized within the scheduled time frame and the initial budget (Jang and Lee, 1998; Bronnenmayer et al., 2016).

A method to determine the value added by consultants which seems reasonable at first sight has been proposed by Solomon (1997). Just as for measuring venture capitalists' impact on firms they invest in, in addition to the increased liquidity (cf. Kleinschmidt, 2007), Solomon proposes to compare the client firm's value prior to and after a consulting project. Of course, this approach is subject to several of the obstacles to evaluation as discussed above. Apart from defining which time interval would be adequate for examination, the biggest problem is controlling for a large number of other factors (often very difficult to observe) influencing the firm value, especially in the case of stock listed companies which were analyzed in Solomon's study.

A number of authors have suggested scales and models according to which project evaluations could or should be conducted, of which the ones being most commonly quoted in the literature are presented below²⁶.

An early contribution by **Klein** (1978) proposes to measure success as a combination of aspects regarding the efficiency and the effectivity of a project where efficiency refers to the input-output relation while effectivity refers to the degree of target fulfillment. Depending on what has been defined as target, this effectivity can be expressed as reaching process oriented (e.g. with respect to time schedule) or quantifiable (e.g. sales increase) goals.

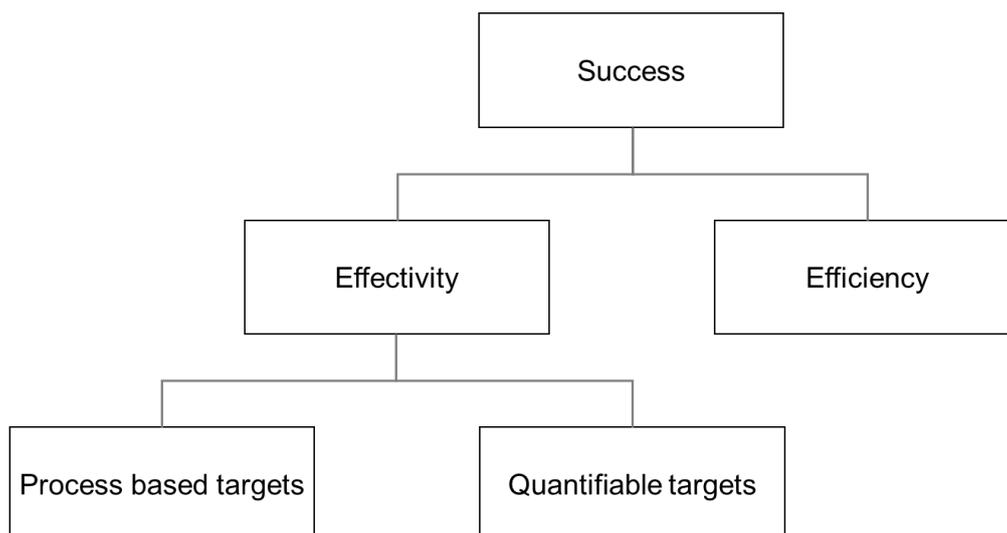


Figure 11: Success dimensions according to Klein; Source: Translation of Klein (1978: p. 108)

²⁶ For an extensive review, refer to Ernst (2002).

2. Consulting: Literature review and synthesis

Rynning (1992: p. 59) gives a long list of factors which should be scrutinized in order to determine how successful a consulting project was. For these, there should be a “visible positive difference” brought along by the respective project:

- *Clarity in need / problem formulation;*
- *Number / quality of new ideas;*
- *New knowledge;*
- *Special knowledge;*
- *New ways of thinking;*
- *Level of planning;*
- *Level of co-operational abilities;*
- *Management of time;*
- *Planning capabilities;*
- *Efficiency of execution;*
- *Strategy development;*
- *Problem solving;*
- *Implementation;*
- *Follow-up;*
- *Economy²⁷*

Gable (1996: p. 1175) suggests three main areas in which to assess projects: “(1) consultant’s recommendations, (2) client learning, and (3) consultant performance.” In order to measure these he combines satisfaction aspects with a few more easily quantifiable measures such as the usage rate. Gable’s dimensions are presented in *Figure 12* below.



Figure 12: Dimensions of engagement success according to Gable; Source: Adaptation of Gable (1996: p. 1180)

²⁷ Term in the context not clearly defined by Rynning (1992) – presumably referring to financial KPIs.

2. Consulting: Literature review and synthesis

Phillips published one of the most influential books on the evaluation of consulting projects in the year 2000, named “The Consultant’s Scorecard”. According to the same author, the methodology described in this book had been used to score around 5,000 projects by 2011 (Phillips and Phillips, 2011)²⁸.

Phillips’ process to ‘filling in’ the evaluation scorecard for consultants basically provides six types of data (Phillips and Phillips, 2011: p. xiii f.; italics added):

- (1) Reaction to and *satisfaction* with the consulting project from a variety of different stakeholders at different time frames.
- (2) The *extent of learning* that has taken place as those involved in the consulting project learn new skills, processes, procedures, and tasks necessary to make the project successful.
- (3) Success with the actual application and *implementation* of the consulting project as the process is successfully utilized in the client's work and organization.
- (4) The actual *business impact* changes in the area where the consulting project has been initiated. These values include hard data as well as soft data and represent typical business measures.
- (5) The actual *return on investment* reported as a ratio or as a percentage comparing the monetary benefits to the costs of the project. Thus measure shows the financial return on the investment in the project.
- (6) *Intangible measures*, which are business measures that have improved as a result of the project but that are not converted to monetary values for use in the ROI formula.

Phillips and Phillips put the most emphasis on the fifth level, the return on investment (ROI) calculation which, ultimately, may also be what corporate decision makers and shareholders care about most. The process of obtaining the measures is proposed to consist of four steps:

First, data is to be collected, for example by means of questionnaires, focus groups and financial KPIs. Second, the effects of the consulting group should be isolated using, among others, control groups and stakeholder estimates. In a third step, the qualitative data is to be converted to monetary values by means of proxies, expert estimations and others. The last step before being able to calculate the ROI is to determine the costs incurred in the course of

²⁸ The author has worked with the second edition of “The Consultant’s Scorecard” from 2011 while many other commentators refer to the initial edition from the year 2000. The methodology described in both editions is similar – only page references will differ versus earlier articles.

2. Consulting: Literature review and synthesis

the project, consisting of both the consultancy fees and internal effort costs. ROI is in most cases calculated as percentage, i.e. $(\text{benefits} / \text{costs}) * 100$, or as payback period. Such a period indicates the time it takes for the project results to justify the incurred costs, i.e. “payback period = costs / monthly benefits” (Ajmal et al., 2009: p. 530).

An interesting perspective has further been taken by **Ehrhardt and Nippa** (2005). For measurements, they propose an analysis of three classes of variables (2005: p. 6):

- (1) Input measures, e.g. number of consultants, hours worked, days of engagement.
- (2) Throughput measures, e.g., knowledge spillover, learning effects, emergent networks.
- (3) Output measures, e.g. costs cut, implementation success, business impact.

What may be more remarkable than the measuring parameters listed in their article is the fact that they also elaborate on the question whether the evaluation can succeed. They argue that the ability, opportunity and motivation to evaluate are decisive. While the motivational aspect is largely omitted from their discussion, the ability and opportunity criteria are moderated by a number of variables, which themselves depend on a number of factors.

The first moderating factor according to Ehrhardt and Nippa is the type of project, which is characterized by “the attributes (a) complexity, (b) dynamism, and (c) predictability” (2005: p. 8). Secondly, the client-consultant relationship is listed, being determined by (a) the frequency of interaction between the parties, (b) the embeddedness of the clients, and (c) the flow of information. The third moderating variable is the evaluator. Of a number of characteristics of this person, according to Ehrhardt and Nippa the most decisive attributes are (a) the authority, (b) the autonomy of this person as well as (c) the previous experience in evaluating consulting projects. Largely in line with the input-throughput-output approach by Ehrhardt and Nippa (2005), **Höck et al.** (2011) use capability, process and result parameters to construct an indication for the service value delivered by management consultants. In this, capabilities are referring to the skills and assets in the consulting company in general and especially those available to the team of consultants to work on a given project. Process variables describe the quality of carrying out actual project work including punctuality and team management. Results refer to the degree of target fulfillment from the client’s perspective. This study puts a special emphasis on “the effects of internal quality, i.e. the influence of the general and project-specific work environment on perceived service quality and customer satisfaction within the context of consulting projects” (Höck et al., 2011: p. 577).

2. Consulting: Literature review and synthesis

Despite the existence of these approaches to be potentially used in order to evaluate consulting projects, in many cases, no evaluation is carried out (Pemer et al., 2014). Even if projects are evaluated, it is commonly done by means of a simple “subjective *ex post* assessment” (Haverila et al., 2011: p. 1357, emphasis in original), based on the satisfaction of one or at most a few members of the client organization. This is in line with the findings by Fleischer (2010), as summarized in the previous section.

Using client satisfaction – commonly defined as delta between clients’ expectations and the actual perceived quality (Lassala et al., 2016) – as an indicator for a successful collaboration seems intuitive and is also employed by several of the approaches discussed above.

McLachlin’s (2000: p. 141) paper on the topic “concludes by suggesting that a consulting engagement is successful if the consultant has met client expectations [...] – whether or not a core need has been addressed – and the consultant has enhanced his / her reputation, with expectations of future revenue streams.”

What is striking about his view is that a project can be classified as successful even though the client company’s core issues are not brought up by the consulting team. By simply telling the client representatives what they would like to hear, the consultants may enhance their chances of future engagements (as recognized by McLachlin). However, referring to such a project as ‘success’ from the perspective of the organization is dangerous. Equating client satisfaction with success has thus been disapproved by reviewers of evaluation models (Ernst and Kieser, 2002; Fleischer, 2010).

Also, basically all the other presented approaches have been subject to criticism. What the approaches lack may be quantifiable results or scores. Thus, what the concepts generate is thus still a rather vague indication of success (Mohe, 2005 with respect to Klein, 1978; Ernst 2002, commenting on Gable, 1996 - also valid for Rynning, 1992 as well as Erhardt and Nippa, 2005).

Despite pursuing the goal of delivering quantitative and comparable results in monetary terms, also the approach by Phillips and Phillips (2011) has revoked extensive critique. It is said to lack customizability (Erhardt and Nippa, 2005) and to be cumbersome and complex (Ernst, 2002; Fleischer, 2010). Moreover, Ernst and Kieser (2012) conclude the problem of subjectivity cannot be sufficiently eliminated by the Scorecard approach. Hence, Mohe’s (2005) remark that there is no reliable and agreed upon approach to evaluating consulting engagements appears to be valid until the present day.

2. Consulting: Literature review and synthesis

Even in case a complex evaluation model could capture sufficiently well all aspects of a consulting project, a thorough evaluation will come along with measurement costs. These need to be contrasted with the possible benefits of an exact assessment. One point to keep in mind is that if latent consulting functions (cf. 2.2.1) make up a significant part of the hiring reasons, these will hardly be reflected in standardized and possibly company-wide used measurement scales (cf. Schweizer et al., 2009).

Summing up the above, the value created by a consulting project is usually not easily determinable. Strictly speaking, there may indeed not be one correct answer to the question how much value a project has generated. To approach the question of how much value was created by a given project, one first of all needs to understand for which reason(s) consultants were engaged, as has been discussed in Section 2.2.

When the value should be measured, the right measurement parameters are required. These may be the “output measures” in the terminology of Ehrhardt und Nippa (2005: p. 6) as mentioned above. Ultimately, clarity is further necessary with respect to which effects are attributed to consulting services and which aspects are beyond the definitional boundaries of what is meant by ‘consulting’ (cf. Section 2.1). For instance, personal coaching by a consultant to an individual manager in the context of the project may or may not be regarded as actual value added to the project.

As laid out earlier in this section, any measurement of results is subject to the selected time horizon and a significant amount of ‘noise’. Unfortunately, and especially relevant for classical consulting projects concerned with long term strategy, while a longer time frame increases the chances for results to materialize it also increases the difficulty in controlling for all possible other factors influencing the client firm’s performance.

Furthermore, it has been shown that the terms ‘success’ and ‘failure’ are strongly subject to whose perspective is taken. Therefore, the ‘value’ of a project will always be contingent on the point of view of the respective percipient.

Assuming that the aforementioned factors have been taken into account, the value of a consulting project may be understood as function of skill gap, resource gap and the participants’ performance. As has been argued in Section 2.2.1, except for latent motives, consultants are usually hired in order to fill one of these two gaps. The bigger the difference between the skills and resources available within the client organization and those to be usefully added by the consulting company, the bigger the potential value to be added by

2. Consulting: Literature review and synthesis

engaging consultants. This is interesting in the context of Section 2.1: as client companies have become more sophisticated, amongst others thanks to having hired former consultants, the skill gap has been narrowed, putting consulting firms under pressure.

Yet, only being capable of helping the client is not necessarily equal to actually helping the client. The efforts must be directed at solving problems (and not primarily to prolonging engagements) and the potentially skilled professionals must put in required effort levels in order to deliver a successful project. The same is true for members of the client team whose cooperation is needed. As mentioned among the success factors above, cooperation can be facilitated by a good fit between the actors involved on both sides. Moreover, the performance of the individuals actively involved in a project depends in part on the provision of necessary resources from adjacent stakeholders.

In order to determine whether or not a consulting project is or has been worth pursuing, for example from the point of view of a decision maker in a client company, naturally, costs have to be deducted. As laid out in Subsection 2.3.3 above, these include actual consulting fees, indirect costs, agency costs, as well as opportunity costs – i.e. the value of the next-best option.

Figure 13 summarizes the above considerations. This conceptual model is not meant to 'compete' with other approaches, e.g. that of Phillips and Phillips (2011), but rather to recapitulate and conceptualize the discussion about consulting value in the context of project work.

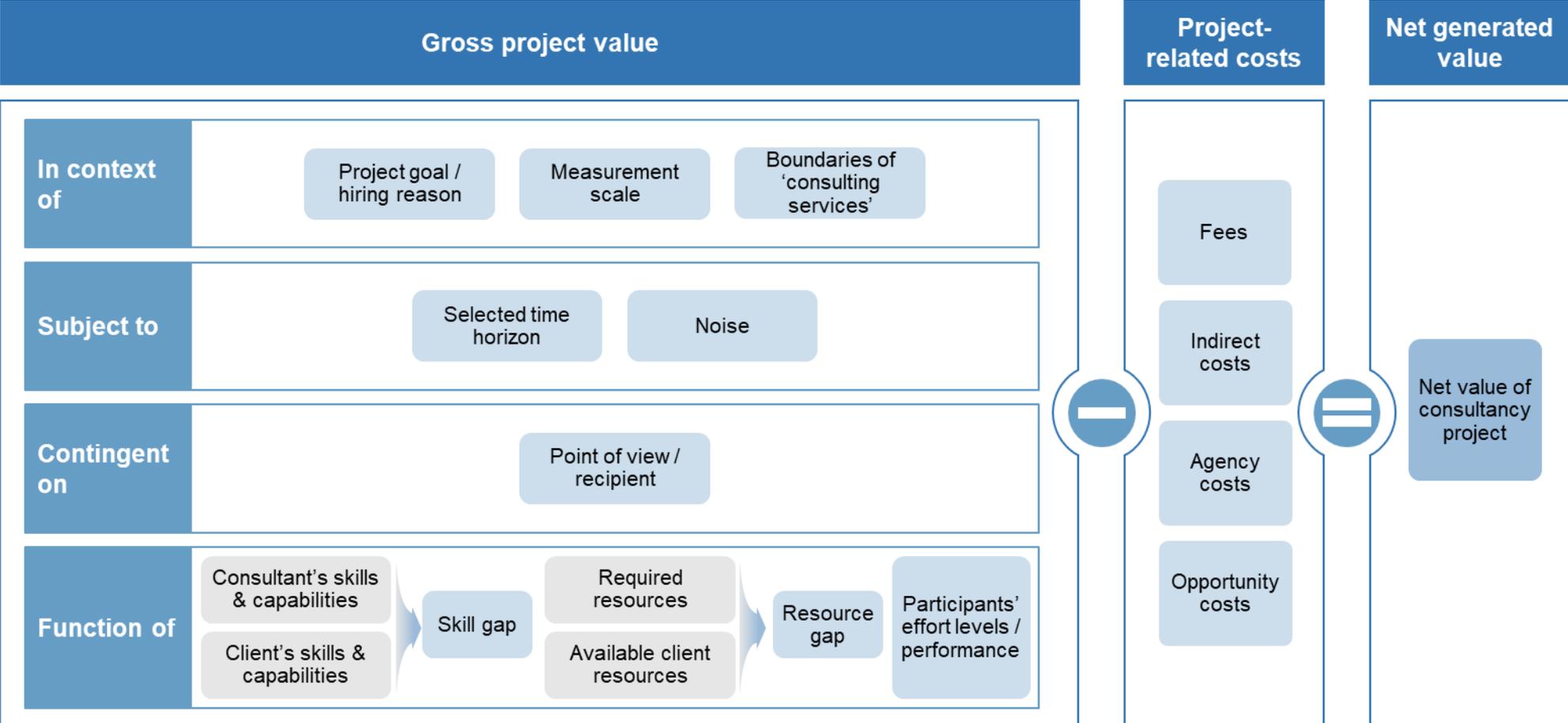


Figure 13: Factors influencing the determination of net project value

Measurement results

Even though the above has made clear that determining the value of consulting engagements is very problematic, there are a number of studies which attempt to provide answers to whether consultants add value and how much.

Naturally, data provided by consulting companies themselves needs to be taken with caution. For instance, Bain & Company (2015) claims that in general their stock listed clients have performed four times better than the rest of the market. Whether there is a cause-effect relationship behind this or whether better performing companies simply have more funds to spend on consulting projects remains unclear. BCG also claims that “our clients have seen tremendous returns on consulting investments” (The Boston Consulting Group, 2015: p. 9) along with case study projects ranging from 25 times the investment in a project in the fashion industry to 750 times the investment returned in a FMCG project. Not surprisingly, examples of unsuccessful projects are not disclosed.

There are also academic contributions indicating the possibility of very positive impact of consultants. Law (2009, p. 63) states that “consulting [projects] often deliver return on investments exceeding 1,000 percent (10 times the investment).”

The aforementioned study by Solomon (1997) compared stock prices of clients in 26 consultancy projects six months before and after the end of respective projects and compared the actual stock prices after the engagements to the predicted stock prices using the “capital asset pricing model” (1997: p. 68). The results indicate that the consultancy projects have added value for the client companies as there is a positive delta between actual results and the predicted outcomes.

Ajmal et al. (2009) also find a positive indication of consulting value. In their study, the return on investment in a sample of 20 consulting projects was evaluated. All of these were profitable or at least close to break-even and had, on average, a considerably short payback period of just over two months.

Both approaches, however, lack representability as they are limited to operations projects and one consulting division of an accounting firm in the case of Solomon and one client firm (presumably also one consulting company) regarded in the study of Ajmal and his colleagues. Whereas the aspect of subjective judgements can be largely disregarded in these contributions other abovementioned obstacles to evaluation, like the isolation of client team performance and of external variables, are still relevant.

2. Consulting: Literature review and synthesis

Also studies taking a meta-approach in reviewing several studies state that academic investigations usually find indications of positive contributions (Ernst and Kieser, 2012). Mohe (2005) provides a review of five different studies, of which each evaluated of between 38 and 100 projects, and estimates the average success rate. According to this data compiled by Mohe (2005), 30% of the engagements were successful and 40% rather successful while 20% were rather not successful and only 10% were not successful.

Still, these results are no reliable evidence of the effects of consulting in general. As Sturdy (2011: p. 527) puts it: “we can conclude that we do not currently have an adequate basis on which to make claims about the impact of management consultancy.” Since the effects of the consulting industry may go beyond concrete and distinct projects, this chapter concludes with a broader view on consultancy impacts below, aiming to provide the reader with a more complete view on the impact of management consulting.

2.4.2 Consultancy impacts beyond the context of projects

Up to this point, this section has discussed the influences consulting projects have on individual actors and on the client organizations. However, as Sturdy (2011: p. 517) argues, the “impact of consultancy may be even greater than is typically assumed.”

This impact becomes visible when a wider perspective is taken in order to investigate the effects of the management consulting industry. The impacts at an intra-industry level, an inter-industry level and the effects on society as such should not be disregarded (cf. Baaij, 2014).

Acting upon consultants’ recommendations can lead a client company to increase its market share in a given industry. Obviously, such a shift in market share will also affect other companies in this industry. In many cases, consulting projects are in part designed to teach the client organization ‘best practices’, i.e. performing certain tasks the way the best-in-class players carry them out. Again, while this can be highly beneficial for the client, “management consultants may erode the competitive advantage” (Baaij, 2014: p. 89) of the leading companies in this industry. Whereas codes of conduct of many consulting companies prohibit the transfer of such information between client firms, there clearly is the risk that an individual consultant who has worked on a project for a given client may continue his or her career at a competitor of this client in the same industry (Glückler and Armbrüster, 2003).

2. Consulting: Literature review and synthesis

Still, one might argue that by helping companies within an industry to catch up with the respective benchmarks can make the industry, on average, more efficient which can be desirable from an even broader perspective, looking at society as a whole. The related view that the wide-spread use of consultants would lead client firms to become increasingly similar, described as isomorphism (cf. DiMaggio and Powell, 1983), has been challenged in recent years. This view is said to underestimate the process in which organizations translate outside information and customize it according to their specific needs and characteristics (Kipping and Clark, 2012).

In case successful ways of working are observed by consultants in one industry and transferred to clients in an unrelated industry (Fink, 2014), the net benefits can be even greater than from knowledge transfer within a single industry. In theory, this can create net value in the sense of a Pareto improvement as no party is made worse off while some benefit from the transfer of information.

Apart from simply bringing existing knowledge from other players to their clients, consultants can also develop new approaches and techniques which may be applied to client companies. Examples of such concepts which were generated and promoted by consultants are abundant. These include the ideas of lean management, business process reengineering and the focus on shareholder value (Fink, 2014). In some cases, those approaches are closely related to charismatic individuals within consulting companies which are sometimes referred to as gurus (Clark et al., 2013). The exact impact and reach is difficult to measure as the ideas are not only transported in the course of projects but also by means of publications, speeches at conferences, or appearances on television (Sturdy, 2011).

Even more difficult to grasp is the influence which consulting companies have by means of their alumni (e.g. Wright et al., 2012). As discussed in Section 2.1, there is a considerable number of former consultants who either found their own companies or who take on important managing positions in other industries. Naturally, these professionals' way of working is influenced considerably by their time as employees of a consultancy, typically early in their careers. In case the training which these individuals have received during their consulting career later on enables them to work more efficiently in new roles, this may be interpreted as value creation by the respective consulting companies.

Moreover, consultants, it is argued, are influencing government policy through their relationships to key decision makers in political parties and the public sector, either in the course of official engagements (Appelbaum and Steed, 2005), or through their unofficial

2. Consulting: Literature review and synthesis

influence “in elite circles” (Mohe, 2011: p. 261). On the same broad level, it has been claimed “that consultants add significant value to society (through their clients) by reducing the problem-solving cycle time” (Canback, 1998: p. 7).

In contrast to the advantages which consultants may have on various levels, there are also disadvantages – or costs – affecting stakeholders in numerous dimensions. One may for instance look at undesired side effects and externalities resulting from the activities of consultants. Measuring spillover effects on all affected stakeholders is very difficult as in an exhaustive approach all detrimental outside effects would have to be regarded as costs.

The respective discussion can be more or less philosophical when dealing with questions such as whether consultants are catalyzers of globalization or whether the KPI-driven approach promoted by many consultants and their alumni alike may be overly short-term focused and thus hurting efforts for long-term sustainability (Geffroy and Schulz, 2015). Besides that, it may be debated whether consultants exert a social harm in bypassing “democratic or rational processes [...] through elite personal relationships” (Sturdy, 2011: p. 518).

Summing up, consultants have a simultaneous influence on all abovementioned levels. A simple example can illustrate this. If consultants are working for a public hospital in order to lower the sourcing expenses, clearly individuals working for the hospital are affected (e.g. sourcing professionals, doctors, or nurses). The hospital as a whole will obviously be affected as well. In case the altered sourcing approach gets transferred to other hospitals, the entire ‘industry’ will experience change. This may be based on a transfer of knowledge from sourcing approaches in other industries.

On the other hand, pharmaceutical companies could be affected negatively in case their hospital clients learn to bundle their orders and source more cost-efficiently. Yet, the elimination of inefficiencies can be expected to be beneficial to the overall society. Thus, the effects are noticeable at (1) individual levels, (2) the organizational level, (3) the intra-industry level, (4) the inter-industry level, and (5) for society at large.

3. Empirical research

As part of this dissertation, the author has conducted a series of interviews with relevant practitioners from the field. The motivation behind conducting empirical research has been twofold. The first goal was to check the validity of the propositions by the existing body of literature versus the current status of the field. As many aspects in the consulting industry have been subject to change within the last years, this also answers to calls by authors like Werr and Perner (2007) and Fleischer (2010) to keep track of ongoing trends and developments in the field versus earlier empirical studies.

The second goal was to identify relevant topics which have thus far not received academic attention. Two of these were identified (see Subsections 3.2.6 and 3.2.7) which serve as basis for detailed considerations in Chapters 4 and 5.

This chapter is structured as follows. First, the methodology is laid out. Second, the main findings from the conducted interviews are presented. In a third section, the findings are contrasted with the predictions from the literature.

3.1 Methodology

In line with several other research projects on management consulting (e.g. Kitay and Wright, 2004; Kakabadse et al., 2006), qualitative research has been chosen as vehicle for this empirical part of the dissertation. Personal interviews are a common mode to obtain data for research in the area of consulting services in which, otherwise, “research access is notoriously difficult to achieve” (Alvesson et al., 2009: p. 257; see also Mohe, 2011).

The author has conducted ten interviews with consultants as well as six interviews with clients of consultancy services and one interview with the founder of a company offering evaluation services for consulting projects. These interviews took place between October 2015 and July 2016. All consultants were employed by management consulting companies, thus working in consulting in a narrower sense, following the terminology of Section 2.1.

Interview partners were contacted either via existing contacts in the network of the author or contacted in a ‘cold’ approach via phone or e-mail. Interviews were conducted with both, consultants as well as client firm representatives, in order to obtain a complete picture on the discussed matters and a broad range of opinions. The topic of external evaluation services

3. Empirical research

was brought to the author's attention in an interviewed partner of a consulting company who had recently been in contact with such a company. Immediately after this interview, the monitoring company was contacted and an interview with the founder could be arranged.

The amount of a total of 17 interviews lies well in the range of sample sizes observed in the research on consulting. However, admittedly, the sample size used in this study is located towards the lower end of the benchmarked studies listed in the *Table 2* below. This table aims to give an idea of common sample sizes in the field and is not claimed to be complete. Nevertheless, the number of new insights obtained per interview declined markedly and the very last interviews were of rather limited additional value in terms of novel information obtained so that saturation was reached (cf. Kakabadse et al., 2006).

Moreover, *Table 3* at the end of this section summarizes the sample in terms of the position of the interviewed persons, the focus area of their work (in case a consulting company is operating in several industry and project types, the personal focus is stated), the companies' size approximated by the respective number of FTEs, and the country in which the interviewees are active. While exact revenue figures of the companies are difficult to obtain, a rough estimation yields that, in terms of revenue, around 20 percent of the management consulting market in Germany are covered by the sample if each interviewee stands for their respective consulting firms.

The interviews were semi-structured and lasted between 30 and 75 minutes. By leaving room for the conversation with the interviewee to develop freely, one allows for the emergence of new insights which would not be possible by asking closed questions only. New insights, which are thereby obtained, can be used to inductively develop theory (Eisenhardt and Graebner, 2007).

The interviewees taking part in this study were ensured confidentiality which is why neither their names nor those of the companies which they work for are disclosed. Interviewees were further free to choose not to answer certain questions. The conducted interviews were recorded, given the interviewees' permission, fully transcribed and subsequently coded using the QRS NVivo software to prepare for the analysis of both planned and emerging topics. The approach of coding and subsequent analyses is extensively described in Potter and Wetherell (1987) and has been a commonly used procedure in empirical studies on the consulting industry (e.g. Kitay and Wright, 2004; Sturdy et al., 2013; Boussebaa et al., 2013). The codes assigned in the process are typically "tags or labels for allocating units of meaning to the descriptive or inferential information compiled during a study. Codes usually are attached to

3. Empirical research

chunks of varying-sized words, phrases, sentences or whole paragraphs, connected or unconnected to a specific setting” (Basit, 2003: p. 144).

As some of the topics discussed in the interviews have been known beforehand from the literature review while others have only come up during the interviews, the subsequent analysis can be described as in part planned and in part emergent (cf. Graebner, 2009).

Naturally, any research design is subject to drawbacks and potential biases, as is the one chosen in this dissertation. First of all, qualitative studies such as this one are generally criticized for lacking representativeness and missing reproducibility (Ernst, 2002). More specific to the choice of interviewees for this study, the results may be subject to a key informant bias as only one person per company has been interviewed (Sieweke et al., 2012). While this may be a valid point, it allows to cover a wider range of companies and thus may help to improve the representativeness of obtained results. Clearly, however, the number of responses is not sufficient in order to achieve statistically significant findings.

As interview partners have been asked about events and experiences from the past, the results may further be subject to cognitive and retrospective biases. This has been attempted to be mitigated as well as possible by following the recommendations by Miller et al. (1997) in asking open questions, ensuring confidentiality and encouraging interviewees to provide detailed examples. The loose structure was further chosen in order to help reduce a possible response bias (James et al., 1984).

Another relevant aspect may be the limited geographical scope of the conducted research. This point is made by Haverila et al. (2011) and Perner et al. (2014) in reference to the canonical work by Hofstede (1984; 1993), hinting at cultural differences in managerial contexts. Indeed, as has been presented by Sturdy (2011), the local consulting markets around the globe display substantial differences which is why findings obtained in one market do not need to hold in others. Facing this risk, the interviews in this study have been conducted with professionals in four different countries to allow for some spread of insights, at least within Europe.

Of all the sources reviewed in the course of this dissertation, two studies display a certain degree of similarity with respect to the subject of the present one in terms of the empirical research. Both have been dissertations by German authors, namely Ernst (2002) and Fleischer (2010). The results of these publications have further been the basis for academic journal articles, i.e. Ernst and Kieser (2002; 2012) and Fleischer et al. (2014).

3. Empirical research

The work of Ernst (2002) is related to the current study in its focus on post-project evaluations. However, the focus of Ernst lies more on psychological aspects and less so on economic considerations. Moreover, the crucial topic of contingency pricing has not been part of her research.

This aspect has been scrutinized in great detail by Fleischer (2010) in the research along six case studies, as laid out in Subsection 2.3.3. Fleischer's work has, however, been limited to these specific cases in which a success-based fee had been agreed on. By drawing on the overall experience of the interview partners, this study allows for a broader view on the topic. What Fleischer cannot offer and what she calls for in future research, is a scrutiny of questions like under which circumstances and in which share of projects contingency fees are employed. Moreover, as in her study the use of a variable compensation is taken as given, she does not put a great amount of emphasis on obtaining interviewees' opinions concerning the usefulness of such a compensation model.

While the study at hand displays considerable differences compared to the two aforementioned publications, comparing the findings from the current and these older surveys can yield valuable information. This is especially true with respect to developments over time, e.g. in the course of increasing client professionalization. The results of this comparison are presented in Section 3.3.

Study	No. of interviews
McLachlin, 1999	8
Höner and Mohe, 2009	12
Fleischer, 2010	14
Kakabadse et al., 2006	17
Werr and Perner, 2007	22
Ernst, 2002	23
Lindberg and Edenius, 2006	28
Haverila et al., 2011	57
Boussebaa et al., 2014	61
Clark, 1993	72
Kitay and Wright, 2004	73
Wright et al., 2012	93
Sturdy et al., 2013	93

Table 2: Sample sizes of selected empirical studies²⁹

²⁹ It should be noted that Wright et al., 2012 and Sturdy et al., 2013 are based on the same interview series, which they refer to as "one of the largest ever" (Sturdy et al., 2013: p. 63).

3. Empirical research

Pseudonym	Position	Industry / focus of activity (Personal)	Company size (# FTE)	Country
Cons. 1	Project Manager	Restructuring / Transformation / Infrastructure	>1,000	Germany
Cons. 2	Partner	Restructuring / Financial transactions / Retail	25-50	Germany
Cons. 3	Partner	Digital transformation / Retail	>1,000	Germany
Cons. 4	Partner	Media	25-50	Germany
Cons. 5	Partner	Retail	50-100	Germany
Cons. 6	Partner	Health care	25-50	Germany
Cons. 7	Partner	Organization / Telecommunication	500-1,000	Germany
Cons. 8	Associate Partner	Automotive	500-1,000	Germany
Cons. 9	Partner	Consumer Goods	100-250	United Kingdom
Cons. 10	Partner	Financial transactions / Logistics	50-100	Netherlands
Client 1	Director	Furniture	>1,000	Denmark
Client 2	Head of Division	Retail	>1,000	Germany
Client 3	Project Manager	Media / Financial transactions	>1,000	Germany
Client 4	CFO	Retail	>1,000	Germany
Client 5	Head of Compliance	Transportation (Public sector)	>1,000	Germany
Client 6	Sourcing Manager	Biotech	>1,000	Germany
Monitor	CEO	Professional services	25-50	Germany

Table 3: Overview interview partners; Source: Interviews, brand eins (2016), company websites

3.2 Empirical findings

The semi-structured interviews have roughly followed the storyline of the theoretical part of this document. This subsection will also be ordered accordingly. First of all, the interviewees were asked for their general perception of trends in the market. A second introductory topic was criticism expressed towards consultants and their profession in general. Thirdly, it has been discussed with both consultants and the client company employees how the tendering process can be described. For the former group of interviewees, the focus was on how new projects are won while for the latter the focus was put on the procurement process and the supplier selection.

Special emphasis was put on the topic of contingency fees in a fourth step. As laid out in the previous chapter, this is a controversial topic. Moreover, it has been claimed that the use of this compensation model has been increasing substantially in recent years and that this trend is expected to continue. However, apart from the mentioned study by Fleischer (2010), empirical evidence is scarce. The discussions around success-based fees included the

3. Empirical research

preconditions, criteria for the evaluation of performance as parameter for the payouts as well as personal opinions on the subject.

Connected to the discussion on performance measurements was the discussion about success factors which is presented in the fifth subsection below. In all of these parts, the statements and opinions by consultants are listed first followed by the client side.

In terms of topics which have been identified only during the series of interviews, two are presented below. In Subsection 3.2.6, the 'optional consulting contract' which is offered by the company of one interviewee (Cons. 2), is explained. This concept will be scrutinized in detail in Chapter 4.

Subsection 3.2.7 deals with external monitoring of consulting projects. After the topic has been brought to attention by one interviewee (Cons. 3), the possibility of third party monitoring has been discussed with all subsequent interview partners. These have been asked for the awareness with respect to this concept and, irrespective of whether or not the interviewees have previously been aware of it, for opinions on using such a third party along the collaboration of client organization and consulting team. The subsection concludes with a summary of the interview with the founder of a company providing such third party monitoring services in the context of consulting projects. According to this interview partner, his company is the first and currently the only one with this particular service offer.

All meetings with interview partners in Germany have been conducted in German. The respective quotes have been translated to English in what follows. Certain parts of figurative speech which are difficult to translate are provided as original statements in parentheses. The key findings of the interviews are summarized in two tables in the end of the section.

3.2.1 Trends

The conversation about trends usually took a rather short period of time during the interviews. In general, consultants perceive that the market is getting (1) more competitive and they expect this development to continue, both in terms of competing for projects and in terms of competition for top talents. In the course of this process, several interviewees refer to (2) an increasing consolidation in the market, as large players are very active in mergers and acquisitions. On the other end of the market, consultants also experience (3) freelancers and small, specialized boutique players carrying out tasks which were traditionally executed by established consulting companies. Moreover, especially related to more sophisticated

3. Empirical research

computer programs which can be used to automate classical tasks of (junior) consultants, the polled consultants also state to see and further expect (4) a commoditization of certain parts of the value chain.

Along with these developments, the respondents from the consulting companies also perceive (5) an increasing professionalization of the client firms in dealing with consultants and expect a further increase in involvement of sourcing professionals. In line with this tightening competition and more sophisticated clients, (6) further pressure on prices in the industry is expected.

(7) The increasing digitalization of the working environment is also expected to bring along changes to the ways in which consultants operate. This has for example been described as follows:

We will sure have to adjust to the new chances and risks brought along by developments in ICT. For example, it may no longer be the case that we will have to be present on the client's side from Monday through Thursday thanks to advances in video conferencing technologies. Cons. 1

While pressures on prices have been mentioned, an increasing development towards more variable compensation has not been mentioned by any of the consultants when broadly speaking about trends.

In the interviews with clients, general trends in the consulting market have not been used as explicit subject. What has been mentioned during the conversations are tightening compliance requirements and a pressure to be able to convince stakeholders of an expected positive bottom line effect before initiating a project with consultants.

3.2.2 Criticism towards consultants

Next to the discussion on general trends, also common criticisms which the consultants tend to face have been talked about in the respective introductory phases of the interviews. The most common points of critique and prejudices can be grouped into the following categories.

First of all, consultants state to often be facing critical comments as they are perceived as being expensive while the actual results are uncertain. Related to this is the criticism that consulting companies are accused of delivering a presentation and leaving afterwards without

3. Empirical research

being accountable for the implementation of the recommendations (*“Papiertiger”*, Cons. 5). As one interviewee put it:

Clients say ‘the recommendations are great, the power point is excellent – but who will support me in the cumbersome process of making it sink in with the organization? Who will talk to the myriad of stakeholders?’ Cons. 6

Apart from the lack of implementation, secondly, the clients’ suspiciousness concerning the commonly young age of consulting professionals has been reflected by several comments (*“Jugend forscht”*, Cons. 1).

Thirdly, consultants state that they are accused of only copying ideas from either members in the client organizations or from other, related contexts instead of being innovative. This is reflected in the statement, that there is criticism

[...] about sharing too much across an industry. So that you are taking what you’ve learned somewhere else and try to resell it. Cons. 9

Fourthly, it has been mentioned that consultants are criticized for being overly interested in selling new projects instead of actually solving the clients’ problems. Pointing in a similar direction, consultants state to be accused of trying to please the decision makers who are in charge of awarding future projects while facts which could displease these individuals are downplayed even though they may be crucial in helping the client company (*“Weichspüler-Berater”*, Cons. 5).

The points which clients appeared to be most critical about are somewhat similar: that consultants in general lack responsibility for the implementation and the results of the projects they are involved in.

3.2.3 Procurement and tendering

In the conversations with the consulting companies, it became clear that the way projects are won essentially was claimed to depend on the question of the size of the client company (and their respective legal entity) and the negotiated project volume on the one hand and on the relationship with the client organization on the other.

3. Empirical research

While the two smallest consultancies in the sample (Cons. 2 and Cons. 6), who, in turn focus mostly on small and medium-sized clients, stated that the vast majority of their projects were purely won based on their network contacts and recommendations, bigger consulting companies had more experiences with official and lengthy bidding processes.

The most extreme example was provided by a partner from a consultancy specialized in media and telecommunication:

There is one telecommunication provider which has pushed it really far. They have their own subsidiary company, a separate legal entity, which is doing the sourcing for all national affiliates worldwide. This company runs an online platform for consultants. If I want to sign up there, I first of all need to agree to their terms, such as payment terms of 90 days and other aspects. The most striking thing is that I have to pay a monthly fee to this company just for being registered. Even if I don't have any projects with the parent company.

So I pay a monthly, or quarterly fee for being listed and on top, in case I win a project, I pay another 4 percent of the project volume as handling fee. That's what this company does for business. But as a consultant, I have no other choice to win project in this group but via this process. Cons. 4

Concerning the level of relationships with client companies, it has been pointed out by the consultant who is focused on the automotive industry (Cons. 8) that while bidding processes exist and play an important role for his consulting company, what is more important are two different ways of winning projects. The first one being through follow-up projects with existing or previous customers and the second one being through employee turnover (“*Warme Kontakte*”). That is, either alumni having left the consultancy to work for potential client companies in the industry or new employees working for the consulting company and bringing along their standing network at their previous employers which may be used to sell projects there.

When talking about the procurement process to clients of consulting companies, the first topic discussed was how many consultancies were usually contacted in the process before an agreement was signed with one of these providers. All respondents gave estimates of received offers between two and five (see *Table 6* at the end of this section). This, according to a consulting partner, could be explained by the trade-off between the benefits of being able to

3. Empirical research

compare a number of qualified offers and the transaction costs involved in thoroughly evaluating them:

I see why you want to invite more than just one consulting company. But when it comes to the decision whether to have the fourth, fifth or sixth consultancy, I believe that the marginal benefit of hearing their pitch presentation is pretty low. Cons. 5

A typical process of the supplier selection is provided by the CFO of a German retail company:

If we decide to start a normal pitch process, we typically begin by formulating a list of requirements for the pitch along with a letter of request. Then, we have an internal discussion which consulting companies we are aware of that may be capable of solving the task. Normally, we then send the letter of request to a set of six to ten consultancies. Some of them, maybe two to four, directly state that they are not interested – they may not have the required capacity or they admit not to have the needed expertise. The others submit a pitch document. Based on these documents, we may eliminate two or three directly so that in the end, we see three to four of them live. Our impressions of their pitch presentations and the estimated price-performance ratio are then the basis for our decision. Client 4

While the number of pitches reviewed is rather similar in the sample, the degree of formalization, nevertheless, displays great differences. In three of the polled companies, this degree should be described as rather low.

There is no company rule for that. Client 1

We don't have the sourcing department involved. Which consultants were hired and what we have worked on with them is also not tracked in something like a central database. So we have it very little formalized – what is important is the personal contact and our impression. Client 3

We do not have a central sourcing for consulting services and no such thing as a preferred supplier pool. It's the decision of the directors or of the department heads. Client 2

The retail company quoted above (Client 4) can be regarded to have a medium level of formalization.

3. Empirical research

There are a number of criteria according to which we do the supplier selection for such services. But we also have some degree of freedom. I would call the process semi-formalized. Client 4

The sourcing for professional services such as consulting in the remaining two organizations may be characterized as formalized.

Ideally, a manager from the departments approaches me [sourcing professional] and tells me for which date and duration which type of projects is planned and what the desired outputs are. Then, I compose the documents around the request for proposal together with this manager and we start looking who, within our pool of preferred suppliers but also in the market in general, may be a suitable company for our needs. And then we start the beauty contest and so on. [...]

With the service providers in our preferred supplier pool, we have an outline agreement for the partnership of our two companies. It includes a non-disclosure agreement, the rates which may be charged per time unit of professional work and it also stipulates legal steps which may be taken in case of disputes.

For actual projects, we then agree mainly on duration, milestones, deliverables and the size of the team which will be billed to us. Client 6

Working for a large governmental organization, the head of compliance (Client 5) reported the strictest guidelines and regulations for sourcing projects within the polled sample.

Since we are working in the transport sector, the way we source is regulated under "Sektorenverordnung 522"³⁰ – at least for project volumes over € 400,000. So we have to publish our call for proposals Europe-wide and are always subject to the threat of getting sued in case a service provider claims to have been treated in an unfair manner.

Below this threshold value, we have our local guidelines, according to which we need to obtain at least three offers. [...] The departments will hand a project description along with a list of five or six possible consulting companies to the central sourcing department which may then add a few more consultancies and contact them. That is the process as it is stipulated. Client 5

³⁰ The German legislation following the EU directive 2004/17/EC.

3. Empirical research

However, even the two representatives from these companies with formalized sourcing processes admit that there are loopholes in the process.

In many cases – and that is bitter from the point of view from someone responsible for compliance – the reality may look different from the rules and guidelines. The departments can define criteria in a scoring model for contesting consultancies in a way that their preferred one is almost certain to come out atop. Client 5

Management consulting is the only area where we as buying department have difficulties to exert the voice and influence to a desired degree. Often, they are working on really top level tasks. And if the CEO wants a certain consulting company, we can be overruled. Client 6

The attitude towards a formalization in the observed sample clearly appears to vary by the positions which the interview partners filled in the respective organizations. While the head of compliance (Client 5) and the sourcing manager (Client 6) appeared to be clearly in favor of the regulation, the attitude of the managerial interviewees was more critical.

Yes, we have some guidelines. I just had to read 13 pages of compliance guidelines for dealing with consultants. In English. Really boring and annoying to read. Client 2

I don't think everything needs to be and can be stipulated in formalized guidelines. I would have difficulties with that. I believe that the recommendations from theory are cumbersome to implement in reality ("praxisfremd"). The range of consulting services is very heterogeneous. So I don't believe in the usefulness of too much formalization. Client 4

Even the aforementioned head of compliance admitted downsides of excessive regulation:

I've talked to the director of our central purchasing office and she told me they had difficulties finding adequate bidders for consulting pitches. 'Nobody wants to be flooded with all this paperwork.' They need to fill out so many forms and have to comply with so many guidelines – the money they can make here is just not enough to make up for that. Client 5

3. Empirical research

3.2.4 Contingency fees

The discussion on contingency fees with the consultants yielded rather heterogeneous results in terms of usage and opinions on it. Out of the ten consulting companies of which senior employees were interviewed, eight stated that, at least sometimes, projects they worked on carried a success-based component. Two of them stated that these compensation models were not used. In one of these cases, however, this was considered for the future. In the other case, such fee agreements were stated to be actively avoided.

The consulting companies which are involved in projects with a variable component were asked under which circumstances such agreements were made. The most common argument was that it depends on the type of project and on the preferences of the customer. In cost-cutting projects and in M&A projects, where results are rather easily obtained, fees are more likely to carry a variable component.

In almost all cases, the consulting interviewees either stated that such fees were (1) demanded by the client as a safeguard against bad performance of an unknown consultant or as means for possible cost savings or (2) used as commercial tool in the form of a signaling device. These points are illustrated by the following quotes.

Let me put it like this: A client who does not yet know us will be more likely to choose the variable model. Clients who already know that we are doing a good job will prefer a fixed rate. Cons. 2

I often feel like contingency fees are a fashionable term and that clients feel like getting ripped off if they don't push for it to be included in the contract – a little like accepting the first price in a bazaar without negotiating further. Cons. 5

[...] If clients don't have a lot of experience with contingency fees, it may appear like the consultants are particularly good, very confident and willing to take risks if they offer a variable component. Cons. 5

If we offer it, then hopefully the client would realize that – just by offering it – we are demonstrating our confidence in our ability to perform and that we are willing to take the risk. So, we are then trying to persuade them that we are willing to do it but that it would be too complicated to administer, so it becomes a bit of a circular logic. Cons. 9

3. Empirical research

In terms of criteria used in order to determine which fraction of a success fee is payable, these also vary by type of project, according to the consultants. In general, the listed criteria often included bottom-line effects in the case of cost reduction projects. Quality-related KPIs and time have been mentioned in operations projects. In M&A projects, criteria like whether a deal was closed or whether financing from a bank was acquired were reported. The most commonly reported criterion was client satisfaction.

Combinations of the above have also been mentioned and, in one case, the use of an external third party monitor was used to obtain the rating along a scorecard consisting of several dimensions in order to determine a rating on which the amount to be paid by the client was based. Thus, the criteria are not necessarily unidimensional and even satisfaction is not in every case only a simple statement by just one stakeholder. Even without the use of an external monitor, one partner reported:

I know of a case in which our client had a detailed report card for each member of our team on which they graded their performance. The result was that four out of five were ranked as outstanding and one just as average which they used as a claim not to pay the full variable component. Cons. 5

The polled consultants further made clear that it is important for them to be able actually influence the success criteria in order to accept a contingency fee agreement.

A very interesting point in the discussion with most of the interviewed consultants concerned the share of variable components that was actually paid to the consulting company. The interviewees were asked to estimate which share, on average, was obtained in projects with a variable component. In order to have a basis for comparison, they were further asked to compare this to what they would have received if these same projects would have been remunerated according to a time-based or fixed fee. Out of the seven consultants who answered this question, none stated that, on the long run, they would be worse off compared to a non-variable agreement. One estimated the value to be more or less at 100, while six claimed to be better off on average (see *Table 4*).

If this is indeed the case, the values above 100 could be interpreted as an insurance premium in case clients demand a variable component as a safeguard against downside risks.

In corporate projects, we almost always get the success fee. Cons. 10

3. Empirical research

Looking back on the past years, clients would have paid less in total if the projects hadn't had a success component – on average, we are reaching more than 100 percent. However, there are always transaction costs – you have to evaluate, you have to discuss and debate... In many cases time and money could have been saved without such a model. Cons. 5

Several of the interviewed consultants have also reported cases in which client organizations have pushed for a high fraction of a variable component, e.g. in cost reduction engagements. In these cases, when savings have been realized and that to a degree above the expected range, lengthy post-project discussions were needed to agree on a final payment amount. The amounts which the consulting firm would have received would have been abnormally high. In almost all of these cases, the consultants stated that they settled for a lower amount than what they would have been entitled to according to the contract. This was done in order to prevent damage to the relationship with the client organization.

With respect to the share of the total compensation which is variable, most interview partners estimated an average of 20 to 30 percent, both as upside and downside (see the summary table at the end of this section for more details). That is – in case of a 30 percent lever – if 100 monetary units were payable under a time-based contract, 70 monetary units are received by the consulting company in case the agreed upon targets are not reached and up to 130 monetary units are payable by the client if all goals are realized.

While a fully variable compensation has been reported not to exist by all but one of the interviewed consultants, this partner stated that in rare cases this is done by his company. He stated further that this is only done with clients with whom the consulting company has a long-standing and trustful relationship.

This interviewee (Cons. 7) has further been the only respondent from the consulting side of the sample who appeared to be clearly in favor of using variable compensation models. Given the often time and resource-demanding discussions involved (cf. quote by Cons. 5 above), many consultants were skeptical of the usefulness of success-based fees – despite the fact that they may, in the end, receive more in fees than under other compensation models.

Another potentially critical point may be the incentives which are present under a contingency fee model. Among others, this has been emphasized by a UK-based consulting partner:

3. Empirical research

I think it can put the consultant at a bit of a disincentive because then you are really just focused on achieving these, say, 5 KPIs. And this may or may just not be the right thing for the client's business. And you kind of lose your objectivity in a sense that if the client then begins to do something which you believe is not the right decision – then you have disincentive to say that because actually you've got to achieve your target. Maybe that's a cost element where you think, they shouldn't necessarily touch – but in order to achieve your target you have to push it.

So, I think it can be difficult and it can become counterproductive. So you've got to be really careful what you do. Cons. 9

While variable components were only used very seldom and to a limited degree in his company, Cons. 6 pointed out that the possibility of contract termination with a very short period of notice by the client covers many of the aspects of a contingency fee agreement:

If clients are not satisfied with what we do, they are free to terminate the contract more or less immediately. Thereby, they are secured against the risk of us not working as they wish. Since for us projects usually become more profitable with a longer duration as start-up investments are written off, we are of course incentivized to work hard and keep clients happy. We also signal our confidence by offering such a contract. In a way, therefore, every new month of a project is like a performance-based reward. Cons. 6

Nevertheless, almost all consultants have stated that variable compensation models have been more frequently observed in recent years and that, at least to a limited degree, this trend is expected to continue in the future.

On the end of the polled client organizations all but one interview partners indicated that success-based fee agreements with consultants were used in their organizations and that they were actively pushing for it. In case of the governmental organization, variable fee agreements were stated to be ruled out by the relevant rules and regulations.

However, the share of projects in which such variable agreements were used differed substantially in the sample:

There are only very few projects where that makes sense. You need to have undisputable KPIs. Client 2

3. Empirical research

We do that without exceptions. There is always a performance-based variable component. Otherwise, we do not start projects with consultants. Client 4

In terms of evaluation criteria on which the payment of variable components depends in their companies, the respondents mentioned financial KPIs, usually connected to the top and / or bottom line of the firm or division (Client 1, Client 2, and Client 6), satisfaction (Client 3) or a combination of these elements (Client 4).

Difficulties in determining the relevant KPIs, however, have also been reported by the polled clients:

In the end, it costs a lot of time and effort to check the KPIs in detail. [...] They need to be clearly defined in the beginning and then it has got to be administered properly. The colleagues from the finance department said in several cases that it is too much work to track the KPIs or that they are not capable of tracking them. Therefore, for some of our projects we have then decided not to include a variable component even though it may have been desirable. Client 6

With respect to the reasons for why success-based fees are used, desired incentive alignment and a safeguard against paying for unsuccessful projects have been expressed by the client representatives:

I like the concept [of contingency fees] and I believe that consultants can be incentivized to reach targets in a way which is desirable for our organization. Client 6

I believe that it drives the consultants' motivation. Client 4

We are not afraid of sharing a success – but we hate to pay for a failure. So if something goes wrong, the consultant should also carry a part of the burden. [...] That way, we can ensure that they are focused and that they really want to give us the best advice. Client 1

3. Empirical research

3.2.5 Success factors and measurements

In talking about success with the consultants and the interview partners from the client companies, two aspects have been focused on in particular. These were the success factors, i.e. which criteria have to be fulfilled in order to make a given project successful, and the respective measuring dimensions, meaning how it is determined whether or not a project can be considered a success.

Almost in response to the commonly faced critique, consultants have emphasized that it is important not to deliver to the clients 'off-the-shelf' solutions like blue-prints but to actually tailor something to their needs. The ultimate goal, according to several respondents, is to create something that is implementable and that has a high probability of being implemented. An associate director who is focusing on projects in the automotive industry stated:

Coming up with a good concept is not so difficult. If you put three smart people in a room together they can put such a concept on slides in one or two days. But actually implementing it throughout the entire corporation is going to be a crucial challenge ("Zerreißprobe") for the next two or three years. Cons. 8

In general, the polled consultants have also emphasized the importance of being aligned with the client team on what actually needs to be done and on what the project's goals and deliverables are. Nevertheless, it may be the case that the actual achievement of a project is to provide the client organization with something that has previously not been known to the management. In this case, the deliverables may not be clearly articulated by the client team. Talking about the notion of success, one consulting partner stated that success is achieved

[...] when you can help a client see their business in a way they haven't seen it before. So that you are really shedding light from a new perspective or new insight on their business which they hadn't had before. That to me is important. Cons. 9

A last major component may be titled as the 'human aspect'. The informants have emphasized that while much of their work is number-driven, achieving positive effects for the client organization necessitates the involvement of all relevant stakeholders and clear and honest communication towards them. In the words of a consulting partner from Germany:

In my opinion, one point that is way too often overlooked is effective change management throughout the entire process. It's not always just about the pre-defined

3. Empirical research

project goals but about feelings and fears of employees, scarcity of internal resources, unexpected points of resistance, or simply achieving mutual understanding. Cons. 7

When asked how they determined whether or not they have been successful, consultants named a few obvious points such as the reduced amount of costs, the percentage increase in profitability or the fact that a deal has actually been closed in M&A projects. Also being actively approached by the same client for future projects was mentioned as an indicator for successful project work.

More emphasis, however, was put on factors such as opening a client management's eyes (*"Aha-Effekt"*, *"Frischen Wind in den Laden bringen"*, both Cons. 6), enabling new perspectives and later on observing that people in the client organization change the way they work.

It was also pointed out that success may not only lie in initiatives which are actually implemented but also in preventing a management team from taking detrimental steps. This may for instance be the case in advising the client firm not to engage in a ruinous price war or not to take over unattractive M&A targets.

When clients were asked under which circumstances they regard a collaboration with consultants to be successful, they also named aspects which are difficult to quantify. For example, the director of a Danish furniture company pointed out:

What is always important is what you can learn from a consultant. Every time you work with a consultant, there are new insights, new tools, and new ways of looking at things. So you can increase your knowledge. Client 1

This is in line with what an internal project manager stated:

Consultants need to bring expertise which is not available in our company. Client 3

The interviewed employees of client companies also recognized the fact that a substantial part of ensuring a fruitful use of the consultancies' resources is in their hand. It has been frequently stated that the support of the top management team is required, that clarity about deliverables and milestones is needed, and that close guidance of consulting teams including frequent progress meetings should be aimed for. A sourcing representative from a major biotech company emphasized:

3. Empirical research

The biggest mistake you can make is hiring consultants without actually knowing what should be achieved in the end – just because their presentation looked so nice and colorful. The goal and the need for the company have to be clear without ambiguity.

Client 6

3.2.6 Emerging topic 1: Optional consulting contract

When discussing contract and pricing models with the interview partners, Cons. 2 described a variant which was particularly interesting as it has previously not been known to the author and as the underlying properties are somewhat counter-intuitive.

The interviewed consulting company is offering to its clients what they refer to as 'optional consulting contract'. Under this contract, the client purchases a specified amount of consulting capacity, i.e. professional time, retrievable over a specified period of time. In case an actual project is initiated during this period, the pre-paid capacity would be used and deducted from the overall project fees. In case no project would be initiated, the pre-paid fee is sunk and the capacity would expire unused.

At first sight, it appears unreasonable for a client organization to enter into such an agreement due to the risk of losing sunk fees while not benefiting – e.g. from rebates – in case a project actually takes place. The conditions under which it may still be reasonable for a decision maker to agree to such a contract model are discussed in Chapter 4.

As the other interviewed consultants did not mention that a comparable contract model is offered by their companies, the detailed scrutiny of such a model is especially interesting for those not offering it, as it may be the case that they are leaving an economically interesting option thus far untapped.

3.2.7 Emerging topic 2: Third party monitoring

In the third interview with a consulting partner, this interviewee mentioned that he had recently been in contact with a company which – on the client's behalf – monitors the performance of consultants. The resulting evaluation may, for instance, be used in order to determine whether a variable component of the consultants' fee is due. As such a service, to the best of the author's knowledge has so far not been considered in academic contributions on consulting, it has been included in the further course of the study.

3. Empirical research

In all subsequent interviews with consultants and clients, the respondents were asked whether they have already been in contact with such a company and even if not, what their opinion on the concept was.

From the seven interviews with consultants conducted after the third party monitoring company was mentioned, none had worked with such a provider and only one consulting partner (Cons. 7) at least heard of this service.

The polled consultants were, in general, critical of such a firm:

I am a little suspicious of such parasitic companies who want to secure a few percent of the overall budget for themselves. Cons. 7

Cons. 3, who initially brought up the existence of such a service also did not appear to be a particular proponent of such a concept. Especially for the business with top managers in which the importance of a trust-based relationship was emphasized by the consultants a use of such an external agency was regarded as not being applicable. However, some consultants believed that there could indeed be a market for such services, especially in long projects with a great number of stakeholders:

I could imagine that the hiring of such a firm could be induced by compliance rules. Cons. 4

They will be successful because there are settings in which people look for external reassurance. [...] So when later on a superior doubts that a variable component has been paid for a justifiable reason one doesn't risk one's own head but can blame an external company. Cons. 5

I can imagine that the sourcing department – and not the specialized department (Fachbereich) – decides to hire such a provider in order to obtain an objective supplier rating. [...] But that will be more likely the case in big projects with large budgets and a substantial influence of the sourcing department. Cons. 8

None of the interviewed representatives of client organizations have been aware of the services offered by external third party monitors. When the concept was described, two respondents' reactions can be described as open and interested (Client 1 and Client 5), two

3. Empirical research

as rather neutral (Client 2 and Client 6), and two as skeptical (Client 3 and 4) as is underlined by the following statements:

It's a very interesting idea. I think it could be valuable to relieve key people in a project off stress. That is especially relevant if there are many stakeholders involved who have a say. Client 5

I would rather have the feeling that it's just another party trying to secure a piece of the cake for themselves. Client 3

To obtain a better understanding of the business model and ways of working of third party monitoring providers, an interview was conducted with the founder and CEO of such a company. The company has been founded in 2010 and is, according to the CEO, the only one offering such a service³¹.

The core product of the interviewed company is a performance rating of professional service firms, mainly in management and IT consulting. These ratings are in many cases used by the client firms to determine the fraction of variable compensation payable to the consultants. A score is stated as value between 0 and 100 and, for example, it may be agreed on that a variable component will only be paid for scores of 75 and above.

The scores are in general obtained by questionnaires distributed to a number of stakeholders within the client company. These stakeholders include the project team, the steering committee and optionally other stakeholders. Their individual scores are converted to an overall score according to a 'one man, one vote' rule. Which stakeholder gave which grades is not disclosed to the rest of the project team. While the consulting team's opinion does not influence the score, it is still polled as a control group and may thus signal possible problems between the client and the consultant side. The fact that no individual rating is disclosed was specifically emphasized:

If you would only ask the internal project manager about his opinion he may be afraid to give a bad rating. Consultants are often well-connected in the client organization and the project manager may fear detrimental consequences if the consultants turn against him. Monitor

³¹ The following paragraphs summarize the statements received by the interview partner. They do not reflect the opinion of the author.

3. Empirical research

The surveys are based on a standardized methodology with customized aspects according to the projects' specificities. There are three basic classes of rating aspects: (1) Input parameters, e.g. the capabilities and qualities of the consulting team; (2) Commitments, i.e. to which degree promises from the pitch have been kept, for instance the size of the network of relevant experts; and (3) Output parameters, considering whether deliverables are complete at milestone dates and how realistic the stakeholders think it is that long-term goals of the projects will be reached.

The surveys are usually conducted at several points in time during projects, approximately every three to four weeks, with the last one usually conducted shortly after the final presentation. In most cases, the third party's services are remunerated as percentage of the project volume.

The monitoring company is sometimes engaged by project sponsors for specific projects but in a majority of cases, the firm has an outline agreement with the client organization that all consulting projects will be scored according to the methodology. In some cases, according to the CEO, also consultants specifically ask for the third party to be involved. On the other extreme, he has also reported cases in which consulting companies have turned down engagements because they should have been evaluated by the monitoring company.

Concluding this section, the following two tables summarize the results from the interviews with the consultants and clients.

Pseudonym	Var. compensation used?	Share of projects	Avg. share of "risk"	Avg. of payout vs. time-based comp.	Experience with third party monitor
Cons. 1	Yes - actively offered	n/a	30%	n/a	<i>not asked</i>
Cons. 2	Yes - actively offered	<30%	30%	>100	<i>not asked</i>
Cons. 3	Yes - if requested by client	<10%	15%	100	Yes
Cons. 4	No - actively avoiding	0%	n/a	n/a	Never heard of, never used
Cons. 5	Yes - actively offered	<25%	20%	>100	Never heard of, never used
Cons. 6	Yes - if requested by client	5%	5%	>100	Never heard of, never used
Cons. 7	Yes - actively offered	10%-15%	20% (up to 100%)	130	Heard of, never used
Cons. 8	No - but considering	0%	n/a	>100	Never heard of, never used
Cons. 9	Yes - if requested by client	5%	10-15%	>100	Never heard of, never used
Cons. 10	Yes - if requested by client	10%	Max. 25% downside and 50% upside	>100	Never heard of, never used

Table 4: Summary table interviews with consultants

Pseudonym	Var. compensation used?	Degree of formalization	Avg. number of contestants in pitches	Experience with third party monitor	Attitude towards third party monitor
Client 1	Yes - actively asking	Low	2-3	Never heard of, never used	Open (positive)
Client 2	Yes - actively asking	Low	3-4	Never heard of, never used	Neutral
Client 3	Yes - actively asking	Low	3-4	Never heard of, never used	Skeptical (negative)
Client 4	Yes - actively asking	Medium	3-4	Never heard of, never used	Skeptical (negative)
Client 5	No - banned by regulation	High	3-5	Never heard of, never used	Open (positive)
Client 6	Yes - actively asking	High	3	Never heard of, never used	Neutral

Table 5: Summary table interviews with clients

3. Empirical research

3.3 Discussion of results

This section contrasts the reviewed literature and the theoretical findings with the results from the empirical research. To enhance the comprehensibility, the topics are discussed in the same order as in Section 3.2.

The trends which the respondents have described are largely in line with those laid out by the literature, as reviewed in Section 2.1.2. Of course, it may be the case that to some of the respondents some of the publications are known and that the conclusions of these articles have influenced the expressed expectations of future developments.

Also in terms of commonly expressed points of criticism and prejudices towards consultants, the statements which were collected during the interviews are largely in line with the points presented in Section 2.1.3, namely lack of responsibility for implementation and impact despite high fees, an extensive focus on selling new projects, as well as sending young and inexperienced consultants.

Some interesting insights have been generated from the empirical research with respect to the procurement of consulting services. It became obvious that the degree to which sourcing is formalized in client organizations is very heterogeneous. Therefore, talking of 'the client' in discussions over sourcing of professional services may be overly simplistic.

In her work, Ernst (2002) contended that even very formalized rules and procedures can be bent and bypassed. Indeed, the statements by the interviewees from the two most formalized client firms have pointed in this direction. If this is the case, such rules may only function as signal to outside stakeholders for close control over supplier selection – however, at a high cost of setting up the procedures and the risk of bad publicity in case the bypassing of the sourcing standards becomes known outside of the core team. Which degree of formalization is adequate, again, depends on the distinct characteristics and circumstances of the respective client company.

The existence of preferred supplier pools for professional services has been previously discussed by several authors (e.g. Sieweke et al., 2012; Perner et al., 2014). The extent of such a model as reported by Cons. 4 – that a subsidiary company of a telecommunications corporation was using the management of such a pool for for-profit business – has, to the author's best knowledge, not been reported in academic publications so far.

3. Empirical research

Concerning contingency fee agreements, it appears that roughly 10 percent is a reasonable estimate for the share of management consulting projects being remunerated with a variable component (cf. *Table 4*). Whereas in all six case studies scrutinized by Fleischer (2010), the payment model was a combination of a fixed and a variable component, the study at hand revealed that while some consulting companies strictly decline projects with a variable component, fully variable compensation also exists in the market.

If a variable component is included, in all cases, the reported variable share is at 5 percent or more of the total fee. In this sense, the findings are in line with the suggestions by Mitra et al. (2016) as discussed in Subsection 2.3.3. With respect to the functions of contingent pricing, however, the perceptions between client organizations and consultants seem to differ. On the clients' end, incentive alignment and a safeguard against malperformance are emphasized. The consultants have presented an agreement or offering of such a payment model mainly for commercial reasons – either giving in to pressures or actively using the signal as commercial tool. This stands in contrast to Fleischer (2010) who found no link between the competitive situation and the use of variable compensation, as laid out in Subsection 2.3.3.

An interesting finding of the interview series has been that the estimates of the respondents indicate that, on average, client companies pay higher amounts to consulting firms if variable compensation models are chosen. While the obtained data may be subject to biases due to the research mode and the number of conducted interviews is likely too small to obtain statistical significance, there is a clear indication for a premium paid under contingency fee agreements. This indication may be validated in future research by means of quantitative analyses in case access to relevant databases can be obtained.

Moreover, the statement by Cons. 6 concerning the effects of a readily terminable contract in parallel to those of a contingency fee model shows that practitioners appear to share the line of argumentation presented in Subsection 2.3.2. That is, a contract which can be terminated at short notice also functions as motivational tool and as signaling device. Therefore, it may augment or substitute a variable fee agreement.³²

With respect to success factors, the polled clients' and consultants' statements did also not contradict the aspects presented in Subsection 2.4.1. For instance, the importance of recommendations being implementation-oriented, of alignment between clients and

³² The effects of an improved coordination, for both, and the benefit of an additional point of contact, especially for the consulting company, as presented in Subsection 2.3.2 would not be achieved means of a terminable contract.

3. Empirical research

consultants on goals and deliverables, as well as the importance of top management support were also discussed in the presented contributions by authors such as McLachlin (1999) or Appelbaum and Steed (2005).

The existing empirical literature has also stated that the authors “could not find evidence that the more sophisticated approaches that were suggested in the literature [...] are used in measuring the success of consulting projects” (Fleischer et al., 2014: p. 235 f.). Whereas rather simple methods such as basic financial KPIs and simple satisfaction ratings appear to still be predominantly used, the interview statements also suggest that more elaborate models are employed. Especially the use of an external third party monitor stands out in this respect.

In the use of three different types of variables, input parameters, commitments, and output parameters, the applied methodology by the interviewed monitoring company appears to be in line with the suggestions by Ehrhardt and Nippa (2005).

In sum, weighing the costs and benefits of close evaluation as well as of the corresponding topic of contingency pricing, it appears that striving for complete elimination of opportunistic behavior may not be the most rational choice for decision makers. Instead, as suggested by Dutta et al. (1994: p. 83), the optimal control level “will generally tolerate some level of bootlegging”.

Ernst and Kieser (2012) have claimed that consultants have a bigger interest in formally evaluating projects than their clients. This view does not seem to be in line with the attitudes expressed in the interviews as consultants tended to be more evaluation-averse than at least some of the polled clients.

Concerning the measurement of success, Ehrhardt and Nippa (2005: p. 18) have concluded that, given the possibly substantial cost and the uncertain benefits from a thorough evaluation, “it may be sometimes wiser to abstain from or minimize evaluation.” This view has been reflected in several respondents’ opinions on the arising transaction costs in evaluation processes. Whether the services offered by the third party monitor can be a means of doing the supplier evaluation in a more cost efficient way will most likely depend on the specific project settings. Factors influencing the possible value of such a service to a project sponsor will be discussed in Chapter 5. Prior to this, Chapter 4 will scrutinize the implications of an ‘optional consulting contract’, as presented in Subsection 3.2.6, for the balance of power between players in a given client organization.

4. Temporal divisibility of fees

In the empirical part of this dissertation, which is presented in Chapter 3 above, a specific contract model mentioned by a consultancy's partner spurred particular interest of the author – namely, the 'optional consulting model' as described in Subsection 3.2.6.

As discussed, given the properties of this contract, it may not be intuitive why a client firm representative should agree to such a contract. However, given the existence of such a contract model, it is likely, that it is attractive for clients or individuals within the client organization to enter into such a contract. In order to understand the motivation to agree to such a contract better, the respective effects within the client company are analyzed in this chapter.

From the point of view of the consulting literature, the topic of temporally divisible fees is of interest, as this aspect – to the best of the author's knowledge – has not yet been scrutinized. Against the background of game theory, such a contract model appears to resemble a costly commitment device which may be purchased by a rent-seeking player. Determining whether such a contract model may indeed represent a device for rent-seeking behavior, and if so under which conditions, is the goal of this chapter.

In order to approach this topic, the first section of the chapter will briefly revisit the literature on consulting contract agreements which were presented in Section 2.3 and show where in the discussion this topic is situated. Since the aspect has so far not been regarded, this represents a corresponding literature gap. The second section presents the theoretical background with respect to such aforementioned commitment devices. In the third section, a simple model is introduced which will be extended and analyzed in the fourth section. The fifth section summarizes the findings before the sixth section discusses possible limitations and tasks for future research.

4.1 Relevant context in consulting literature

Subsection 2.3.3 has reviewed the literature on pricing in consulting, arguing that fees are most commonly based on time and expenses, (i.e. contingent on inputs) but that also agreements based on results (i.e. contingent on outputs) as well on factors such as satisfaction (which can be interpreted as contingent on throughput measures) exist (e.g. Fleischer, 2010; Owusu-

4. Temporal divisibility of fees

Manu et al., 2012). Combinations of these pricing schemes in which a major fee component is calculated based on input variables while an upside or downside component exists, based on throughput or output variables, are claimed to be increasingly often used and this trend is expected to continue (Christensen et al. 2013).

Moreover, project agreements with a fixed fee, independent of factors such as the amount of professional hours put in or results measures, are reported (Owusu-Manu et al., 2012). However, in many cases such fixed fees are based on an estimation of required inputs.

Related to the agreed upon remuneration scheme is the underlying type of contract which, at least under German law, is in almost all cases either a contract of employment or a contract of services, as presented in Subsection 2.3.2. Besides the type of contract, it has been presented that contracts between a client company and a consultancy are usually terminable on short notice (Fleischer et al., 2014). This terminability has been discussed to possibly function as control mechanism for clients, possibly as a substitute for satisfaction-based pricing schemes (cf. Subsection 2.3.3) and, in turn, as incentive mechanism for the consulting team delivering the project work (cf. Subsection 2.3.2).

While contract structure, contract terminability, and remuneration schemes have been discussed in the field of consulting research, the idea of an 'optional consulting contract' hints at an aspect which thus far has not been regarded in the field: the temporal divisibility of fees.

The next section will provide the theoretical background on the concept of divisible fees embedded in a context of strategic commitment devices. This will set the ground for the model in a consulting context to be developed in the two subsequent sections.

4.2 Theoretical background

As stated in the beginning of this chapter, it is scrutinized whether and under which conditions a consulting contract with temporally divisible fees functions as strategic device to influence the interaction between certain players. If this is the case, the purchase of such a device would be a strategic move by an individual player.

First of all, it is useful to recall the definition of such a move: "A strategic move is one that influences the other person's choice, in a manner favorable to one's self, by affecting the other person's expectations on how one's self will behave" (Schelling, 1980: p. 160).

4. Temporal divisibility of fees

In the particular case, it will be analyzed whether a player can effectively commit him or herself to a reaction in case an opposing player chooses a given action first. That way, the optimal choice by this opposing player and thus his or her behavior can be altered. Such a commitment needs to be credible, meaning that the opposing player should not doubt that a threatened move will actually be carried out by the respective initial player. According to Dixit and Nalebuff (1991: p. 162f.), there are eight ways to make commitments credible, which they cluster under three principles:

The first principle is to change the payoffs of the game. The idea is to make it in your interest to follow through on your commitment: turn a threat into a warning, a promise into an assurance.

(1) *Establish and use reputation.*

(2) *Write contracts.*

A second avenue is to change the game to limit your ability to back out of a commitment.

(3) *Cut off communication.*

(4) *Burn bridges behind you.*

(5) *Leave the outcome to chance.*

(6) *Move in small steps.*

A third route is to use others to help you maintain commitment.

(7) *Develop credibility through teamwork.*

(8) *Employ mandated negotiating agents.*

The following discussion is mainly related to the sixth point of the above list, i.e. moving in “small steps”. The basic concept behind my model, presented in the sections to follow, is due to Bebchuk (1996), formulated in the area of economic analysis of law.

In his paper, Bebchuk proposes that a plaintiff may be able to obtain a positive settlement amount despite facing situation which initially yields a negative expected value (NEV). In principle, this is due to expected legal costs exceeding expected trial rewards. The basic intuition is that a defendant would not pay a positive settlement amount outside of a court trial knowing that the respective plaintiff would not take the case to court in case of a NEV suit.

4. Temporal divisibility of fees

In case the legal costs can be split in a way such that a part of these is already sunk by the time the plaintiff and the defendant negotiate about an out-of-court settlement, the situation can be different. The threat to sue can then, with only a remainder of the legal fees being relevant for a decision on approaching a court, be credible. Thus, the plaintiff would be credibly committed to suing in case no settlement is agreed on which may, in turn, convince the defendant to pay a settlement amount.

In a later paper, Bebchuk discusses more broadly

[...] a set of assumptions under which a plaintiff with an NEV suit will never be able to extract a settlement offer: (1) there is no asymmetry of information between the parties; (2) the plaintiff's litigation costs are not divisible; (3) the defendant does not have to incur some upfront costs before the plaintiff incurs any costs; (4) the plaintiff does not employ some special contractual arrangements with the plaintiff's lawyer; (5) the plaintiff does not have a reputation that enables it to bind itself to going to trial if the defendant refuses to settle; and (6) the expected value of the judgement is expected to remain below total litigation costs throughout the litigation. [...] relaxing any one of the above six assumptions introduces a factor that can sometimes enable a plaintiff with an NEV suit to extract a settlement (Bebchuk, 1998: p. 1f.).

Out of these conditions, the second one is especially relevant for the discussion at hand.

Summing up, devices which can make a threat to carry out an action, such as filing a lawsuit, credible can be beneficial for given players based on their intertemporal distribution of payments (see also Kirstein, 2000).

In case of the 'optional consulting contract', as described above, it will be analyzed whether the spread of consulting fees over time, i.e. their divisibility, can be expected to have an influence on an intra-firm bargaining process within a client organization which is faced with a potential consulting intervention.

4.3 The basic model

Before being able to scrutinize the effects of divisibility of consulting fees over time, the basic setting of analysis needs to be described. For this setting, I again draw on the players M and E, which have been introduced in Section 2.3. I assume that player M is a manager who can

4. Temporal divisibility of fees

make decisions on the engagement of consultants while E is another actor within the same client organization.

The game between these two players is set under the assumption of perfect and complete information, assuming risk-neutrality of the players who are rational utility maximizers.

The idea of the game is as follows. M would like to propose changes in the organization which are detrimental for E. These proposed changes could for instance be cost savings affecting E but benefiting the bottom line of the organization. I assume M to be incentivized in relation to the company's bottom line while E is not.

In the basic setting, presented in this section, I use three phases: a proposal stage, a negotiation stage, and a decision stage. In the proposal stage, M decides whether to approach E with a proposal for changes or not. In case M decides not to approach E, the effect on both players is zero (V in *Figure 14* below). If M decides to propose changes to E, both players enter the negotiation stage.

In this negotiation stage, M has proposed to E to change the current situation in a way that reduces E's payoff by an amount of Y. In case E accepts this proposal, the effect on E will be $-Y$ while M will receive λY , where λ denotes the share of the savings which will be obtained by M (I in *Figure 14*). I define λ such that $0 \leq \lambda \leq 1$. If M, for example, were the only shareholder of the company, this value would be $\lambda = 1$ (assuming that taxes and other dues on the savings are negligible). In order to keep the model traceable, I assume Y to be a non-negotiable value which is proposed to E in a take-it-or-leave-it manner. In case E rejects this offer, M has to decide on how to proceed further.

This will be done in the decision stage. Given that E has rejected M's proposal, M can decide to directly approach the board of directors, D, with the proposal of reducing E's payoff by amount Y (represented by II below). The board's decision is assumed to be final and directly effective for both M and E. D's decision is modelled as distribution of probabilities. With probability ω , D will accept M's proposal in which case it will be implemented. In case M's proposal is declined, with probability $(1 - \omega)$, D can decide to further sanction M for bad management with probability σ or not to do so $(1 - \sigma)$. If M is sanctioned, this will result in a disutility denoted by Ψ (e.g. due to replacing the manager). The expected payoffs for M and E in this case are $(\lambda\omega Y - (1 - \omega)\sigma\Psi - N ; -\omega Y)$, where $N > 0$ represents M's preference for a solution at an earlier point in time.

4. Temporal divisibility of fees

Instead of approaching the board of directors on his or her own, M can also use consultants to prepare a presentation in front of the board (represented by III). The consultants will propose a change in E's payoff by Z. For their work, the consultants will charge a fee $F > 0$, which will affect M's payoff by $-\lambda F$. This proposal can again be accepted by D, with probability ω_c , or declined with $(1 - \omega_c)$. In case the proposal made by the consultants on M's behalf is rejected, M may again be punished. This is done with probability σ_c . The respective expected payoffs are: $(\lambda\omega_c Z + (1 - \omega_c)\sigma_c\Psi - \lambda F - N ; -\omega_c Z)$.

Lastly, M can also decide not to approach the board at all after E's rejection, resulting in the respective payoffs $(-N ; 0)$ (represented by IV). In the form of a game tree, this is depicted in Figure 14 below.

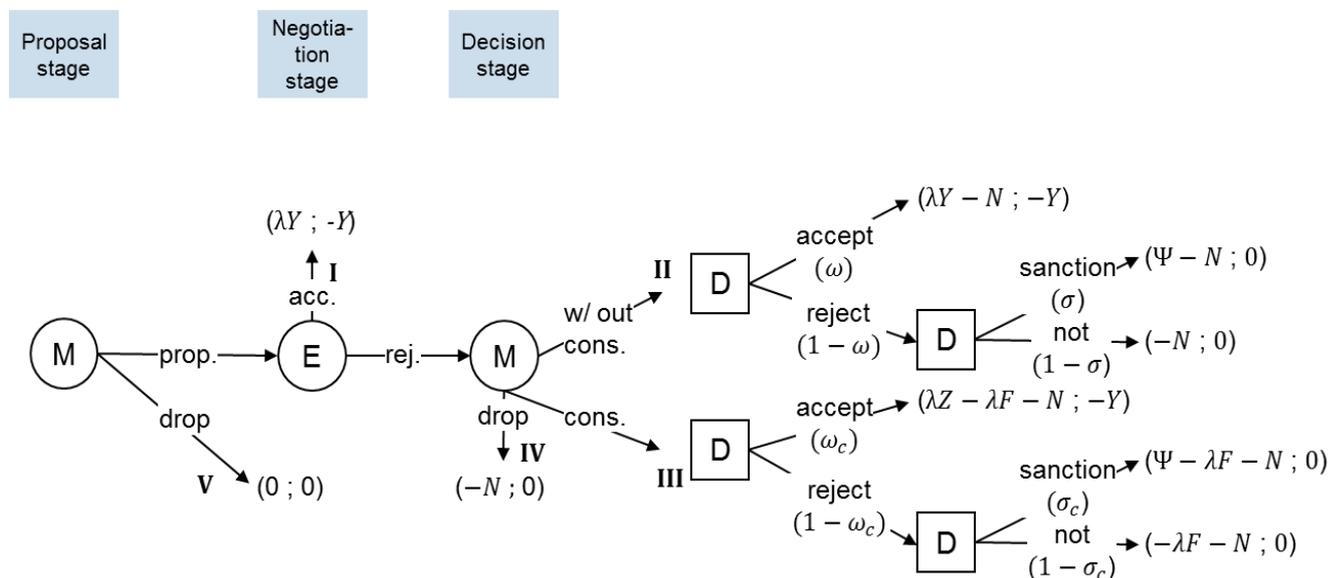


Figure 14: Basic game tree

From this model, some interesting insights can already be obtained. Regarding the decision on whether or not M will hire a consulting company, it can be assumed that the benefit from having the consultants' help will have to offset or overcompensate the charged fee³³. Therefore, I propose a necessary, albeit not sufficient, condition for M to hire consultants.

Proposition 1: Given the described situation with M being responsible for hiring consultants, in order for an engagement to happen, at least one of the following three conditions needs to be fulfilled:

³³ I assume that M would prefer to continue without consultants in case the fee is exactly as high as the value of M's relative benefits.

4. Temporal divisibility of fees

- (a) $Z > Y$, i.e. the consultants' proposition is more beneficial to M than M's own concept.
- (b) $\omega_c > \omega$, i.e. the chance of convincing the board of directors is higher when consultants prepare the respective presentation.
- (c) $\sigma_c < \sigma$, i.e. the risk of detrimental effects to M based on a rejected concept is lower with consultants than without them.

Linking this back to Subsection 2.2.1, a situation in which consultants would be hired given that part (b) would hold while (a) and (c) would be violated would represent an engagement initiated in order to legitimize existing concepts (especially for $Z = Y$).

In case consultants would be hired if (c) holds while conditions (a) and (b) are not fulfilled, the hiring reason by M appears to be given by a "scape-goating" function of these consultants in deflecting blame from M.

Moreover, as the potential benefits (Z, Y) and the fees (F) are modelled in a way such that only part of them enters M's payoff function, while the potential sanction, $-\Psi$, affects M in full, it can be deduced that, *ceteris paribus*, the fear of the personal damage is relatively higher, the smaller the value of λ .

4.4 The model with a partial pre-payment

The basic model introduced above does not allow for any findings on the divisibility of the consulting fees. These have thus far been implicitly assumed to be payable at once, given that consultants are hired in order to help M in approaching D.

In order to scrutinize an 'optional consulting contract', a stage prior to the initial proposal by M needs to be introduced. In this prepayment stage, M can choose whether or not to enter into an agreement with the consultancy including a partial prepayment (abbreviated p-i-p in the following figure, for a pay-in-part scheme). This prepayment is to be deducted from final fees in case an actual project is carried out. In case no project is carried out within a defined period of time, the prepayment is sunk.

If M decides not to agree to such a scheme, the game between M and E will be similar to the basic model presented in the previous section. In case M decides to pay part of a potential fee up front, the game will be as depicted in the lower half of *Figure 15*. The fraction of the fee payable is denoted by π , with $0 \leq \pi \leq 1$.

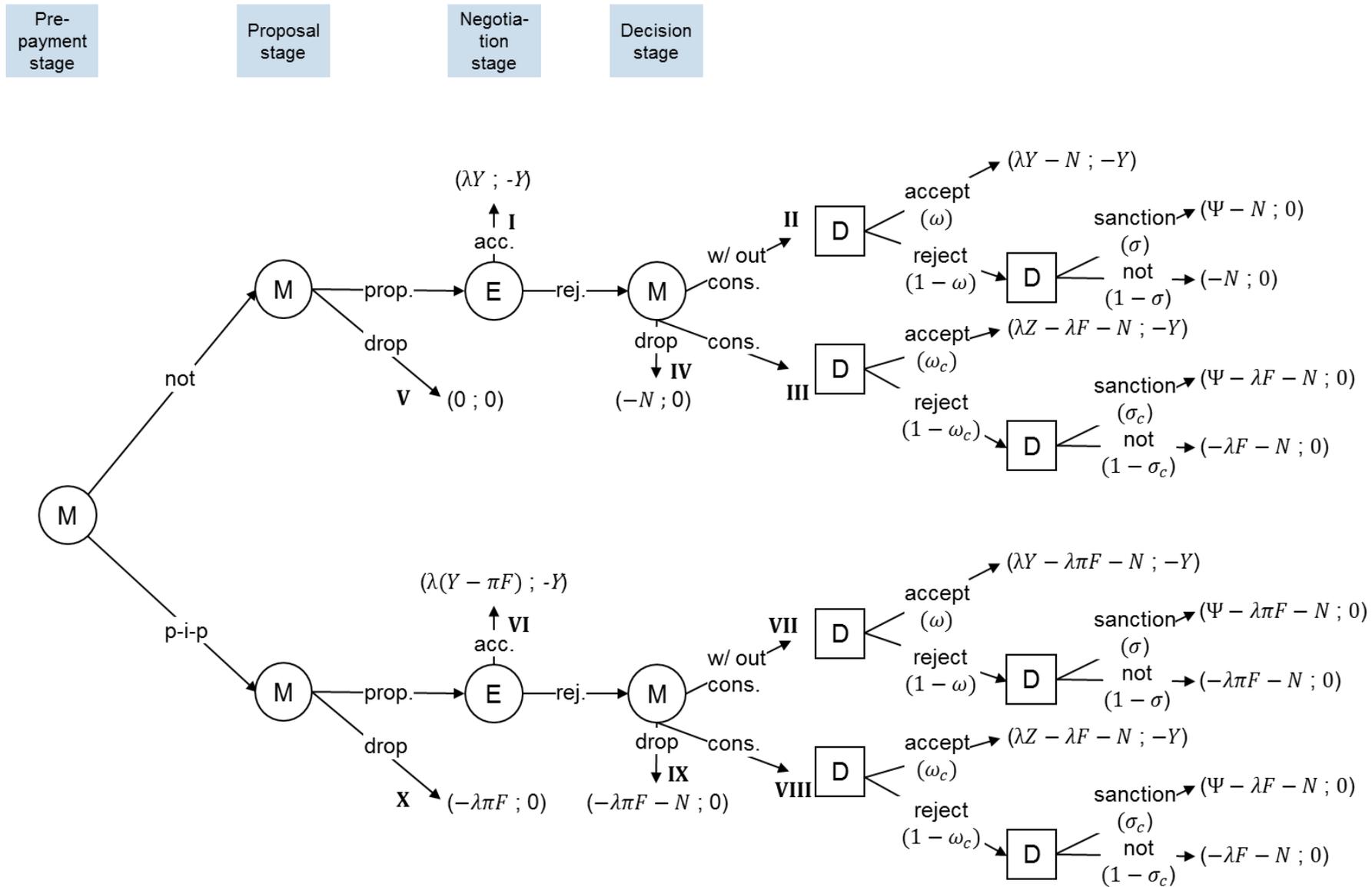


Figure 15: Extended game with pay-in-part option

4. Temporal divisibility of fees

Based on the described game, the following subsections will analyze conditions under which (1) a proposal with initially negative expected value, or (2) a proposal which would initially have been pursued by M alone, lead to an agreement by E in the negotiation stage due to changes in M's payoff structure brought along by the pay-in-part option.

4.4.1 The NEV case

Following the aforementioned description, an NEV-proposal is one in which M would not expect a positive (or neutral) return from approaching the board or directors. Thus, M would not have a credible threat versus E to take the proposal to the board in case E would not agree voluntarily to M's proposal. This could be true for the case of an approach of the board alone or with consultants, given a non-divisible fee.

If, however, a part of the cost of having the presentation in front of the board prepared by consultants, i.e. πF , is paid before M and E negotiate, the situation may be different.

In order for the partial payment to turn a NEV-proposal into a proposal with positive expected value (PEV), two main conditions have to be fulfilled:

- (1) Without a partial prepayment, M would prefer not to propose at all.
- (2) With a partial prepayment, M would choose to propose.

Following backwards induction, these two conditions can be translated into several sub-conditions, namely:

- (1.1) Given that E has rejected the proposal, approaching the board without consultants would not yield a positive expected outcome (i.e. $\text{II} < \text{IV}$ for M).³⁴

$$\lambda\omega Y - (1 - \omega)\sigma\Psi < 0$$

- (1.2) Given that E has rejected the proposal, approaching the board with consultants would also not yield a positive expected outcome (i.e. $\text{III} < \text{IV}$ for M).

$$\lambda\omega_c Z - (1 - \omega_c)\sigma_c\Psi - \lambda F < 0$$

- (1.3) E would not accept voluntarily in the negotiation stage, knowing that conditions (1.1) and (1.2) hold (i.e. $\text{I} < \text{IV}$ for E).

³⁴ Equations in subconditions have already been simplified, e.g. factors canceled out if present on both sides of an inequation.

4. Temporal divisibility of fees

$$Y > 0$$

- (1.4) M would not propose in the proposal stage, given that E would not accept the proposal and that an approach of the board, both with or without consultants, would not yield a positive expected value (i.e. $IV < V$ for M).

$$N > 0$$

- (2.1) Given that a partial prepayment has been made, approaching D would yield a positive expected value for M, following a rejection by E (i.e. $IX < VIII$ for M).

$$\lambda\omega_c Z - (1 - \omega_c)\sigma_c\Psi - (1 - \pi)\lambda F < 0$$

- (2.2) Knowing that M would approach the board with consultants after a rejection in the negotiation stage, E would accept if accepting is preferable to the expected outcome of a consulting intervention (i.e. $VIII < VI$ for E).

$$Y < \omega_c Z$$

- (2.3) Due to expected acceptance by E in the negotiation stage, M would propose, given that a partial payment has been made (i.e. $X < VI$ for M).

$$\lambda Y < 0$$

- (3) Lastly, comparing the respective outcomes of the game with and without a partial prepayment, the option with the prepayment needs to be preferred (i.e. $V < VI$ for M).

$$Y > \pi F$$

The above equations can be summarized such that one obtains an ordering of variables which needs to hold.

Proposition 2: In order to turn a NEV proposal (initially, before prepayment) into a PEV proposal by means of a partial prepayment, this partial prepayment needs to be positive, smaller than the intra-firm settlement value, which in turn needs to be smaller than the expected effect of a consulting intervention on E, i.e.:

$$0 < \pi F < Y < \omega_c Z$$

For the probability of a proposal brought by consultants to succeed, i.e. ω_c , one obtains that the following inequations have to hold:

$$\omega_c < \frac{Y}{Z}; \frac{(1 - \pi)\lambda F - \sigma_c\Psi}{\lambda Z + \sigma_c\Psi} < \omega_c < \frac{\lambda F - \sigma_c\Psi}{\lambda Z + \sigma_c\Psi}$$

4. Temporal divisibility of fees

The latter one only holds for a positive prepayment, i.e. $\pi > 0$.

4.4.2 The case of initial board proposal by M alone

In the previous subsection, it has been analyzed under which conditions a proposal which initially had a negative expected value for M would have been pursued due to an acceptance by E in the negotiation stage.

The partial prepayment may also alter the outcome of the negotiation between E and M if initially M would have approached the board without support by consultants (i.e. $\text{II} > \text{III} \wedge \text{II} > \text{IV}$ for M) after E's rejection but – having a credible threat to approach the board of directors with consultants after a partial prepayment – would be able to extract an acceptance by E under a p-i-p scheme.

The line of argumentation is largely analogous to the above. The two main conditions here are:

- (4) Without a partial prepayment, M would propose and, following E's rejection, approach the board alone.
- (5) With a partial prepayment, E would accept M's proposal.

Again, these conditions can be translated into several sub-conditions:

- (4.1) For M to approach the board alone in the decision stage, the expected outcome of this approach needs to be positive (i.e. $\text{II} > \text{IV}$ for M).

$$\lambda\omega Y - (1 - \omega)\sigma\Psi > 0$$

- (4.2) For M to prefer an approach of the board alone without consultants, without a partial prepayment being sunk, the respective expected outcome needs to be bigger than with consultants (i.e. $\text{II} > \text{III}$ for M).

$$\lambda\omega Y - (1 - \omega)\sigma\Psi > \lambda\omega_c Z - (1 - \omega_c)\sigma_c\Psi - \lambda F$$

- (4.3) Knowing that M would approach the board of directors alone, in case of rejection, E will always reject in the negotiation stage as long as there is a positive chance of M's proposal being rejected by the board (i.e. $\text{II} > \text{I}$ for E).

$$Y > \omega Y \leftrightarrow \omega < 1$$

4. Temporal divisibility of fees

- (5.1) After a partial prepayment has been made, the option to hire consultants needs to be preferred by M in order to change the course of the game (i.e. **VIII** > **VII** for M).

$$\lambda\omega Y - (1 - \omega)\sigma\Psi - \lambda\pi F < \lambda\omega_c Z - (1 - \omega_c)\sigma_c\Psi - \lambda F$$

- (5.2) Given that M would approach the board with consultants in the decision stage, E would accept in the negotiation stage only if the expected outcome of a consulting intervention is worse than voluntary acceptance (i.e. **VIII** < **VI** for E).

$$Y < \omega_c Z$$

- (5.3) For M to propose in the proposal stage, given that a partial prepayment has been made, the obtained outcome must be preferable to the result obtained from dropping (i.e. **X** < **VI** for M).

$$\lambda Y > 0$$

- (6) Lastly, the result of E's acceptance after a partial prepayment has to be preferred by M to the expected outcome without the partial prepayment (i.e. **II** < **VI** for M).

$$\lambda\omega Y - (1 - \omega)\sigma\Psi - N < \lambda(Y - \pi F)$$

For the amount of the partial prepayment, one obtains: $0 < \pi F < \frac{(1-\omega)(\lambda Y + \sigma\Psi) - N}{\lambda}$.

4.5 Summary of results

Above, it has been shown that a partial prepayment can – under the described conditions – turn a NEV proposal into a PEV one. Alternatively, it can force an acceptance from player E in a case in which M would have otherwise approached D alone.

In both cases, a partial prepayment, πF , is paid out of the client company's funds to the consulting firm without the consulting firm actually taking action³⁵. Thus, this partial prepayment represents a costly commitment device purchased in order to influence the behavior by E to the benefit of M.

It is worth pointing out that if the consulting firm had been hired anyways (i.e. outcomes **III**, **VIII** in *Figure 15*), a partial prepayment would not have altered the game. Therefore, offering such

³⁵ For the sake of simplicity, I assume interest rates on an earlier received part of the fee to be negligible.

4. Temporal divisibility of fees

a contract from the point of the consulting firm may generate extra income while not requiring extra professional working time.³⁶

From the point of view of the board of directors, a payment to consultants without any action by these does not appear to be desirable. If, however, the company's bottom line is improved due to E's acceptance of M's proposal under a threat of a consulting project, it may even constitute a desirable second-best outcome. Otherwise, the board may demand that sourcing professionals take the hiring decision instead of M (cf. Section 2.3).

4.6 Implications for future research

Whereas the goal of the simple model above – to demonstrate that an 'optional consulting contract' may be interpreted as commitment device in the sense of Bebchuk (1996) – has been attained, some extensions and altered assumptions could lead to fruitful results in future analyses.

For instance, the simplifying assumptions that the involved players act under certainty and without information asymmetry could be loosened. Moreover, the assumed risk neutrality of the players could be changed. Further, in modelling the players' negotiations, the possibility to punish the opponent at one's own cost could be introduced (cf. Rabin, 1993).

While in my model, I limit the analysis to one decision per round without renegotiations, multiple rounds and different orders of who is making proposals may be introduced when extending the model (cf. Daughety and Reinganum, 1994). In this sense, also the assumption that commitments are irrevocable could be alleviated (cf. Henkel, 2002). Besides expanding the number of rounds, also the setting with just two actors may be enlarged to an N-player case with more involved stakeholders (cf. Napel, 2002). The tools used for the analysis of a multi-player case would, however, likely be the same ones as used in the scrutiny of bilateral negotiations (Daughety and Reinganum, 2005).

Another interesting extension of the model could be to also grant E the possibility to engage consultants in order to develop alternative proposals. The fact that consultants increasingly also serve non-management clients has been laid out in Subsection 2.1.2 and could extend the discussion here. As both sides' consultants would be remunerated out of the company's

³⁶ Except for possible transaction costs in issuing an 'optional consulting contract' and negotiating the amount of the partial prepayment.

4. Temporal divisibility of fees

funds, the risk of engaging in an arms race is evident. According to Dixit and Nalebuff (2008: p. 62), in such a situation, both sides would be “better off when they cooperate and avoid an arms race. Yet, the dominant strategy for each is to arm itself heavily”.

This view is somewhat opposed by Dewatripont and Tirole (1999), showing that giving two conflicting sides each an advocate may lead to outcomes preferable to a single agent (e.g. consultant) being hired to propose a solution to intra-organizational disputes.³⁷

Lastly, as only one interviewee from the sample has mentioned the existence of such a contract model, it would be interesting to interrogate a larger number of interview partners in order to determine how common such agreements are in the marketplace.

³⁷ For contributions on intra-firm bargaining see e.g. Pull (2003) or Addison et al. (2004), specifically on the role of works councils which by player E may represent.

5. Monitoring of consulting projects

This chapter analyzes if and how project sponsors³⁸ can make compliant behavior of engaged consultants by means of external monitoring more likely compared to using internal means of monitoring. The underlying question is in part triggered by the literature on consulting and in part by the insights gained from the empirical research.

As the literature review on consultants in Chapter 2 has revealed, client organizations often have great difficulties in evaluating and measuring the performance of consulting teams which they employ. The empirical study presented in Chapter 3 has brought up the business model of a specialized, independent monitoring company which client companies may hire in order to evaluate the performance of consulting teams, seemingly attempting to capitalize on the aforementioned difficulty. Accordingly, the question arises under which conditions it would be the optimal decision to hire such a service provider.

The following considerations are based on a setting in which project sponsors who, as discussed in Subsection 2.2.2, are usually not involved in projects on a day-to-day basis have an interest in evaluating consulting projects in order to ensure compliant behavior by the hired consulting company. Non-compliance, here, may for instance be present if consulting companies “sell partner – deliver junior” (Baaij, 2014: p. 333; cf. point 3 in the list of common criticism in Subsection 2.1.3) or if billed professionals devote the paid-for time for tasks outside of the particular project at hand.

The project sponsor is assumed to be benevolent in a sense that while non-compliant behavior is preferred to be penalized, e.g. by terminating the project, he or she does not want to punish the consulting team undeservedly (i.e. if in reality the consultants have worked as promised but the sponsor has mistakenly perceived non-compliant behavior). Due to being remote to the actual project work, the project sponsor is further assumed not to be able to evaluate the performance him- or herself. This is why in the presented model the project sponsor has to choose whether to obtain a performance evaluation by the internal project manager of the client organization (M) or by a third party monitor (T).

This chapter is structured as follows. First, some relevant concepts for the behavior of players under inspection – in the context of this chapter, consultants – are reviewed. Second, the sponsor’s choice between obtaining the evaluation from M or T is discussed. Third, the central model of this chapter, employing the concept of Bayesian enforcement, is presented and

³⁸ For role descriptions within consulting projects, please refer to Chapter 2.

5. Monitoring of consulting projects

equilibrium conditions are determined. In a fourth section, the results and implications are summarized before the fifth section of this chapter discusses possible limitations and future modifications of the model.

5.1 Theoretical background

The model which will be presented and employed in this chapter is an adaptation of a Bayesian enforcement model in line with respective the contributions by Kirstein (2008, 2014). Before introducing this model in detail, two relevant alternative approaches should be laid out which could be used to model the interaction between a supervisor and a suspect to be supervised.

In the context at hand, the supervisor is the project sponsor of the client organization wanting to ensure compliant behavior by engaged consultants. Other examples of players in similar situations include the public and an offender (Becker, 1968), police and criminals (Tsebelis, 1990), tax authority and tax payers (Kirstein, 2008), and a doping enforcer and athletes (Kirstein, 2014).

Enforcement models in the sense of Becker (1968) basically assume that a potential offender decides whether or not to commit a crime based on the probability of being caught, on the expected benefit from committing a crime, and on the penalty which the offender faces in case of conviction. Thus, a risk-neutral or risk-averse offender can be expected to be deterred from committing a crime if the value of the penalty multiplied by the probability of being caught exceed the expected benefits from wrongdoing in case it is not detected.

Following the assumption that improving detection skills or inspecting more frequently is costly, the respective recommendation to a policy maker, in the sense of Becker, would be to choose a very high fine as penalty in order to prevent violations of the law³⁹. As Kirstein points out, the original version of Becker's approach takes into account the possibility of an offender 'getting away' with unlawful behavior but ignores the risk of punishing innocent persons due to imperfect detection skills. Transferred to the context of a consulting project, a positive probability of undeservedly facing a very large penalty could prevent all consulting companies from accepting a project at the respective client company. This risk will be taken into account in the model presented below.

³⁹ This assumes that increasing a fine is costless.

5. Monitoring of consulting projects

While, according to the aforementioned assumptions underlying Becker's approach, perfect deterrence of misbehavior is possible, this is not true for the 'inspection game'. This game has no Nash equilibrium in pure strategies. An example provided by Tsebelis (1990) nicely illustrates the absence of such an equilibrium in an inspection game. In this case, dealing with criminals and the police, Tsebelis assumes that criminals prefer to commit a crime if they are not controlled by the police while preferring not to commit a crime in case the police does control them⁴⁰. The police, on the other hand, prefers to control if there are criminals to be caught while preferring not to control if nobody violates the law. This leads to the following expected reactions by the criminals and the police to each other's behavior:

If the police enforce the law, the criminals will stop violating it [...].

If the criminals stop violating the law, the police will stop enforcing it [...].

If the police stop enforcing the law, the criminals will violate it [...].

If the criminals violate the law, the police will enforce it [...].

If the police enforce the law, the criminals will stop violating it [...].

(Tsebelis, 1990: p. 261)

Such an inspection game can also be set up for the interaction between the project sponsor, S, and the consultant, C⁴¹. I assume those to be rational and risk-neutral players, playing a simultaneous game with one round. In case S monitors C's work, monitoring cost $-\Gamma$ is incurred. In case S monitors C's work and C is caught to put less effort into the project than what was agreed on, C will be dismissed and suffer a damage of $-P$ (e.g. future revenues foregone, damaged reputation, etc.). In case S does not monitor, C is able to obtain a benefit, $B > 0$, in case C puts in low effort. I assume that this benefit is smaller than the potential damage from being caught, thus $P > B$. In case C puts in low effort, S will suffer a damage of $-X$, with $X > B$.

C's decision on the effort level is assumed to be binary, between good work ($d = g$) with probability γ and bad work ($d = b$) with probability $(1 - \gamma)$. S can choose to monitor with probability δ or not to monitor with probability $(1 - \delta)$. *Figure 16* below depicts the described game.

⁴⁰ The original wording speaks of a choice between "enforce" or "not to enforce" the law, (Tsebelis 1990: p. 260).

⁴¹ For the sake of simplicity I speak of the consultant as single person here. The results can also be expected to hold for a consulting team with several members.

5. Monitoring of consulting projects

	S	Monitor, δ	Not, $(1 - \delta)$
C			
Good, γ		$-\Gamma$	0
		0	0
Bad, $1 - \gamma$		$-\Gamma$	$-X$
		$-P$	B

Figure 16: Inspection Game between Sponsor and Consultant

As stated above, in pure strategies, such a game has no Nash equilibrium. In mixed strategies, the equilibrium is given by γ^* and δ^* respectively.

$$\delta^* = \frac{B}{B + P} ; \gamma^* = \frac{X - \Gamma}{X}$$

By γ^* it is obvious, that the consultant’s strategy in equilibrium depends on X and Γ but not on the value of the penalty, P. In this respect, the result of the inspection game is clearly different than the approach following Becker as discussed above.

So far, the mode of monitoring has not been regarded in detail. However, as stated in the beginning of the chapter, I assume the sponsor not to be able to monitor him- or herself but to rather choose between the internal project manager, M, or an external provider of monitoring services, T. The relevance of this choice is laid out in more detail in the next section.

5.2 Choice of monitor

The empirical study, presented in chapter 3, has revealed that at least some clients use external, specialized providers of monitoring services for consulting projects in order to obtain an evaluation of the service quality delivered by the hired consulting company. This business model, to the best of the author’s knowledge, has not yet been discussed in academic contributions in the context of management consulting. Naturally, the question arises if and under which conditions such a monitoring company should be hired by project sponsors.

As has been extensively discussed in previous chapters, the results of consulting projects are very difficult to grasp in many cases and, even if it is possible to measure those, results usually only materialize after a given project has ended. Therefore, in order to ensure compliant behavior during a project, close monitoring of the involved parties may be required.

5. Monitoring of consulting projects

In line with many other authors, Wathne and Heide (2000: p. 36) point out that “if the risk of opportunism in a particular relationship is sufficiently high, considerable resources must be spent on control and monitoring, resources that could have been deployed more productively for other purposes.”

Certainly, monitoring can be done by internal resources of the client organization. The question of who ought to be doing so internally is largely similar to the one discussed in Subsection 2.3.1 where the debate about the responsibility for hiring decisions with respect to consultants, i.e. individual managers versus purchasing departments, was reviewed. The literature review at that point yielded that the degree of formalization of sourcing processes and the structured involvement of purchasing departments is still rather low but reportedly increasing.

With respect to project monitoring and evaluation, the degree of formalization is even lower than for pre-contractual activities, according to Perner et al. (2014). The authors criticize this fact as post-contractual monitoring carries great “importance in enhancing the value of the purchased services” (Perner et al., 2014: p. 846). In the empirical analysis of their study, it is observed that only about 15% of the polled companies employ formal guidelines for the assessment and evaluation of engaged consulting companies.

From this, one can conclude that in the majority of cases consultants are not monitored in a formalized way. If they are evaluated, this is usually done by directly involved individuals, in most cases the respective internal project manager.

What is rather obvious in this case is that, again, there may be a conflict of interest for the involved internal project manager in reporting on the performance of the consulting team. This may be due to several reasons. For one, it is often the case that if a project is considered to be successful, the involved internal project manager in a given client company has good chances of being responsible for the implementation which means an enhancement of career perspectives compared to a failed project. In that way, a positive evaluation of the project can be regarded as self-protecting behavior (Werr and Perner, 2007; Fleischer, 2010; Ernst and Kieser, 2012). The opposite may be true for unsuccessful projects. In the words of Macdonald (2006: p. 413) “it is in the interest of neither party to examine [...] failure.”

Further, an evaluation bias may not even result from conscious misinterpretation of the observed quality of work but may be explained by psychological phenomena (Ernst, 2002, as mentioned in Section 3.5). This bias is shown in a study by Pfeffer et al. (1998). In their experiment, MBA students with previous work experience were used as subjects. The

5. Monitoring of consulting projects

participating students were told they had to assume the role of a marketing manager in which they had to evaluate an advertising campaign. One group of participants was only shown the final version of an advertisement while another group was first shown a draft and later the final version. The latter group was able to give feedback on the draft but was, however, told later on that due to time constraints their feedback could not be implemented. Still, when judging the final version, the latter group assessed the results significantly better than the group which was only shown the final version – even though both groups were presented the same advertisement. The authors explained this result by a higher perceived “individualized supervisory involvement” (Pfeffer et al. 1998: p. 320).

In reality, management consulting project evaluations appear to be conducted by single persons who are also involved in the project. According to the case studies conducted by Fleischer (2010), which were discussed in Subsection 2.3.3, the satisfaction rating (relevant in Fleischer’s cases 1 and 3) was only based on the opinion of one respective manager. Further, she reported that in several cases there was disagreement about the final amount to be paid. These disputes were only arising at a personal, bilateral level in post-project negotiations.

If involved individuals tend to make incorrect judgements and if there further is a substantial risk of disputes driven by differing perceptions of whether or not a judgement is fair, this relates back to the initial question – whether monitoring tasks should rather be done by an external, impartial entity.

Apart from providing the service of carrying out monitoring and measurements, the role of a third party could be compared to that of a notary, in being an impartial expert (cf. Nahuis and Noailly, 2005). Further useful comparisons may be drawn from arbitration, which is a “private adjudication system” (Bloom and Cavanagh, 1987: p. 353). In settling disputes between business partners, compared to courts, arbitrators are said to allow for “greater flexibility in decision making and they are considered to be more private, economic, rapid, certain, and conducive to business relationships” (Bonn, 1972: p. 254). Moreover, such arbitrators are usually subject matter experts. For a specialized third party monitor for consulting projects, this would most likely also be true.

While the description of the business model of and services provided by an actually existing company, positioning itself as such a third party monitor, has presented in Subsection 3.2.7, this chapter deals in a more theoretical manner with the question under which conditions such an external party may be preferable to the use of alternative options.

5. Monitoring of consulting projects

In what follows, I assume that the project sponsor, S, cannot monitor the consultants him- or herself. This could for example be due to time constraints or geographic distance. Thus, the choice at hand is between obtaining an evaluation by the internal project manager of the client organization, M, or by a third party, T, providing monitoring services. These two players are assumed to differ in their diagnosis skills, their reaction strategy, and their costs.

The diagnosis skills by players M and T are given by two factors which I denote by ρ_i and φ_i respectively, with $i \in (T, M)$. In this, I use an adaptation of a concept provided in Kirstein (1999) which in turn draws on Heiner (1983). The basic idea behind this representation is that the accuracy of a judgement depends on two factors which are corresponding to Type 1 and Type 2 errors in statistics. The former factor, ρ_i , represents the probability that a diagnosis results in 'good' given that the behavior by the subject (in my case the team of consultants) was indeed good, i.e. $\rho_i := pr\{diagnosis\ result = g \mid d = g\}$.⁴² The latter factor, φ_i , represents the probability that a diagnosis signal of type 'good' is received despite the fact that the actual behavior is bad, i.e. $\varphi_i := pr\{diagnosis\ result = g \mid d = b\}$. For the sake of simplicity, both the performance of the consultants and the obtained results of diagnoses are assumed to be binary, either 'good' or 'bad'.

In case both probabilities are equal, i.e. $\rho_i = \varphi_i$, the diagnosis would be just as good as guessing. If every actual good behavior by the consultants would result in a 'good' rating, i.e. $\rho_i = 1$, and no 'good' rating would ever be obtained in case the actual behavior was bad, i.e. $\varphi_i = 0$, the diagnosis would be perfect. However, I assume that the diagnosis skills of both alternative options to obtain monitoring, M and T, are positive but less than perfect. That is $0 < \varphi_M < \rho_M < 1$ and $0 < \varphi_T < \rho_T < 1$.

Ceteris paribus, a higher ρ_i or a lower φ_i indicate a better diagnosis skill. Comparing the diagnosis skills of the two options in case the values for ρ_i and φ_i are different in a way that each option is better in one dimension while the other is superior with respect to the other criterion (i.e. $\rho_M < \rho_T \wedge \varphi_M < \varphi_T$ or $\rho_M > \rho_T \wedge \varphi_M > \varphi_T$) is less straightforward. These qualities are usually compared by means of "receiver operating characteristic" (Kirstein 1999: p. 70), short ROC, curves. Examples of such curves are shown in *Figure 17* below, where a level closer to the point $\rho_i = 1; \varphi_i = 0$ is better than a level closer to the diagonal with $\rho_i = \varphi_i$.

⁴² The expression "pr" is used here as abbreviation for probability.

5. Monitoring of consulting projects

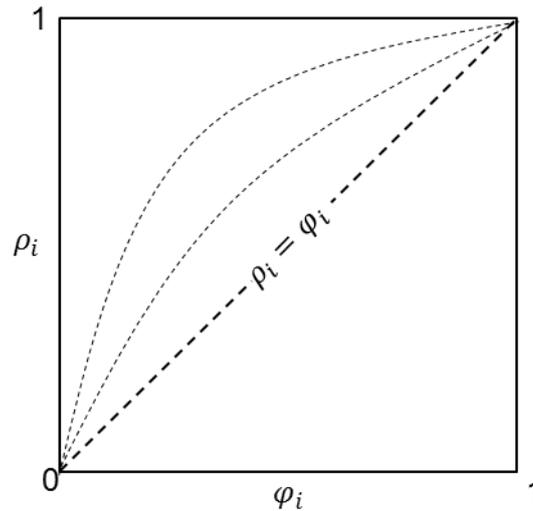


Figure 17: Possible diagnosis skill levels of player i ; Source: Adaptation of Kirstein (1999: p. 71)

From the discussion above about possible conflicts of interest by the involved parties it follows that the monitoring signal which the project sponsor receives does not only depend on the actual diagnosis skill of M or T but also on the motivation to report truthfully. If indeed, M has an incentive to overstate the quality of the consultants' work, the signal received by S is not the same as the diagnosis result which M has obtained initially. I denote signal reported by player i as o_i .

This reaction strategy of player i is defined by probabilities η_i and ϑ_i :

$$\eta_i := \text{pr}\{o_i = g \mid \text{diagnosis result} = g\}$$

$$\vartheta_i := \text{pr}\{o_i = g \mid \text{diagnosis result} = b\}$$

Thus, the accuracy of the signal which is received by S depends on both, the diagnosis skill and the motivation of player i . I define:

$$r_i := \text{pr}\{o_i = g \mid d = g\}$$

$$w_i := \text{pr}\{o_i = g \mid d = b\}$$

Given the above definitions, one can derive⁴³:

$$r_i = \eta_i \rho_i + \vartheta_i(1 - \rho_i)$$

⁴³ Proof: If $r_i := \text{pr}\{o_i = g \mid d = g\}$, then $r_i = \text{pr}\{o_i = g \mid \text{diagnosis result} = g\} \cdot \text{pr}\{\text{diagnosis result} = g \mid d = g\} + \text{pr}\{o_i = g \mid \text{diagnosis result} = b\} \cdot \text{pr}\{\text{diagnosis result} = b \mid d = g\}$

5. Monitoring of consulting projects

$$w_i = \eta_i \varphi_i + \vartheta_i (1 - \varphi_i)$$

In order to make the signal obtained by either M or T preferable to not obtaining any signal, i.e. guessing – with $w_i = r_i$ – but still less than perfect – with $r_i = 1; w_i = 0$ – from S's perspective, I assume $0 < w_i < r_i < 1$.

As S is assumed to prefer to receive a true signal over a wrong one, a necessary, albeit not sufficient, condition for being willing to pay an external monitoring party, T, a fee greater than the costs of obtaining an evaluation by the internal resource M, is that T's signal is of higher accuracy than that of M.

Having discussed S's choice between obtaining an evaluation by M or T, who each are able to monitor with an informative but imperfect diagnosis skills and possible incentive conflicts, the next section will discuss the actual behavior of the consultant given the sponsor's enforcement strategy and vice versa.

5.3 Model of Bayesian enforcement for consulting projects

In this section, I will model the interaction between the project sponsor and the consultant⁴⁴ in a sequential order, adapting a model approach used by Kirstein (2014). That is, first, the consultant decides whether to perform good or bad. Based on this performance, either M or T will report a signal about the quality of C's work to S. For the sake of simplicity, monitoring costs are set to zero for the moment. These will be discussed at a later stage.

After receiving the respective signal, S makes a decision on whether or not to terminate the project, i.e. whether to punish C. In order to analyze the strategies by C and S, I introduce a number of additional variables below.

- j – Judgement by S, having obtained signal o_i , $j \in (g, b)$
- α – Probability that judgement by S is 'bad' given that received signal was 'good', i.e.
 $\alpha := pr(j = b \mid o_i = g)$
- β – Probability that judgement by S is 'bad' given that received signal was 'bad', i.e.
 $\beta := pr(j = b \mid o_i = b)$

⁴⁴ As stated above, for the sake of simplicity, I refer to the consultant as a undefined player here.

5. Monitoring of consulting projects

- μ – S' believe that C has actually chosen 'good' given that received signal was 'good',
i.e. $\mu := pr(d = g | o_i = g)$
- ν – S' believe that C has actually chosen 'good' given that received signal was 'bad',
i.e. $\nu := pr(d = g | o_i = b)$

These probabilities can be summarized as follows in *Figure 18*:

C's behavior (d) →	Good (g)	Bad (b)
Obtained signal (o_i) ↓		
Good (g)	μ	$1-\mu$
Bad (b)	ν	$1-\nu$

Figure 18: Conditional probabilities for S's believe in truthfulness of signal obtained

- $G - S'$ benefit from correctly sanctioning a non-compliant C; $G > 0$
- $-L - S'$ loss from incorrectly sanctioning a compliant C; $0 < L < \infty$

The corresponding Bayesian enforcement game is shown in *Figure 19* below. In parentheses, the payoffs by S and C are presented. S cannot know the difference between 'top' and 'bottom', denoted by the dotted ellipse.

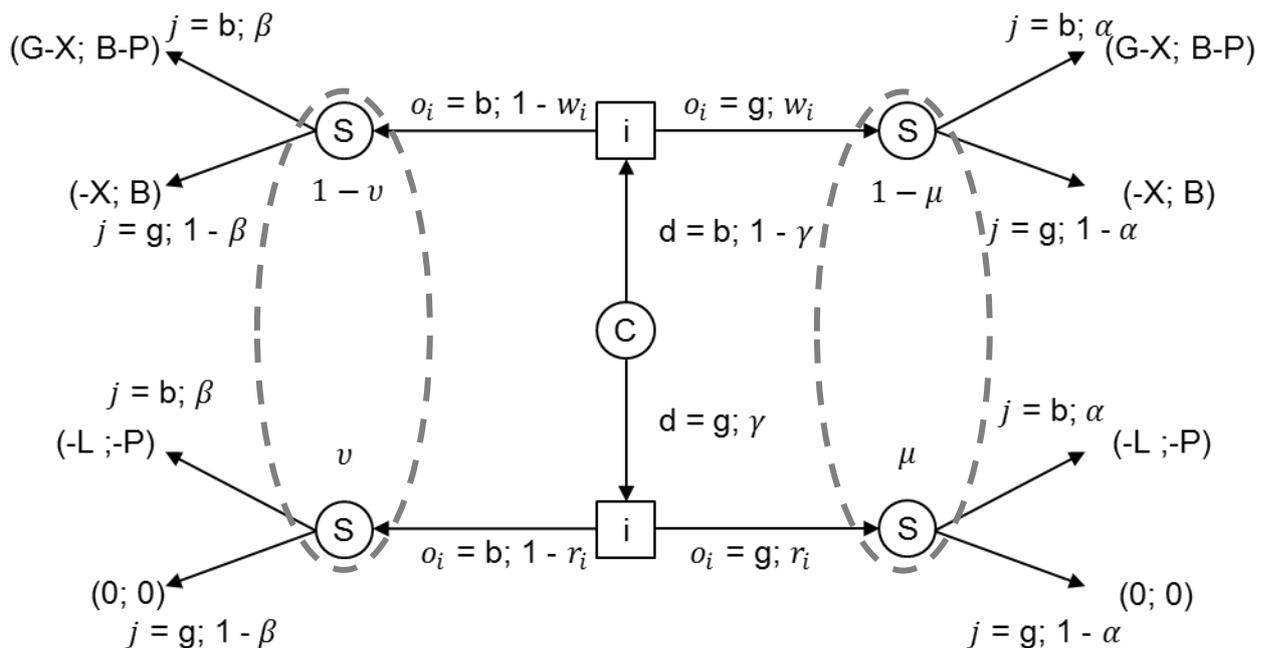


Figure 19: Bayesian enforcement game; Source: Adaptation of Kirstein (2014: p. 9)

5. Monitoring of consulting projects

Having established the underlying model, the next two subsections scrutinize the strategies of the two players at hand.

5.3.1 The consultant's choice

The payoff function of the consultant can be expressed by the following equation:

$$\Pi_C = (1 - \gamma)B - \gamma[r_i\alpha + (1 - r_i)\beta]P - (1 - \gamma)[w_i\alpha + (1 - w_i)\beta]P$$

In order to obtain C's best response to the factors not controlled by C, one needs to take the first derivative with respect to γ . This is equal to:

$$\frac{\partial \Pi_C}{\partial \gamma} = P(r_i - w_i)(\beta - \alpha) - B$$

Given the underlying assumptions, this leads to a number of intermediate results:

- The higher the damage, P , suffered from being detected, the lower the incentive for C to choose "bad" performance.
- The more likely the signal quality delivered by player i is correct – due to a higher r_i or a lower w_i – the lower the incentive for C to choose "bad" performance.
- The higher the benefit, B , to be obtained by non-compliant behavior, the higher the incentive for C to choose "bad" performance.

In order to scrutinize the consultants' best response to S' expected judgment behavior, denoted by $\gamma^*(\alpha; \beta)$, I proceed analogous to Kirstein (2014), analyzing the behavior of an athlete given the behavior of a doping enforcer. In order to abbreviate the notation, a term $K = \frac{B}{P(r_i - w_i)} > 0$ is introduced. Using this term, the optimal response of $\gamma^*(\alpha; \beta)$ can be formulated:

$$\begin{aligned}\beta - \alpha > K &\leftrightarrow \gamma^* = 1 \\ \beta - \alpha = K &\leftrightarrow 0 \leq \gamma^* \leq 1 \\ \beta - \alpha < K &\leftrightarrow \gamma^* = 0\end{aligned}$$

Thus, as long as $B > P(r_i - w_i)$, i.e. $K > 1$, the consultant would choose "bad" behavior. For $B = P(r_i - w_i)$, i.e. $K = 1$, only a response of $\beta = 1$ and $\alpha = 0$ by the sponsor would make the consultant indifferent to choose a γ between 0 and 1.

These points will be useful in a later equilibrium analysis. In a next step, the optimal choice of the project sponsor needs to be analyzed in the following subsection.

5. Monitoring of consulting projects

5.3.2 The project sponsor's choice

The choice which S has to make is whether or not to 'punish' C, given that S has received a signal o_i by the player M or T. As stated earlier, this signal can either be 'good' or 'bad', i.e. $o_i \in (g, b)$. First, I will scrutinize S' optimal response to a 'good' signal and subsequently the optimal response to a 'bad' signal.

In case S receives the signal $o_i = g$, S will want to maximize the following payoff term with respect to the endogenous variable α .

$$\Pi_S^{o_i=g} = -\mu\alpha L + (1 - \mu)(\alpha G - X)$$

Taking the first derivate with respect to α yields:

$$\frac{\partial \Pi_S^{o_i=g}}{\partial \alpha} = G - \mu(G + L)$$

The probability μ describes the sponsor's believe with respect to the consultants' choice indeed having been 'good' given the expectations on the truthfulness of the reported signal 'good' by player i, defined by r_i and w_i . Thus:

$$\mu = \frac{r_i \gamma}{r_i \gamma + w_i (1 - \gamma)}$$

This can be substituted into the above equation of the first derivative of S's payoff with respect to α given a positive signal, i.e.

$$\frac{\partial \Pi_S^{o_i=g}}{\partial \alpha} = G - \frac{r_i \gamma}{r_i \gamma + w_i (1 - \gamma)} (G + L)$$

If this term equals zero, S will be indifferent between choosing any α between 0 and 1. This is the case if and only if the following equation holds

$$\gamma \stackrel{!}{=} \frac{G w_i}{G w_i + L r_i} = \gamma_\alpha$$

The particular value for γ , denoted as γ_α can be used to express S's optimal reaction $\alpha^*(\gamma)$ given that the received signal was positive:

$$\begin{aligned} \gamma < \gamma_\alpha &\leftrightarrow \alpha^* = 1 \\ \gamma = \gamma_\alpha &\leftrightarrow 0 \leq \alpha^* \leq 1 \\ \gamma > \gamma_\alpha &\leftrightarrow \alpha^* = 0 \end{aligned}$$

5. Monitoring of consulting projects

Next, S' optimal reaction to a 'bad' signal, i.e. $o_i = b$, needs to be scrutinized, determining $\beta^*(\gamma)$. The payoff term of S given that a 'bad' signal was received is:

$$\Pi_S^{o_i=b} = -v\beta L + (1-v)(\beta G - X)$$

The first derivative with respect to the endogenous variable β is:

$$\frac{\partial \Pi_S^{o_i=b}}{\partial \beta} = G - v(G + L)$$

Analogous to the above, the probability v describes the sponsor's believe with respect to the consultant's choice indeed having been 'good' given the expectations on the truthfulness of the reported signal 'bad' by player i, defined by r_i and w_i . Thus:

$$v = \frac{(1-r_i)\gamma}{(1-r_i)\gamma + (1-w_i)(1-\gamma)}$$

By substitution, one obtains:

$$\frac{\partial \Pi_S^{o_i=b}}{\partial \beta} = G - \frac{(1-r_i)\gamma}{(1-r_i)\gamma + (1-w_i)(1-\gamma)}(G + L)$$

Again, S will be indifferent to choose any value for β between 0 and 1 if this term equals zero. This is true if and only if the following equation holds:

$$\gamma \stackrel{!}{=} \frac{G(1-w_i)}{G(1-w_i) + L(1-r_i)} = \gamma_\beta$$

Using this γ_β , S' optimal response with respect to $\beta^*(\gamma)$ can be formulated as follows:

$$\gamma < \gamma_\beta \leftrightarrow \beta^* = 1$$

$$\gamma = \gamma_\beta \leftrightarrow 0 \leq \beta^* \leq 1$$

$$\gamma > \gamma_\beta \leftrightarrow \beta^* = 0$$

Now that $\gamma^*(\alpha; \beta)$, $\alpha^*(\gamma)$, and $\beta^*(\gamma)$ have been scrutinized, possible equilibria in mixed strategies between S and C can be analyzed.

5. Monitoring of consulting projects

5.3.3 Equilibrium analysis

In equilibrium, the strategies of both players are determined by their best response to the respective best response of the other player. This combination is thus given by $\gamma^*(\alpha^*; \beta^*)$, $\alpha^*(\gamma^*)$, and $\beta^*(\gamma^*)$. Recalling that for $\beta - \alpha = K$, C is indifferent between choosing any γ between zero and one, the following *Figure 20* depicts the project sponsor's response for $K < 1$. Four points depicted in this graph are of special interest, labelled I, T, D, and L.

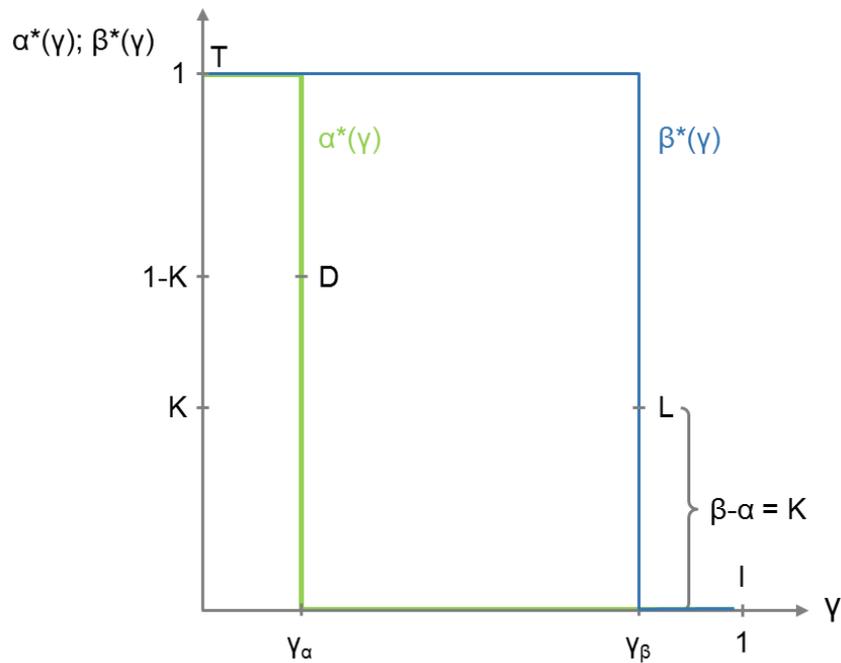


Figure 20: Best response of project sponsor

At point I, one has $\gamma > \gamma_\beta \wedge \gamma > \gamma_\alpha$, which would mean $\alpha^* = \beta^* = 0$ is the optimal choice of S. However, given that C would in this case never be called upon for ‘bad’ performance, $\gamma^* = 1$, i.e. choosing ‘good’ with certainty would not be chosen.⁴⁵ As, due to the underlying assumptions with respect to B, P, r_i and w_i , $K = \frac{B}{P(r_i - w_i)}$ is always greater than 0, the equation $\beta - \alpha < K$ would hold in this case and $\gamma^* = 0$ would be C’s response. Thus, point I does not represent an equilibrium in this game.

Proposition 1: Given the Bayesian enforcement game with $0 < w_i < r_i < 1$, $0 < L < \infty$, $0 < G$, and $0 < B < P$, the consultant will never choose ‘good’ behavior with certainty.

⁴⁵ For the reasoning behind this, also recall the example of the police and the criminals as presented in the first section of this chapter.

5. Monitoring of consulting projects

At point L, S chooses $\alpha^* = 0$ and $\beta^* = K$, which would correspond to $\gamma_\beta = \frac{G(1-w_i)}{G(1-w_i)+L(1-r_i)} = \gamma^*$ as equilibrium choice of C. Speaking in the terminology provided by Kirstein (2008, 2014), at this point one finds a *lenient equilibrium*, meaning that S will never sanction C in case the signal 'good' is received and, for $K < 1$, S will not sanction C with certainty in case the signal 'bad' is received.

At point D, S chooses $\alpha^* = K$ and $\beta^* = 1$, which would correspond to $\gamma_\alpha = \frac{Gw_i}{Gw_i+Lr_i} = \gamma^*$ as equilibrium choice of C. This point is a *draconian equilibrium* in the terminology of Kirstein, at which S would sanction C with certainty in case the signal 'bad' is received while C will be sanctioned with a positive probability if the signal 'good' is obtained.

Lastly, at point T, S chooses $\alpha^* = \beta^* = 1$ which would correspond to C choosing $\gamma^* = 0$. Unlike at point I, at this point none of the players would have an incentive to alter his or her response given the other's strategy. This point is referred to as *tyrannic equilibrium*.

This combination of $\alpha^* = \beta^* = 1$ and $\gamma^* = 0$ also constitutes an equilibrium for $K \geq 1$. For all cases of $K > 1$, this is the only equilibrium. In case $K = 1$ holds, besides the tyrannic equilibrium, also a lenient equilibrium exists, meaning that S would not sanction C in case the signal 'good' is obtained. From $\alpha^* = 0$ follows $\beta^* = 1$ in this case.⁴⁶ This combination of α^* and β^* would make a range of values for γ^* possible, namely $\gamma_\alpha < \gamma^* < \gamma_\beta$.

In order to correctly describe perfect Bayesian equilibria (PBE), besides $\gamma^*(\alpha^*; \beta^*)$, $\alpha^*(\gamma^*)$, and $\beta^*(\gamma^*)$ also the equilibrium believes μ^* and ν^* need to be stated. These can be obtained by inserting the respective values for γ^* into the equations $\mu = \frac{r_i\gamma}{r_i\gamma+w_i(1-\gamma)}$ and

$$\nu = \frac{(1-r_i)\gamma}{(1-r_i)\gamma+(1-w_i)(1-\gamma)}$$

respectively. Then, the PBEs can be formulated in the form $\{(\alpha^*; \beta^*); (\mu^*; \nu^*); \gamma^*\}$ for (a) $K > 1$, (b) $K = 1$, and (c) $K < 1$.

(a) For $K > 1$, the only equilibrium is the tyrannic one with $\{(1;1);(0;0);0\}$

(b) For $K = 1$, two equilibria exist:

- tyrannic equilibrium: $\{(1;1);(0;0);0\}$
- lenient equilibrium: $\{(0;1); \mu^*; \gamma^*\}$ with $\mu^* \in]\mu(\gamma_\alpha); \mu(\gamma_\beta)[$ and $\gamma^* \in]\gamma_\alpha, \gamma_\beta[$

(c) For $K < 1$, three possible equilibria exist:

- tyrannic equilibrium: $\{(1;1);(0;0);0\}$

⁴⁶ Given $\alpha^* = 0$, $K=1$, and $K = \beta - \alpha$, $\beta^* = 1$ is required, as any $\beta^* < 1$ would correspond to $K < \beta - \alpha$ and would thus induce 'bad' behavior by C with certainty.

5. Monitoring of consulting projects

- draconic equilibrium: $\{(1-K; 1); (\frac{G}{G+L}; \frac{G(1-r_i)w_i}{G(1-r_i)w_i+Lr_i(1-w_i)}; \gamma_\alpha = \frac{Gw_i}{Gw_i+Lr_i}\}$
- lenient equilibrium: $\{(0; K); (\frac{G(1-w_i)r_i}{G(1-w_i)r_i+Lw_i(1-r_i)}; \frac{G}{G+L}); \gamma_\beta = \frac{G(1-w_i)}{G(1-w_i)+L(1-r_i)}\}$.

5.3.4 Implications for choice of monitor

The analysis above has shown that even under the assumption of no monitoring cost, C can never be deterred from misconduct with certainty (see Proposition 1). This raises the question if an investment by S in a more skillful and honest monitor could be reasonable.

I assume that the benevolent S prefers the probability that C chooses 'good', γ , as high as possible. Following the argumentation in the previous subsection, the highest attainable value is $\gamma = \gamma_\beta$ in the lenient equilibrium. Given that the choice of monitor between M and T is one between their respective signal qualities determined by $(r_i; w_i); i \in (M; T)$, the effect of the signal quality on C's behavior needs to be analyzed. Taking the first derivatives of γ_β with respect to r_i and w_i yields:

$$\frac{\partial \gamma_\beta}{\partial w_i} = \frac{GL(r_i - 1)}{(Gw_i + Lr_i - L - G)^2} < 0$$

$$\frac{\partial \gamma_\beta}{\partial r_i} = \frac{GL(1 - w_i)}{(L(1 - r_i) + G(1 - w_i))^2} > 0$$

Proposition 2: In the lenient equilibrium, the probability of the consultants to choose a 'good' performance is increased by a better signal quality, i.e. a higher r_i or a lower w_i .

In case the signal qualities to be obtained by M or T are distributed in a way such that $r_M < r_T \wedge w_M < w_T$ or $r_M > r_T \wedge w_M > w_T$, the respective ROC-curves, analogous to the discussion in Section 5.2, need to be known in order to determine whose signal S would prefer.

Assuming that hiring the external party T is costly whereas M's signal can be obtained without an additional cost, a necessary condition that S would be willing to pay a fee to T is:

$$\gamma_\beta(r_T; w_T) > \gamma_\beta(r_M; w_M)$$

That is, S may be willing to pay for T's services if, and only if, employing T induces C to comply with a higher probability in equilibrium. The maximum willingness to pay (WTP) by S in

5. Monitoring of consulting projects

equilibrium would be equal to the difference in payoffs by using T over using M in case using T leads to better performance of C, and zero otherwise. In case this difference is positive, hiring T would have created value for the client organization.⁴⁷

$$WTP = \max\{(1 - \gamma_\beta^T)(1 - w_T)(K^T G - X) - \gamma_\beta^T r_T K^T L - (1 - \gamma_\beta^M)(1 - w_M)(K^M G - X) - \gamma_\beta^M r_M K^M L; 0\}$$

It is important to point out that this is only true for the lenient equilibrium. Obviously, in a tyrannic equilibrium with $\gamma^* = 0$, an investment in better signal quality would have no effect.

In case of a draconic equilibrium, C chooses $\gamma = \gamma_\alpha$. Analyzing the effects of r_i and w_i here yields $\frac{\partial \gamma_\alpha}{\partial w_i} > 0$; $\frac{\partial \gamma_\alpha}{\partial r_i} < 0$. Thus, a higher signal quality would lower the probability of C choosing 'good' behavior in equilibrium under a draconic policy.

All of the above has assumed that the signals are informative but less than perfect. Despite the fact that a perfect monitor (with $r_i = 1$; $w_i = 0$) does not appear to be a very realistic concept, under such a certainly correct signal, S would choose $\alpha^* = 1$; $\beta^* = 0$ and C would be induced to comply with certainty in equilibrium, i.e. $\gamma^* = 1$.

5.4 Summary of results

This section briefly summarizes the main results of the considerations above before the following section will discuss limitations and possible routes for future research.

It has been shown that, under the given assumptions in Section 5.3, perfect deterrence of 'bad' behavior by C is not part of an equilibrium as long as the signal reported to the project sponsor is less than perfect. Further, it has been laid out that three types of equilibria (tyrannic, draconian, and lenient) exist which are characterized by S's sanctioning behavior and C's corresponding reaction. In a lenient equilibrium the probability of 'good' behavior by C is the highest.

In such a lenient equilibrium, an investment in better signal quality leads to a higher probability of compliance by C. If the project sponsor is to choose whether to rely on a signal by the

⁴⁷ Nota bene: Equation derived by inserting $\alpha^* = 0$ and $\beta^* = K^i$; As factor K depends on r_i and w_i , a superscript is needed.

5. Monitoring of consulting projects

internal project manager, M, or an external third party monitor, T, this decision depends on three factors: the diagnosis skill, the reaction strategy, and the costs, as presented in Section 5.2. Under certain configurations of these factors, for example T being better at diagnosis skills than M and M having interests which diverge from those of the project sponsor, it can be the optimal decision for S to engage an external monitoring party. This is the case if (1) the prevented expected damage by non-compliant behavior by C is larger than the service fees charged by T, and (2) the transaction costs arising from a collaboration with T are offset by the superiority of T's signal compared to the alternative use of M's signal.

Lastly, just as in the inspection game, presented in Section 5.1, an increased punishment (P) does not affect the consultant's behavior in equilibrium in the Bayesian enforcement game of Section 5.3.

5.5 Implications for future research

The model presented in this chapter is designed to inform practitioners and scholars about the monitoring of consultants – both in terms of the choice of who ought to carry out the monitoring as well as the implications of reactions to a received monitoring result. In order to keep matters comprehensible, some assumptions are made on which the model builds. Loosening some of these assumptions may lead to fruitful insights and should be of interest for future research. This is especially true for a concept that is as new as external monitoring is to consulting research.

In the model, the consultants are assumed to undertake a binary choice on their input parameter 'good' and 'bad', based on which a monitor (M or T) obtains a binary signal which, in turn, is used by S to decide between two possible reactions. While this setting is handy in conducting the analysis, it might be more realistic to model more fine-grained ranges (e.g. in units of professional time by the consultants or an evaluation scale from 1 to 100 by the monitor, as presented in Subsection 3.2.7).

Moreover, the actors have been assumed to be risk-neutral. As Cons. 5 in the interview series has stated, external monitoring services may be especially attractive to risk-averse decision makers, looking for reassurance. Thus, a scrutiny of risk-taking behavior could be included in an extended version of the model.

5. Monitoring of consulting projects

As the 'punishment', P , received by the consultant was not in any form collected by the project sponsor, the extent of this punishment does not have a deterring effect in the model above. An interesting modification would be to assume that at least some of the penalty would be collected by the sponsor. Kirstein (2008) shows that in a modified version such a penalty with a fiscal effect can indeed have a deterring effect on potential offenders. This kind of collection could reflect a lowered consulting fee payable in case of a contingency agreement.

In terms of sequence, it is assumed that C first decides whether or not to perform 'good', knowing the mode of monitoring (M or T) and the payoffs of S of a decision after having received a signal of type 'good' or 'bad'. It is implicitly assumed that S is committed to choose the monitor with the more accurate signal. However, T may, under certain conditions, be only used as a threat. One could assume that T indeed delivers signaling results more accurately than M , and S , in a lenient equilibrium, would be willing to pay T in order to monitor C in a way that increases the probability of 'good' behavior. In case S only contracts a third party monitor after C has decided on the behavior, actually contracting T may no longer be needed in order to have a desired effect with respect to C 's choice. In case S only threatens to employ T , T may not receive any business. In order to mitigate this risk, companies offering such services may limit their services to projects which have not started at the point of the agreement between T and S (cf. Kirstein and Rickman, 2004). This may be reflected by the fact that the interviewed performance evaluation company has stated to rather work on longer-term outline agreements than on the basis of single project contracts.

With respect to the truthfulness of the reported signal by the monitoring player (represented by $\rho_i; \varphi_i$), many authors have suggested that the internal project manager is facing an incentive conflict and may report overly positive for reasons of self-protection (e.g. Ernst and Kieser, 2012; see Section 5.2). Moreover, also the founder of the interviewed provider of third party monitoring services has explained part of the advantage of his company over internal options by this conflict of interest of managers. If, on the other hand, one assumes that the monitoring company has undistorted preferences as it "has to maintain a reputation for good ratings when competing for potential customers" (Kirstein, 2002: p. 404, in a related context), there may only be an incentive conflict for one of the two monitoring options, namely M .

Yet, it should not be overlooked that M and S may have a substantially higher number of interactions than T and S . In vein of the Folk Theorem (cf. Fudenberg and Maskin, 1986), it may be doubtful that T would be less prone to misbehave than M . One may therefore ask "who monitors the monitor" (Kumar and Sivaramakrishnan, 2008: p. 1371) and scrutinize whether

5. Monitoring of consulting projects

consulting monitors and consulting companies or consulting monitors and project sponsors may be inclined to collude.

In case the use of third party monitors should become popular in consulting projects, another relevant question may be how many of such monitoring entities would be optimal to participate in the market from an economic point of view. The answer could be a single, government-controlled organization, a private monopolist, a small group of companies competing in an oligopolistic market, or a large number of small service providers.

Related to this thought would be the consideration of how large the market volume for such services could be in reality. A rough 'back of the envelope' calculation can give an idea on the potential market size. One may assume that strategy consulting is the segment in which such a close monitoring is most applicable, given the difficulties in measuring outputs. In Germany, the market size for strategy consulting services in the year 2015 is estimated at € 6.7 bn (BDU, 2016). Furthermore, it may be the case that projects with a variable component display the most relevant field for external performance evaluation. These currently make up no more than 10 percent of consulting projects, as presented above. If lastly, one assumes that the third party monitor is remunerated by a fraction of 1-2 percent of the total project values, this would lead to a market volume for such monitoring services of about € 7 mn to € 13 mn in Germany. Clearly, this estimation is rather rough and potentially too conservative. While it would need a more elaborated approach to be reliable, the estimation at least gives an indication of a comparatively small market size which providers of monitoring services for consulting projects would be operating in.

This limited market size could be interpreted to be in line with the fact that the extent of market failures due to agency problems is usually bigger from a theoretical perspective than observations in real world markets or experiments confirm (Kirstein and Kirstein, 2009). In order to deepen the understanding, empirical testing of the described game between the project sponsor and the consultant, and the stated predictions with respect to their behavior, could be useful to be conducted in the course of future research.

6. Conclusion and outlook

In this chapter, the main findings of the previous parts are summarized followed by a brief description of possible avenues for future research. The summary part shall be structured according to the research questions which have been presented in the introduction.

RQ 1: How can the value of management consulting projects be conceptualized?

By means of the thorough literature review presented in Chapter 2, it has been argued that the question whether or not a consulting project can be considered to be successful – or adding value – cannot be answered without defining the point of view. For the client organization as a whole, a project result may be regarded as a failure while still being beneficial for certain interest groups within it and possibly, at the same time, a commercial success for the engaged consulting company.

As it has been shown, in general neither ‘the consultant’ nor ‘the client’ are single actors or groups with homogenous preferences. Even if, for the sake of simplicity, ‘the consultant’ is conceptualized as single player, there is a long list of different roles of consultants which have been proposed by academic commentators. Which role consultants are hired for, essentially depends on the client’s business needs and on the question of who is the ultimate client within the client organization.

Not only does the client organization normally consist of a substantial number of stakeholders with potentially conflicting agendas, also the team of consultants usually consists of several actors with different positions in the hierarchy within the consulting company. Therefore, the setting of a consulting project should be understood as complex social system with a considerable number of principal-agent relationships.

Apart from an understanding of the point of view to be taken and the reason for why consultants were to be hired, it needs to be clarified along which measurement scale and in which time frame the outcomes of a consulting project should be evaluated.

Based on a thorough review of different streams of literature, a conceptualization of the impact of management consulting services has been proposed. This can be the basis for ongoing academic discussions as well as for practitioners debating about the impact of consultants’ work. It has been shown that, all other things equal, it can be assumed that value creation for the client organization is likely to be greater, the more skilled the consultants are relative to the

6. Conclusion and outlook

client organization, the more complementary the consultants' resources are versus those available to the client side, and the more aligned the incentives of the involved actors are.

In order to obtain the net value of a consulting project, the related costs need to be taken into consideration. As has been discussed, these include direct costs in the form of fees, indirect costs such as the time of internal resources used to work on a given project, agency costs occurred in governing the relationship between the involved parties and in preventing misbehavior of which, as well as opportunity costs referring to the value of the next-best option besides the respective consulting project.

It needs to be pointed out that, even with a better understanding of the concept of net value of consulting projects, measuring this value will in many cases remain cumbersome. While the results of some types of projects, such as cost reduction projects, may be comparably easy to determine, for a majority of consulting projects an evaluation is considerably difficult and may involve substantial measuring costs – possibly exceeding the benefits of obtaining an all-embracing evaluation.

RQ 2: To which degree are predictions of the literature concerning the relation between clients and consultants and the governance of this relation in line with statements by practitioners and which aspects have not yet been regarded from an academic point of view?

Overall, it appears that the current body of literature provides a fair reflection of the reality in the consulting industry and of the perceptions from within client firms. This has for example been shown to be true for topics such as general trends, common criticism, and general success factors as recorded in the empirical study.

With respect to sourcing of consulting services in general and especially the formalization thereof, the obtained interview data has underlined that the standards and attitudes in the field are widely heterogeneous. This is true for both representatives of consulting and client companies. The highest quoted degree of formalization of the sourcing process goes beyond what, to the best of the author's knowledge, has previously been recorded in academic literature on management consulting.

A similar degree of heterogeneity of attitudes on clients' and consultants' sides has been observed with respect to contingency fees. The most extreme case of fully variable fees of strategy consultants, goes beyond previous authors' reports. The obtained indication that

6. Conclusion and outlook

variable fees, according to the interviewees from consulting companies, on average lead to a higher income than purely time-and-expense based fees gives rise to the hypothesis that on such fee agreements, client representatives are paying a premium – comparable to an insurance – in the longer run. This hypothesis would need to be checked with a greater sample size in future research.

Two previously unknown aspects – the ‘optional consulting contract’ and the existence of professional external monitoring services – were recorded and have led to research questions 3 and 4.

RQ 3: Can a divisible, pay-in-part consulting contract be a device to change the balance of power between intra-firm shareholders?

By means of the game-theoretic model, as presented in Chapter 4, it has been demonstrated that a contract under which part of the consultants’ fee is pre-paid can change the balance of power within a client organization.

Making a pre-payment to consultants can render a part of the costs of a potential project sunk. If a manager is responsible for making the decision on whether and which consultants to hire, he or she can strategically make use of the fact that some costs are sunk by the time he or she negotiates with an opposing party within the client organization.

This, following the logic laid out in Chapter 4, can be the case if the opposing party expects the outcomes of a consulting project to be negative for the own position – and more negative than voluntarily agreeing with the manager on a solution outside of a project. In case the manager would not hire consultants at full project cost and there is no option of splitting these costs, there would be no need for the opposing party to agree voluntarily to a proposal by the manager. If, however, this party knows that the manager will engage consultants, given that the incremental costs of actually starting a project are lowered due to a pre-payment, a voluntary agreement to such a proposal can possibly be attained.

Yet, given the setting discussed in Chapter 4, once a voluntary agreement is reached, no consulting project would take place. The discussed ‘optional consulting contract’ may thus be interpreted as strategic commitment device under the conditions described above. By this result, the presented model offers an explanation for the existence of such a contract model in management consulting.

6. Conclusion and outlook

From the perspective of consulting firms, offering such a contract may generate a source of revenue without requiring the use of costly professional time.

RQ 4: Under which conditions should a third party monitor be engaged in a project setting?

As discussed, the underlying question is whether a project sponsor who is remote to the actual project work can induce 'better' behavior of engaged consultants by means of an external monitor than by use of internal resources.

Given the assumptions about the player's behavior as used in the model in Section 5.3, incompliant behavior by the consultants can never be prevented with certainty. However, indeed, the probability of 'good' behavior by the consultants can be increased by investing in higher quality of the monitoring signal received by the project sponsor.⁴⁸

This quality depends on the ability of the possible monitors to correctly observe the consultants' behavior, compared to the capability and capacity of the project sponsor, on the one hand and on the willingness to truthfully report the observations to the project sponsor on the other hand. Against the background of possible conflicts of interests of individual managers within the client organization versus the organization's goals, this appears to provide a case for external monitoring professionals to be useful. Thus, *ceteris paribus*, the more remote a project sponsor is to a project and the less he or she trusts the internal project manager, the more likely it would be advisable to hire an external monitor. Whether it is worth incurring the costs to engage an external monitor depends further on the prevented expected damage resulting from incompliant behavior by the respective management consultants.

The presented approach to deciding on whether or not to make use of this recently introduced external monitoring service can be expected to be valuable for managerial decision makers. Moreover, it lays the basis for future academic discussions.

Implications for future research

The still considerably small empirical research base in the field of management consulting can benefit from more qualitative as well as quantitative studies. The findings obtained in this dissertation can be regarded as a point of departure for future research. For example, the

⁴⁸ Highest probability of compliant behavior by consultants in a 'lenient' equilibrium. See Subsection 5.3.3 for equilibrium analysis.

6. Conclusion and outlook

indicative values with respect to the share of contingency fee agreements used for consulting projects, the involved share of the variable components in relation to total fees, as well as on the average amount of actual pay-outs, as presented in Section 3.2, would need to be validated by a bigger sample and statistical analyses. Questions like the relation between the clients' industry or the geographic location and the use of success fees could be scrutinized that way. Furthermore, the development of the observed trends ought to be tracked by similar investigations at a later point in time.

In analyzing the consulting industry and its effects, according to Kipping and Clark (2012: p. 5), “[t]here are few, if any, studies that use approaches from economics”. The use of game-theoretic modeling in Chapters 4 and 5 offers a thus far scarcely used tool for the analysis of consulting-related phenomena. In this dissertation, mainly proven existing models have been adapted to the settings of consulting projects to scrutinize the research questions at hand. The presented models may be enriched by loosening the underlying assumptions such as the number of players or their risk preferences. Future research may also develop new and original models to better understand the interactions of the relevant stakeholders and to derive recommendations. For instance, a question to which game theoretic modelling may also be a useful tool and which has hardly been considered so far, is whether the consulting industry ought to be subject to governmental regulation.

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