Harvard Business Review

October 2013

Consulting on the cusp of disruption (edited extract)

by Clayton M. Christensen, Dina Wang, and Derek van Bever

Clayton M. Christensen is the Kim B. Clark Professor of Business Administration at Harvard Business School. **Dina Wang,** formerly an engagement manager at McKinsey & Company, was a fellow at the Forum for Growth and Innovation at Harvard Business School and has just returned to the firm. **Derek van Bever,** a senior lecturer at Harvard Business School, is the director of the Forum for Growth and Innovation and was a member of the founding executive team of the advisory firm CEB.

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In our research and teaching at Harvard Business School, we emphasize the importance of looking at the world through the lens of theory—that is, of understanding the forces that bring about change and the circumstances in which those forces are operative: what causes what to happen, when and why. Disruption is one such theory, but we teach several others, encompassing such areas as customer behavior, industry development, and human motivation.

Over the past year we have been studying the professional services, especially consulting and law, through the lens of these theories to understand how they are changing and why. We've spoken extensively with more than 50 leaders of incumbent and emerging firms, their clients, and academics and researchers who study them. In May 2013 we held a roundtable at HBS on the disruption of the professional services to encourage greater dialogue and debate on this subject.

We have come to the conclusion that the same forces that disrupted so many businesses, from steel to publishing, are starting to reshape the world of consulting. The implications for firms and their clients are significant. The pattern of industry disruption is familiar: New competitors with new business models arrive; incumbents choose to ignore the new players or to flee to higher-margin activities; a disrupter whose product was once barely good enough achieves a level of quality acceptable to the broad middle of the market, undermining the position of longtime leaders and often causing the "flip" to a new basis of competition.

Early signs of this pattern in the consulting industry include increasingly sophisticated competitors with nontraditional business models that are gaining acceptance. Although these upstarts are as yet nowhere near the size and influence of big-name consultancies like McKinsey, Bain, and Boston Consulting Group (BCG), the incumbents are showing vulnerability. For example, at traditional strategy-consulting firms, the share of work that is classic strategy has been steadily decreasing and is now about 20%, down from 60% to 70% some 30 years ago, according to Tom Rodenhauser, the managing director of advisory services at Kennedy Consulting Research & Advisory.

Big consulting is also questioning its sacred cows: We spoke to a partner at one large firm who anticipates that the percentage of projects employing value-based pricing instead of per diem billing will go from the high single digits to a third of the business within 20 years. Even McKinsey is pursuing innovation with unusual speed and vigor. Though the full effects of disruption have yet to hit consulting, our observations suggest that it's just a matter of time.

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When Knowledge Is Democratized

Kennedy Research estimates that turnover at all levels in prestigious consulting firms averages 18% to 20% a year. McKinsey alone has 27,000 alumni today, up from 21,000 in 2007; the alumni of the Big Three combined are approaching 50,000. Precise data are not publicly available, but we know that many companies have hired small armies of former consultants for internal strategy groups and management functions, which contributes to the companies' increasing sophistication about consulting services. Typically these people are, not surprisingly, demanding taskmasters who reduce the scope (and cost) of work they outsource to consultancies and adopt a more activist role in selecting and managing the resources assigned to their projects. They have moved more and more work in-house, such as average costing analysis, an exercise that once racked up billable hours.

Companies are also watching their professional services costs, a relatively new development that was triggered by the 2002 recession. Ashwin Srinivasan, an expert on procurement practices with CEB, says that C-suite executives are the "worst offenders of procurement best practices, but when spend is aggregated and they see the full impact of their individual decisions on the expense line, it wakes them up." In other words, cost pressures force clients to abandon the easy assumption that price is a proxy for quality.

Their growing sophistication leads clients to disaggregate consulting services, reducing their reliance on solution-shop providers. They become savvy about assessing the jobs they need done and funnel work to the firms most appropriate for those jobs. We spoke to top managers of *Fortune* 500 and FTSE 100 companies who were once consultants themselves; they repeatedly described weighing a variety of factors in deciding whether the expensive services of a prestigious firm made sense. As one CEO (and former Big Three consultant) put it, "I may not know the answer to my problem, but I usually roughly know the 20 or so analyses that need to be done. When I'm less confident about the question and the work needed, I'm more tempted to use a big brand."

This disaggregation is also explained by a theory—one that describes the increased modularization of an industry as client needs evolve. As the theory would predict, we are seeing the beginnings of a shift in consulting's competitive dynamic from the primacy of integrated solution shops, which are designed to conduct all aspects of the client engagement, to modular providers, which specialize in supplying one specific link in the value chain. The shift is generally triggered when customers realize that they are paying too much for features they don't value and that they want greater speed, responsiveness, and control.

Examples of this shift are many. When Clay Christensen first started working at BCG, in the early 1980s, a big part of his job was assembling data on the market and competitors. Today that work is often outsourced to market research companies such as Gartner and Forrester, to facilitated networks that link users with industry experts such as Gerson Lehrman Group (GLG), and to database providers such as IMS Health. As access to knowledge is democratized, opacity fades and clients no longer have to pay the fees of big consulting firms…

The rise of alternative professional services firms, such as Eden McCallum and Business Talent Group (BTG), is another chapter in the modularization story. These firms assemble leaner project teams of freelance consultants (mostly midlevel and senior alumni of top consultancies) for clients at a small fraction of the cost of traditional competitors. They can achieve these economies in large part because they do not carry the fixed costs of unstaffed time, expensive downtown real estate, recruiting, and training. They have also thus far chosen to rely on modular providers of research and data rather than invest in proprietary knowledge development.

Although these alternative firms may not be able to deliver the entire value proposition of traditional firms, they do have certain advantages, as our Harvard Business School colleague Heidi Gardner has learned through her close study of Eden McCallum. Their project teams are generally staffed with more-experienced consultants who can bring a greater degree of pragmatism and candor to the engagement, and their model assumes much more client control over the approach and outcome. We expect these attributes to be particularly compelling when projects are better defined and the value at risk is not great enough to justify the price of a prestigious consultancy.

Eden McCallum and BTG are growing quickly and zipping upmarket. While it's fair to question whether they will need to take on some of the cost structure of incumbents as they expand, their steady growth suggests that they've been successful without doing so. For example, **Eden McCallum** launched in London in 2000 with a focus on smaller clients not traditionally served by the big firms. Today its client list includes Tesco, GSK, Lloyd's, and Whitbread, among many other leading companies. In addition, some of its contacts at smaller companies have moved into more-senior positions at larger companies, taking the **Eden McCallum** relationship with them. That dynamic is one that the consulting majors have long used to drive growth.

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Implications for an Industry

As noted, we're still early in the story of consulting's disruption. No one can say for sure what will happen. Disruption is, after all, a process, not an event, and it does not necessarily mean all-out destruction. We believe that the theory has four implications for the industry:

1. A consolidation—a thinning of the ranks—will occur in the top tiers of the industry over time, strengthening some firms while toppling others.

2. Industry leaders and observers will be tempted to track the battle for market share by watching the largest, most coveted clients, but the real story will begin with smaller clients—both those that are already served by existing consultancies and those that are new to the industry.

3. The traditional boundaries between professional services are blurring, and the new landscape will present novel opportunities.

4. The steady invasion of hard analytics and technology (big data) is a certainty in consulting, as it has been in so many other industries.

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Disruption Is Inevitable

The consultants we spoke with who rejected the notion of disruption in their industry cited the difficulty of getting large partnerships to agree on revolutionary strategies. They pointed to the purported impermeability of their brands and reputations. They claimed that too many things could never be commoditized in consulting. Why try something new, they asked, when what they've been doing has worked so well for so long?

We are familiar with these objections—and not at all swayed by them. If our long study of disruption has led us to any universal conclusion, it is that every industry will eventually face it. The leaders of the legal services industry would once have held that the franchise of the top firms was virtually unassailable, enshrined in practice and tradition—and, in many countries, in law. And yet disruption of these firms is undeniably under way. In a recent survey by AdvanceLaw, 72% of general counsel said that they will be migrating a larger percentage of work away from white-shoe firms.

Furthermore, the pace of change being managed by the traditional clients of consulting firms will continue to accelerate, with devastating effects on providers that don't keep up. If you are currently on the leadership team of a consultancy and you're inclined to be sanguine about disruption, ask yourself: Is your firm changing (at least) as rapidly as your most demanding clients?

Finally, although we cannot forecast the exact progress of disruption in the consulting industry, we can say with utter confidence that whatever its pace, some incumbents will be caught by surprise. The temptation for market leaders to view the advent of new competitors with a mixture of disdain, denial, and rationalization is nearly irresistible. U.S. Steel posted record profit margins in the years prior to its unseating by the mini-mills; in many ways it was blind to its disruption. As we and others have observed, there may be nothing as vulnerable as entrenched success.