

**HOW KNOWLEDGE ACCUMULATION CHANGED THE COMPETITIVE
ADVANTAGE OF STRATEGY CONSULTING FIRMS***

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How knowledge accumulation changed the competitive advantage of strategy consulting firms*

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Abstract

Research evidence confirms that the accumulation of knowledge contributes to the competitive advantage of firms. In the strategy consulting industry, one of the most knowledge-intensive professional services industries, however, established firms that exploited their knowledge accumulation by adding exploitative consulting practices have found their performance has deteriorated. To investigate this phenomenon, this paper will describe how the increasing share of exploitative practices in the strategy consulting industry has attracted both established ICT-related consulting firms and new entrants, and enabled clients to expand their problem-solving abilities. We will argue that these developments in terms of competitiveness and client competencies have reduced the attractiveness of exploitative practices for established strategy consulting firms. To analyse these developments and to provide strategic options for the established strategy consulting firms, a conceptual framework will be proposed. Based on this framework, three strategic options are identified: 'Follow the herd', 'Become ambidextrous' and 'Back to the original focus.' In summarizing our argument, we highlight the pros and cons of these options and the implications for top management.

Keywords: Strategy Consulting; Knowledge; Exploitation and Exploration; Ambidextrous Organization.

Introduction

Research based on Resource-Based View and the Knowledge-Based View of the firm suggests that the accumulation of knowledge contributes to the success of firms (Grant, 1996; Van den Bosch et al., 1999; 2003). Paradoxically, in strategy consulting, which is one of the most knowledge-intensive professional services, accumulating knowledge has reduced the attractiveness of the industry. Although established strategy consulting firms were successful for a long time, these firms face serious problems at present. Previous research by e.g. Kipping and Engwall (2002) and Wright and Kitay (2002) found that the performance and legitimacy of management consultants had come under pressure. The established strategy consulting firms are also threatened by changing client demand and new competitors. According to Fortune Magazine (2003: 50) the “pure-play strategy guys” are in trouble. Similarly, The Economist (2002: 61) concluded, “the strategy consulting industry is wasting away.”

What has caused this parlous situation for the established strategy consulting firms? This question is not only relevant to the consultancies concerned but also for their clients and for the practitioners and scholars engaged in the strategy field. As the core product of strategy consulting is knowledge, we use a *knowledge-perspective* in investigating this question. By doing so, we hope to contribute to previous research on management consulting (e.g. Perren and Atkin, 2000; Ernst and Kieser, 2002; Kipping and Engwall, 2002 and Armbrüster and Kipping, 2003). We focus on the impact of knowledge accumulation on the strategy consulting industry in general, and on the position of established strategy consulting firms in particular. We also discuss briefly strategic renewal options of these firms (Volberda et al., 2001). Our analysis is based on both public and company data. Interviews were also conducted with partners in strategy consulting firms during the period 2003-2004.

The paper is structured as follows. First, we describe how knowledge accumulation by established strategy consulting firms has induced exploitative and hybrid consulting practices and we suggest a conceptual framework to investigate this development. Second, in illustrating the framework we show how these exploitative and hybrid consulting practices attracted both established IT-related consulting firms and new entrants to strategy consulting. Third, we examine how clients benefited from knowledge accumulation by strategy consulting firms and subsequently, increased their ability (Sanchez *et al.*, 1996) to solve their

own problems. Finally, in terms of strategic change, we discuss several basic options for the established strategy consulting firms and the implications for top management.

Distinguishing between explorative, exploitative, and hybrid consulting practices

In strategy consulting, as in any professional service, a spectrum of key benefits that clients seek can be identified. This spectrum ranges from creativity to improving efficiency, depending on the particular type of problem experienced by the client (e.g. Maister, 1993). Clients' problems range from those that are new to the strategy consulting firm, to problems that are familiar to them. This distinction is relevant because different client problems require different consulting practices. From a knowledge-perspective, we can distinguish a spectrum of consulting practices related to different kinds of clients' problems.

Following March (1991), who introduced the distinction between exploration and exploitation activities in organizational learning, exploration includes activities such as search, experimentation, discovery and innovation, while exploitation involves imitating, refining and adapting existing knowledge. Applied to consultancy practices, *explorative consulting practices* are about creating knowledge that is new for the consulting firm. Exploitative consulting practices are associated with leveraging existing knowledge known to the consulting firm. Exploitative practices focus on efficiency in knowledge processes and may utilize 'routine recipes' as opposed to "deep strategic thinking" in explorative practices (Franklin, 2001). Explorative and exploitative consulting practices, therefore, require different resources such as using senior consultants versus a commodified knowledge base, a different number of (junior) consultants per partner (leverage), different organizational structures and different leadership styles.

These differences are in line with the literature on the organizational and managerial implications of performing explorative and exploitative knowledge activities in firms (Benner and Tushman, 2003; Jansen et al., 2005). During one of our interviews, a partner in an explorative practice pointed out the difference in leverage between both practices:

"We do not have any juniors working around here. We have principals and directors. The experience base of a principal would be around ten years...and for partners let us say five years plus. There are no juniors. There are no graduates. So the bottom large two layers of the pyramid structure of the exploitative practice are not present in our company."

Figure 1 provides an overview of the spectrum of consulting practices that range from explorative to exploitative types including the associated main characteristics of the practice and managerial and organizational requirements. The requirements to deliver explorative

versus exploitative consulting practices are quite different. Hybrid practices consists of a mixture of both explorative and exploitative practices. To simplify Figure 1, these practices are left out.

[Insert about here Figure 1]

The impact of knowledge accumulation on the strategy consulting industry and on the established strategy consulting firms.

In emerging professional service industries, most projects will be new for the service firms as well as for their clients. This results in a substantial demand for explorative practices. However, when the professional service firms gain experience and accumulate knowledge, client problems will become increasingly familiar. Client problems that previously required an explorative approach can now be solved through a hybrid or exploitative one. The accumulation of knowledge by the professional service firms through learning from client projects expands the range of problems familiar to these firms at the expense of problems that are new to them. This development corresponds with Maister's (1993: 28) observation: "In every profession, one can point to practice areas that in only a few short years, have moved rapidly from being frontier activities handled by only a handful of innovative firms to high-volume practices offered by increasingly large numbers of competent firms."

To illustrate the main argument of the paper, we introduce *a conceptual framework* inspired by Maister (1993). The framework (see Figure 2) depicts the development of the share of explorative, exploitative and hybrid practices in the total number of client projects completed within the industry. Due to the ongoing process of knowledge accumulation and other related drivers of change to be discussed below, this development results in a declining share of explorative practices and a rise in the share of exploitative and hybrid practices. At the start (T1 in Figure 2) of a professional service industry, like strategy consultancy, almost all problems will be new to the professional service firm. At time period T1, therefore, the share of explorative practices will be about 100%. However, due to accumulation of knowledge by the consulting firms, the share of problems that are new to them and hence the share of the explorative practices will decline. At time period T2 the share of the explorative practice has declined from about 100% to A%, while the share of the exploitative practice has risen from about 0% to C%. The hybrid practices has increased to B%.

[Insert Figure 2 about here]

As the range of client problems familiar to established strategy consulting firms increased over time, the shares of exploitative and hybrid practices increased accordingly (see Figure 2). In this connection a partner with one of the established strategy consulting firms pointed out in an interview:

“For each client assignment we have analogies at our disposal... I’ll search our firm’s database and look up who has carried out a similar assignment before.”

A partner with another consulting firm referred to explorative practices when he told us:

“Where-ever you look for inspiration, you have to go beyond the normal bounds of what everybody is studying normally in your industry and you have to combine that information to stimulate thinking about what happens.”

These two quotations illustrate the difference between both practices as depicted in Figure 1. Exploitative practices use, to a large extent, “commodified” knowledge bases while explorative practices are conducted by senior consultants that do not rely extensively on these knowledge bases.

Entering the growing market segment of exploitative practices was attractive for the established strategy consulting firms as it allowed these firms to leverage their knowledge bases accumulated during past projects. These consulting firms responded to the transformation of their industry by adopting a strategy of broadening their scope of practices. However, not all established firms adopted this strategy. Some established top tier strategy consulting firms retained a focus on their traditional explorative practices.

To illustrate the conceptual framework (see Figure 2) regarding knowledge accumulation by the established strategy consulting firms of a particular business problem, we use the example of business process-re-engineering (BPR). In the first half of the nineties, the importance of BPR was recognized and the required new knowledge was created to address the associated problems for clients. In that period BPR was to a large extent an explorative practice. At the end of the last decade, however, BPR became a familiar problem for strategy consulting firms and hence evolved into a hybrid or exploitative practice. This development is supported by a study regarding established strategy consulting firms indicating the use of ‘strikingly similar’ methods and tools for business process re-engineering (Werr, Stjernberg and Docherty, 1997).

ICT-based knowledge management enabled exploitative consulting practices, the commodification of knowledge and attracted new entrants.

The increasing use of exploitative and hybrid practices by established strategy consulting firms required Information and Communication Technologies (ICT)-based knowledge management. To benefit from the accumulated knowledge, ICT increasingly provides the ‘production technology’ that strategy consulting firms rely upon for exploitative practices (Sarvary, 1999). Consulting firms have been among the first businesses during the 1990s to make heavy investments in ICT-based knowledge management (Hansen et al., 1999). These technologies facilitate the codification, storage, access, and dissemination of *explicit* knowledge within the consulting firm. Explicit knowledge relates to knowledge that can be easily codified, i.e. written down in documents and put into data bases. Contrary to explicit knowledge, *tacit* knowledge resides in the heads of individual consultants and cannot be easily codified. Using this type of knowledge for explorative practices, networks of professionals who can be approached for their tacit knowledge are required (Hansen, Nohria and Tierney, 1999).

In a further attempt to capture and leverage the accumulated explicit knowledge, some strategy consulting firms attempted ‘*commodification*’ of this knowledge. ‘Commodification’ is the term used to describe the transformation of unstructured problems and solutions into standardized problems and solutions (e.g., Elkjaer, Flensburg, Mouritsen and Willmot, 1991). These firms ‘programmed’ knowledge in procedures, methods and tools that could be stored in their ICT-based knowledge management systems. The “commodified”, or “packaged”, approach is typical of exploitative practice (see Figure 1).

Robust and easy to handle procedures, methods and tools increase the efficiency of the consulting practice as they can be administered by junior (less expensive) consultants (Ernst and Kieser, 2002). Commodification, therefore, enables the increase of leverage. Moreover, the commodified approach to strategy consulting knowledge offers the strategy consulting firms advantages in the marketing of their services (Ernst and Kieser, 2002). With regard to Figure 2, commodification induces the growth of the exploitative practices segment at the expense of the hybrid practices segment. The increasing importance of ICT-based knowledge management in strategy consulting, however, changed the trend of competition within the industry. As Sarvary (1999: 97) pointed out: “Originally, the consulting firm’s proposition was to provide a resource: smart people to solve the client’s problem... It is no longer enough... The firm must demonstrate the power of its collective knowledge base.”

The growth of exploitative consulting practices and, in particular, the emergence of commodification of strategy consulting knowledge, lowered the entry barriers and made the strategy consulting industry increasingly attractive to new exploitative players. Typically, these entrants used a strategy of commodifying knowledge to ‘colonize’ strategy consulting (Suddaby and Greenwood, 2001). In terms of Figure 1, these firms entered at the right side of the spectrum which corresponds to the exploitative practices segment in Figure 2. Both small specialists and large (ICT-related) consulting firms have entered strategy consulting during the past decade. Compared to the established strategy consulting firms, the large ICT-related consulting firms have a number of competitive advantages in the exploitative practice segment: (1) their larger scale; (2) their ability to combine strategy and ICT; and (3) their ability to implement solutions.

Knowledge accumulation of strategy consulting firms increased clients’ problem-solving abilities

Knowledge accumulation and commodification on the part of the established strategy consulting firms also influenced the ability of their clients to improve problem-solving by themselves. (Sanchez *et al.*, 1996). Instead of hiring strategy consulting firms as was customary in the past, clients increasingly conduct consulting activities themselves. To investigate which consulting practices were affected, we discern two strategies of clients to absorb part of the accumulated knowledge from established strategy consulting firms. In this connection, we propose to distinguish two basic *strategies of clients*: (1) clients attempt to learn from previous consulting projects and (2) clients hire ex-consultants. Using the strategy mentioned first, clients use the consulting firms’ solutions, procedures, methods, and tools to address repeated or similar problems. This client strategy negatively affects the demand for exploitative practices of consulting firms.

Using the second strategy mentioned, large client firms hire ex-consultants, or alumni, from the same strategy consulting firms they used to hire for solving problems. The clients use the knowledge and problem-solving skills of the alumni to solve their problems instead of hiring the consulting firms. The level of seniority of the alumni influences which consulting practices will be affected. Due to the pyramidal structure and the ‘up or out’- career policy of most established strategy consulting firms we may expect most alumni to be juniors. The hiring of junior alumni by clients will therefore mostly affect the exploitative practices of strategy consulting firms. Regarding this second client strategy, a partner in a strategy consulting firm pointed out in an interview:

“There are far more alumni consultants [from the established strategy consulting firms] working at customers’ firms than there are working at the consulting firms... There are so many ex-consultants with clients that they can do that [the relatively low value-added consulting work] themselves.”

Overall we expect that exploitative practices of consulting firms will be most vulnerable to the spillover of accumulated knowledge from strategy consulting firms to clients. In relation to Figure 2, we expect that the knowledge spillover to clients inhibits the growth of the industry segment of exploitative practices in particular.

Strategic options for established strategy consulting firms

Established strategy consulting firms that broadened the scope of their practice by adding exploitative and hybrid practices now face a threatening situation. These firms have moved from a traditional focus on the segment of explorative practices to a broader scope that includes all three segments (see Figure 2). By expanding beyond their traditional scope of explorative practices, they have entered into consulting practice segments that have become less attractive.

Besides competing in increasingly less attractive practice segments, the competitiveness of established strategy consulting firms is hindered by the issue of managing multiple consulting practices within one firm with conflicting requirements (see Figure 1). The conflicting requirements of explorative and exploitative practices in terms of, among other aspects, resources, organizational structures, incentives, and leadership, create severe internal tension and stress (Maister, 1993; Benner and Tushman, 2003). Broadening their scope, these firms are neither focused explorative nor exploitative players, but are ‘stuck in the middle.’ The challenge of these firms is to try to combine both practices in a way to improve their competitive advantage, that is by adapting an ambidextrous organizational form. Ambidextrous firms try to reconcile the tension between the conflicting managerial and organizational requirements of performing both exploitation and exploration activities (Birkinshaw & Gibson, 2004). The “stuck in the middle” firms are, therefore, threatened by the existence of focused competitors: in the explorative segment they face established strategy consulting firms that restrict themselves to the original focus, that is explorative practice, and in the exploitative segment they are confronted by ICT-related consulting firms and other new entrants that focus on exploitative practices. These competitive threats suggest various options. Based on Figures 1 and 2, we identify *three strategic options* for established strategy

consulting firms: (1) the “follow the herd” option; (2) the “become ambidextrous” option; and (3) the “back to the original focus” option.

In the *‘follow the herd’ option*, the established strategy consulting firms continue to follow the industry through its life cycle by adding exploitative practices to an increasing extent. This option implies that established firms participate in each of the three practice segments. ‘Following the herd’ behaviour by large established firms can be observed in other industries as well (e.g., Volberda *et al.*, 2001; Stienstra *et al.* 2004). This option, however, does not seem to be viable in the long run. Competing in the exploitative and hybrid practice segments will be especially difficult because of the developments in terms of client self-consulting capabilities and new entrants. If the established firms want to compete in the exploitative segment with these newcomers, they need to overcome their competitive disadvantages. Developing scale and building the capabilities for implementation and for combining strategy and ICT will require major investments by the established firms, and this takes time. Furthermore, the conflicting organizational requirements of the three practices will undermine the competitive advantage of the established strategy consulting firms in all segments.

The *‘become ambidextrous’ option* means the established strategy consulting firms combine both explorative and exploitative practices to increase their competitive advantage and performance. To this end, top management has to create a proper organization context to resolve issues of conflicting organizational and managerial requirements (Jansen, Van den Bosch, Volberda, 2005; Volberda, 1998). In the literature (e.g. Birkinshaw and Gibson, 2004) two distinct, but complementary, organizational forms of ambidextrous organizations are discerned. First, structural ambidexterity, that is, the creation of separate organizational structures within a firm. For example a business unit focusing on exploratory and another business unit on exploitative practices. Top management decides about the proper organizational structure and the relative importance of both practices, and defines the management roles. This form of ambidexterity is characterized by top-down decision-making. Contrary to structural ambidexterity, contextual ambidexterity allows systems and organizational structures to be more flexible and is characterized by less top-down and more decentralized decision-making. Such an organizational context allows knowledge workers “to use their own judgement as to how they divide their time” between exploratory and exploitative practices (Birkinshaw and Gibson, 2004: 49). According to these authors, contextual ambidexterity requires knowledge workers that are multitaskers, brokers of information and knowledge, and have a cooperative attitude. Creating an organizational

context enabling contextual ambidexterity is difficult and, therefore, also difficult to imitate. Exhibit 1 depicts both forms of ambidexterity. Comparing both forms of ambidexterity from the knowledge perspective chosen in this article, we believe the contextual ambidexterity form seems to be the most promising in terms of creating and of sustaining a competitive advantage for strategy consulting firms.

[Insert Exhibit 1 about here]

The “*back to the original focus*” option implies that established strategy consulting firms with a broad scope reduce their scope to the original focus on explorative practices. With reference to Figure 2, this option implies that these firms withdraw in particular from the exploitative practices segments. This option will result in a significant downsizing of current businesses of the established strategy consulting firms, and in a reduction of their leverage. This reduction will have a substantial impact on the amount of revenue as well as income per partner.

We have so far assumed that established strategy consulting firms remain independent. If this is the case, the first strategic option in particular will require substantial investments and time consideration to match the scale, and the abilities for implementation and for combining strategy and ICT advice. However, established strategy consulting firms may also consider strategic alliances, or even mergers, with new entrants that already possess these abilities.

Conclusion

Considerable evidence suggests that knowledge accumulation contributes to the competitive advantage of firms. However, in strategy consulting, established firms that exploited their accumulated knowledge now face a problematic situation. An explanation for this paradox is that many established strategy consulting firms adopted a strategy of adding exploitative and hybrid consulting practices to their traditional scope of explorative practices. By broadening their scope these firms became “stuck in the middle” as they were confronted with the conflicting requirements of explorative and exploitative practices. However, the exploitative practices in particular lost their potential attractiveness because both clients and

new competitors also exploited the results of knowledge accumulation by strategy consultancy firms.

As the conceptual framework depicted in Figure 2 shows, knowledge accumulation, the emergence of ICT-based knowledge management and the commodifications of knowledge, increasing clients' problem-solving abilities and new entrants constitute major drivers of change. Confronted with these drivers of change, top management of the "stuck in the middle" established strategy consulting firms face the basic choice of at least three strategic options: (1) the 'follow the herd' option; (2) the 'become ambidextrous' option; and (3) the "back to the original focus" option.

These options are not typical of the strategy consulting industry. Other knowledge-intensive professional service industries are also confronted with similar developments, such as knowledge accumulation, increasing clients' capabilities and new entrants. However established strategy consulting firms in particular cannot postpone strategic decisions. Helping client firms with similar, difficult strategic positioning processes presupposes an intimate knowledge of the subject. This knowledge may be created by strategy consulting firms in their efforts to help clients. But at least as important is to acquire this knowledge through the efforts to reposition themselves aimed at gaining a strong competitive advantage vis-à-vis new entrants.

From the knowledge perspective taken in this article and based on the conceptual framework, we suggest becoming ambidextrous seems to be the most demanding, difficult to imitate, and therefore, the most rewarding of the three options. This option enables the established strategy consulting that are currently "stuck in the middle" to reconcile the conflicting requirements of explorative and exploitative practices and use the potential synergy between these two practices. For the established strategy consulting firms this option offers an opportunity to create new knowledge and serve as a role model for client firms.

The newly created knowledge of becoming ambidextrous by reconciling the conflicting forces of profits for today, requiring exploitation, and flexibility to adapt for tomorrow, requiring exploration (Volberda, 1998), contributes to new explorative practices on the part of their clients. Over time, however, due to knowledge accumulation and commodification processes analyzed in this paper, these explorative practices may evolve eventually into more hybrid and exploitative practices. Such a development may again challenge the sustainability of the competitive advantage of strategy consulting firms. Indeed, strategy and strategy consulting will never be an easy job. Pro-actively anticipating this

development will, therefore, be a key requirement for top-management of successful strategy consulting firms.

Biographical Notes

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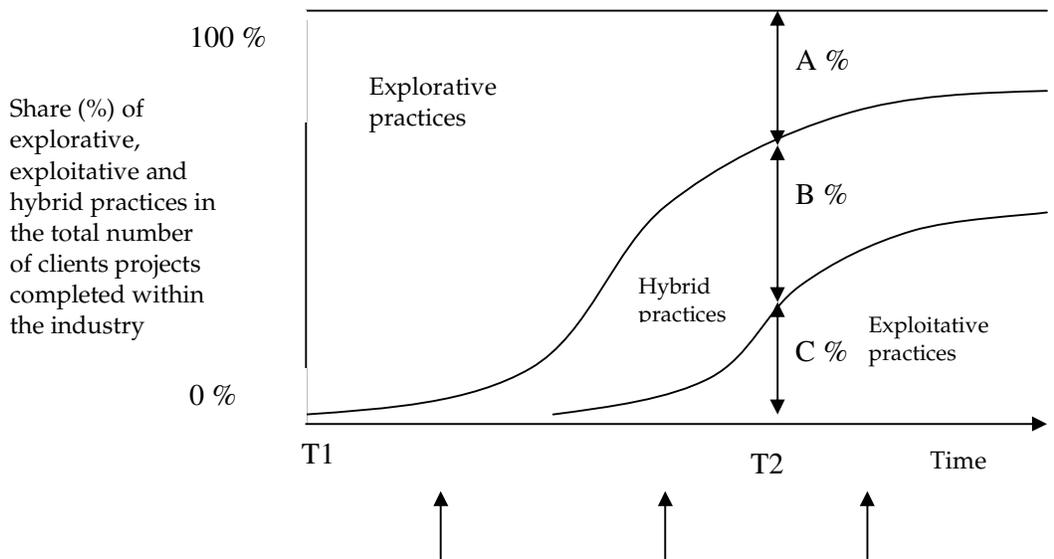
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Figure 1: The spectrum of strategy consulting practices and the conflicting requirements

Requirements:	Spectrum of strategy consulting practices:	
	Explorative practice ←	→ Exploitative practice
Type of client problem	New for consulting firm	Familiar to consulting firm
Approach of consulting practice	Creating new knowledge	Leveraging the existing knowledge base of the consulting practice
Key benefits for clients	Creativity, “deep strategic thinking”	Efficiency
Key resource of consulting practice	Senior consultants	Collective base of commodified knowledge
Size of typical consulting practice	Small	Large
Structure of consulting practice	Informal, collegial partnership of peers, low leverage	Formal, mechanistic, high leverage
Leadership of consulting practice	Informal, inspirational	Formal, authoritative

Figure 2: A conceptual framework to investigate the impact of knowledge accumulation and relates drivers of change on the share of explorative, exploitative and hybrid practices of strategy consulting as a knowledge-intensive professional service industry



Drivers of change:

- Knowledge accumulation
- Commodification and leverage of knowledge by ICT enabled knowledge management
- New entrants
- Increased clients' problem-solving abilities

Exhibit 1 Exploitation, Exploration and Ambidextrous Organizations

- To survive in dynamic and competitive environments, ambidextrous organizations reconcile exploitation and exploration activities as two contradictory organizational processes by implementing particular managerial and organizational requirements (March, 1991; Adler et al. 1999; Benner and Tushman, 2003).
- Two complementary forms of ambidexterity.

	Structural ambidexterity:	Contextual ambidexterity:
How achieved?	By separating exploration and exploitation in different units	Individual employees divide their time between exploration and exploitation activities
Locus of decision about exploitation / exploration	At the top of the organization	At front-line level
Role of top-management	Define structure, roles, responsibilities	Developing organizational context that enable employees to exhibit initiatives, cooperation, brokering skills and multitasking abilities
Skills of employees	More specialists	More generalists

Source: adapted from Benner & Tushman (2003) and Birkinshaw & Gibson (2004)

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