The Origins of Modern Management Consulting

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In 1993, AT&T spent more on management consulting services than on corporate research and development, and AT&T is not alone [8, p. 60]. Wall Street analysts expect billings for consulting services to advance at twice the rate of corporate revenues over the next decade. Yet, despite the size, growth, and influence of consulting firms, business historians have remained uncharacteristically silent about the origins, development, and impact of management consulting, or "management engineering" as it was known before the Second World War.[2] In this paper, I will describe the professional origins of management consulting firms at the turn of the century and discuss why, after slow, gradual growth through the 1920s, these firms took off during the 1930s. I argue (1) that historians have wrongly assumed that management consulting arose directly out of Taylorism, (2) that engineers, accountants, and lawyers, often supervised by merchant bankers, provided counsel that later became the primary repertoire of management consultants, and (3) that the legal separation of investment and commercial banking in 1933 drove the rapid professionalization and growth of management consulting during the Great Depression.

Recent historians of scientific management, including Daniel Nelson, Stephen Waring, and Judith Merkle, have traced the impact of Taylorism on contemporary institutions as diverse as business education, public administration, and British industry long after the Progressive-era craze for "efficiency" ended [29, 36, 26]. The proponents of scientific management, Frederick Taylor, Henry Gantt, Morris Cooke, Frank and Lillian Gilbreth, and Harrington Emerson, consulted with nearly 200 businesses on ways to systematize the activities of their workers through the application of wage incentives, time-motion studies, and industrial psychology [29, p. 11]. Naturally then, historians of Taylorism have assumed that they could describe contemporary practitioners of "industrial engineering," "production

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[1] This article is drawn from my dissertation, "The History of Management Consulting, 1880-1980."

[2] The Association of Management Consultants (ACME) defines management consulting as a service provided for a fee by objective outsiders who help executives improve the management, operations, and economic performance of institutions. Since the institutionalization and professionalization of management consulting occurred within firms, not among solo practitioners, this paper focuses on management consulting firms.

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engineering," "consulting engineering," and "efficiency engineering," as early management consultants. Similarly, management consultants, like Thomas Cody, trying to trace the history of management consulting have assumed that:

> undoubtedly the most influential factor in the growth of modern management consulting was the development of the concept of 'scientific management' by Frederick Taylor.... The concept combined the practice of engineering with the principles of economics, and it was out of this coupling that today's profession was born [11, p. 24].

But Taylorists and management consultants actually had very different professional and ideological origins.

As Hugh Aitken pointed out in *Scientific Management in Action*, those executives and their advisors in large scale business who were "concerned with problems of formal organization and control at the administrative level," came out of a different intellectual tradition than the shop management movement from which Taylor made his reputation [1, pp. 17-18]. Taylorists were largely concerned with industrial relations while early management consultants focused on problems of bureaucratic organization. While Harrington Emerson's firm of "efficiency engineers" did survive as a very small consulting firm through the 1980s, and the British "management consultancies" founded in the 1930s were undoubtedly Taylorist, none of the large modern American management consulting firms have Taylorist origins [31, 35]. Rather, professionally-trained accountants and engineers, often with backgrounds in law or banking, founded the early "management engineering" firms to offer advice to executives on the organization of their boardrooms, not on the efficiency of their shop floors.

The growth and complexity of the largest industrial organizations in the United States created a market at the turn-of-the-century for the professional firms of engineers, accountants, and lawyers which offered independent corporate counsel [9, pp. 464-468]. By the 1890s, executives of large manufacturing companies who needed engineering advice, but did not want a full-time engineer on staff, could turn to consulting chemical engineers like Arthur D. Little or electrical engineering firms like Stone & Webster for technical knowledge [20; 19, pp. 386-391]. Similarly, in the 1890s, corporate managers employed American subsidiaries of the British accounting firms, like Price Waterhouse, to provide external audits and financial controls for their growing companies [9, p. 464]. By the 1900s, American-based accounting firms like Arthur Anderson, Haskins & Sells, Ernst & Ernst, and Seidman & Seidman were expanding throughout the country [23, pp. 1-3]. In law, large New York corporate law firms like Cravath Swaine, Davis Polk, and Sullivan & Cromwell provided legal advice to businesses headquartered in New York. At the same time growing regional firms like Jones Day in Cleveland and Baker and Botts in Houston served local divisions of national companies [24, p. 22]. The three professions, engineering, accounting, and law, all enjoyed strong growth in firm numbers and size from the 1890s onward because of the specialized skills that larger partnerships could offer their expanding corporate clients.

This expanding corporate clientele enabled younger partners to build practices of "management engineering" within older, larger firms or to found new specialty firms. These younger professionals intentionally borrowed skills and credentials from fields outside their professional training as they struggled to attract clients. For example, the electrical engineering consulting firm of Stone & Webster worked for J. P. Morgan & Co. after the 1893 recession, appraising the value of electrical utility companies owned by General Electric [21, pp. 21-24]. Their appraisals combined engineering expertise and accounting skills as they traded on their Wall Street contacts.[3] While engineers were performing accounting, accountants marketed themselves as engineers. In 1927, James McKinsey, an accountant and lawyer from Chicago, put "accountants and engineers" on his letterhead, as did Miller, Franklin, Basset & Company, an accounting firm based in New York [28]. This blurring of professional boundaries was sometimes just a response to demand but frequently it was the result of training in more than one profession. James McKinsey was not alone in combining legal training with management consulting; his former boss, George Frazer, and his protégé, Marvin Bower, were both trained as lawyers [17, p. 7; 6, p. 1]. Management engineers, like others struggling for professional status, used multiple professional credentials to support their claims to specialized knowledge and professional approval in their efforts to market a new and poorly understood service [7].

These engineers, accountants, and lawyers often worked for merchant bankers who, in turn, coordinated a wide array of services which were, at the turn of the century, the closest functional equivalent in the American setting to management consulting.[4] Since merchant bankers provided both commercial and investment banking services, bankers acted both as internal advisors to help their client companies and as external regulators to safeguard investors' interests. For example, bankers hired countless engineers, accountants, and lawyers to assist them in reorganizing the thirteen large railroads which failed between 1893 and 1898 [14, p. 5]. Bankers frequently needed to evaluate the worth, organization, and prospects of companies for projects as diverse as the valuation of an initial public offering, the reorganization of a bankrupt company, or the administrative integration of two merging corporations. During the 1920s, National City Bank (now Citibank) performed management engineering studies to evaluate the initial financing of United Aircraft, troubled loans at Anaconda Copper, and the merger of six separate business machine companies to form Remington Rand [2]. To gain a thorough understanding of increasingly complex corporations, bankers called upon and coordinated the work of both internal and external professionals. Investment houses employed engineers for valuations and organizational surveys, accountants for audits and the installation of financial cost controls, and lawyers to serve on reorganization and bond-holder committees. In the 1920s, Arthur Andersen & Company became nationally known for its investigations of "plants, products, markets, organization, and future prospects" of companies that investment banks in

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[3] Edwin Webster was the son of a partner at Kidder, Peabody & Company in Boston. His father, Frank G. Webster became head of Kidder, Peabody in 1905. In 1930, following the stockmarket crash, Edwin Webster purchased the bankrupt Kidder, Peabody and installed his son, Edwin G. Webster, Jr., as Kidder, Peabody's new President [21, p. 3, 156].

[4] While this paper is not comparative, bankers appear to have served as the source of organizational advice in Northern Europe and Japan throughout this period.

New York and Chicago were underwriting [3, p. 13-14]. By drawing on a range of professional services as they advised corporate management on planning, organization, and executive control, bankers provided a range of organizational advice, backed by a blue-blooded reputation, which only management consultants would later equal.

While management consulting services were available from the turn of the century onward, the rapid growth, both in numbers and in size, of independent management consulting firms did not begin until the Great Depression. It wasn't until the 1930s that management consulting firms grew beyond a few founding partners and established branches in new cities. In 1926, after twelve years in business, Edwin Booz employed only one other management engineer; by 1936, Booz -Allen & Hamilton had eleven consultants on staff [5, pp. 7, vi]. Similarly, James O. McKinsey and Company, which McKinsey founded in Chicago in 1926, had, by 1936, expanded to more than 25 employees and had a second office in New York [30, p. 11]. The growth in the number of firms mirrored the expansion of the firms themselves. Between 1930 and 1940, the number of management consulting firms grew, on average, 15% a year from an estimated 100 firms in 1930 to 400 firms by 1940 [4, Table 2]. It was no coincidence that the economist Joel Dean wrote in 1938 that "unheralded, almost unnoticed, professional management counsel has become an important institution in our business world" [15, p. 451]. During the 1930s the services that management consulting firms provided began to increase in importance. In the 1920s, acquaintances in local companies hired management engineers to analyze limited, technical problems. But, by the 1930s, hundreds of large corporations including Armour, Union Carbide, Kroger, Carrier, Sunbeam, U.P.S., Borden, Upjohn, Johnson Wax, and Sears routinely hired management engineers to improve their organization's overall strategy, structure, and financial performance. Consultants later assumed that this growth during the depression was a countercyclical reaction as troubled firms used management engineers to cut costs and improve operational efficiency. Yet, management consultants suffered badly during the 1920-21 recession and, fifty years later, following the 1973 oil embargo – in both cases, clients simply put off expensive studies as their plants sat idle [27, 13]. The growth of management consulting in the 1930s was not simply a "natural" market response to the economic downturn. It was, instead, an institutional response to new government regulation.

New Deal banking and securities regulation propelled the growth of management consulting in the mid-1930s. Firms of management consultants prospered as companies turned from bankers to management engineers for organizational advice. In this last section of the paper, I will illustrate this process of institutionalization by describing (1) the reorganization of U.S. Steel by Ford, Bacon & Davis between 1935 and 1938, (2) the career of management engineer George Armstrong, and (3) the development of the "general survey outline" at James O. McKinsey and Company in the 1930s.

Congress passed the Glass-Steagall Banking Act of 1933 to correct the apparent structural problems and industry mistakes that contemporaries believed led to the stockmarket crash in October 1929 and the bank failures of the early 1930s. Glass-Steagall divided the investment and deposit-taking functions within banks like J. P. Morgan and National City Bank into two separate industries: commercial banking and investment banking. J. P. Morgan & Company, for example, chose to remain a commercial bank, but several partners left to form the investment banking firm of Morgan, Stanley & Company. Simultaneously, Congress created the Securities and Exchange Commission to regulate financial markets and enforce a more open system of corporate disclosure [25, pp. 169-171]. These legislative changes which reconfigured banking and promoted the rapid growth of independent accounting audits also shaped the institutionalization of management consulting. Since Glass-Steagall prohibited commercial banks from engaging in "non-banking activities," like management engineering, commercial banks could no longer act as management consultants [32, p. 23]. Federal regulators forced commercial banks to cease their non-banking activities like insurance, real estate development, or management consulting. And, while Glass-Steagall did not restrict investment banks from acting as management consultants, S.E.C. regulations required that underwriters perform external due diligence on securities issues and corporate reorganizations so investment banks could not use their internal management engineers to certify new issues. Federal regulation forced investment and commercial banks from 1934 onward to hire outside consultants to render opinions on the organization of a bankrupt company or the prospects of a newly-formed public company. Commercial bankers simultaneously encouraged business executives to hire management consultants since officers inside the banks could no longer coordinate internal organizational studies of their clients. The new institutional arrangements in banking opened up a vacuum into which firms of management consultants rushed.

The contrast between the old and new institutional order was evident in Ford, Bacon & Davis' reorganization of U.S. Steel between 1935 and 1938. In 1901, J. Pierpont Morgan had personally supervised the initial organization of U.S. Steel, but in 1935, U.S. Steel's Chairman, Myron Taylor, asked his college friend, George Bacon, to oversee the reorganization of the largest industrial firm in the country [22]. As Taylor reported to the stockholders of U.S. Steel in 1938,

> In 1935 we retained the firm of Messrs. Ford, Bacon & Davis to go through all of our properties, methods, personnel and markets and, in collaboration with our engineers and executives to formulate definite recommendations [cited in 18, p. 619].

Ford, Bacon & Davis' study took three years, cost 3.2 million dollars, and eventually included 203 separate reports produced in collaboration with five different sub-contracting consulting firms, including McKinsey, Wellington & Co [16]. It was the largest study ever done by management engineers, and the recommendations which Ford, Bacon, & Davis made on the organization, strategy, and operations of U.S. Steel influenced the company's investment, labor, and administrative policies through the 1950s. In labor relations, for instance, the 1937 accord reached with workers overturned a long-standing antagonistic relationship endorsed by the Morgan Bank which would have immobilized U.S. Steel in the tight labor markets of the Second World War [34, pp. 15-17].

George Armstrong, a Vice-President in charge of industrial investigations at National City Bank between 1921 and 1932, personified the changes caused by the Glass-Steagall Act. During the 1920s, National City Bank had Armstrong conduct studies of their troubled loans to the Saco-Lowell Shops, of the proposed merger of Palmolive, Kraft, and Hersey, and (at J. C. Penney's personal request) a comparative study of the Penney chain stores and their relative expense ratios [2].

In 1932, however, with inside assurances from his uncle that Franklin D. Roosevelt intended to break apart commercial and investment banking, Armstrong resigned from National City Bank to found his own consulting firm. His timing was shrewd since lawyers who examined the new statues agreed, in Armstrong's words,

> that any financing be preceded by the exercise of due diligence. This was interpreted to mean the investigation of the subject by a firm of competent engineering consultants and the review of the Registration Statement by such consultants [2, p. 69].

Armstrong's new firm, George S. Armstrong & Company was successful from its founding in 1933. The firm worked for a succession of investment banking firms during the 1930s investigating such corporate giants as Jones & Laughlin, Seagrams, Birdseye Frozen Foods, and Philip Morris. George Armstrong profited from the transition from banker supervision of management engineering studies to the institutionalization of management consulting even though the types of studies that Armstrong performed did not change. George S. Armstrong & Co. grew rapidly not because it offered a new form of organizational advice but because Armstrong had founded an independent firm.

The history of James O. McKinsey & Company illustrates the institutionalization of management consulting after the Glass-Steagall Act. During the 1930s, James McKinsey worked to systematize the complicated process of soliciting new clients and conducting a management engineering survey. In order to secure new clients, McKinsey methodically cultivated contacts throughout the financial community. He claimed to have taken every important banker in Chicago or New York to lunch and, in return, "'nearly every one at one time or another has given me some work....'" [37, p. 42]. Perhaps James McKinsey's greatest contribution to the institutionalization of his firm was the "general survey outline," which he drafted in December 1931, to give young, inexperienced consultants a model to follow when, as McKinsey specified, they were asked to prepare a complete study of a company that was in financial difficulties [30, p. 11]. Marvin Bower, who joined the firm in 1933, has written that the general survey resembled the corporate reorganizations for bondholders' committees which Bower had previously overseen as a young lawyer at Jones, Day [6, p. 17]. Indeed, because consultants frequently prepared these general surveys for investment firms during the 1930s, the partners at James O. McKinsey and Company came to refer to them as "banker's surveys." The general survey outline survived in modified form in McKinsey and Company's training manual until 1962 [30, p. 12]. As early as the 1930s, James O. McKinsey and Company was profiting from the external imposition of banking and finance regulation, a transition it was well equipped to exploit. The firm also profited from its internal systematization of client contact and report writing. These internal arrangements allowed McKinsey and Company to overcome the limitations of novice consultants and variable economic conditions as the firm's organization grew beyond its founder and expanded throughout the world.

The origins of modern management consulting are in the 1930s. Contrary to popular assumptions, Taylorism was not the predominant influence on the development of consulting firms. Rather, management engineers drew on the practices of accountants, engineers, and lawyers to offer CEO-level studies of organization, strategy, and operations. The major change in this emerging quasi-profession took place in the 1930s and was primarily a product of political developments. Before the 1930s, merchant bankers coordinated these studies. But, the Glass-Steagall Act and S.E.C. disclosure regulations forced commercial and investment bankers to abandon internal management consulting activities even as regulators mandated that they commission outside studies. These required studies, combined with the increasing acceptance of management engineers by corporate executives, propelled the rapid growth of consulting firms from the 1930s onward. New Deal legislation and firm-level systemization catalyzed the development of this particularly American form of professionalized corporate counsel.

Since the 1930s, management consultants have reorganized the largest and most important organizations in the world. During the Second World War, the Federal Government hired large numbers of consultants to streamline civilian production, reorganize the military, and oversee the rapid expansion of the Federal Administration. By 1949, Cresap, McCormick & Paget was working for the Hoover Commission restructuring the Executive Branch [12]. As consultants worked for the government, they carried ideas between the public and private bureaucracies, accelerating the process of organizational innovation and dissemination. Since other countries did not legislate the separation of commercial and investment banking, the institutionalization of management consulting never happened outside of the United States. When American management consultants expanded into Europe in the early 1960s, they sold American management "know-how" to European managers eager to employ the organizational structures that J. J. Servan-Schreiber labeled "The American Challenge."[5] By the 1970s, McKinsey and Company had decentralized one-quarter of the hundred largest companies in Great Britain [10, p. 239]. Whether reorganizing the Bank of England, Royal Dutch Shell, the Government of Tanzania, or even the World Bank, management consultants disseminated American management techniques throughout the world. But, it was the institutional and professional growth of consultants during the 1930s that was the necessary precursor to the predominance of American management consultants throughout the world and, through them, the ascendancy of American models of corporate organization after the Second World War.

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[5] Indeed, Servan-Schreiber, in his bestseller from 1968, noted that hand in hand with the growth of American industrial subsidiaries in Europe, "the three American consultant firms with European branches (Booz-Allen, and Hamilton, Arthur D. Little, Inc., and McKinsey and Co.) have *doubled* their staffs *every year* for the past five years" [33, p. 8, emphasis in original].

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