

# MANAGING INTERNAL CONSULTING ORGANIZATIONS: A NEW PARADIGM

By H.P. Johri, J. Chris Cooper, and J. Prokopenko

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## Introduction

Internal management consultants are regarded as change agents and, like their external counterparts, are expected to influence and advise people, and persuade and help them to do things differently. Internal consulting is a refinement in the evolution of the staff concept in management, a concept that emphasizes making available to the manager a specialized resource within the organization to assist in identifying and studying problems and opportunities, preparing recommendations and assisting in their implementation. Internal consulting was, therefore, an organization's solution for dealing with some types of problems without permanently overstaffing each line unit or purchasing the service outside. It has proved to be a particularly apt solution when special skills are needed only periodically, or when problems cut across internal divisional boundaries.

Internal consulting functions started in different U.S. companies in different ways in the early 1950s. In some cases, the driver was decentralization and the specialization of company operations into profit centers, requiring more integration of the groups within the company. In other companies, internal consulting began as a systems and procedure function, like management information systems, management sciences, and industrial engineering. The main purpose of an internal consulting group (ICG) was to enhance the productivity of functional or product divisions through the provision of common services. Following these early beginnings, major forces propelled the growth of internal consulting during the 1960s. These included the need to allocate scarce professional competence, varied experience, full-time devotion to consulting, professional independence, and action orientation. Use of internal consultants grew in the 1970s, attributable to the fast-paced environmental and technology changes of that decade, and the need for growth, the absorption of new technologies, and more flexible organizational design. According to one estimate, 500 to 600 companies had internal consulting groups, and there were 7,300 internal management consultants about 12% of the total number of external and

internal professional management consultants. In the beginning of the '80s, internal consulting was the fastest growing segment of the consulting business.

In contrast, there was an unprecedented and precipitous decline of internal consulting groups in the mid-1980s. According to Dekon (1987), "Economic strictures induced by the oil crisis, inflation, Japanese and other competition, the effects of the 1959 Tax Act, and a host of other factors, including merger mania, all conspired to decimate internal consulting." While it is true that the economic environment of the 1980s did play a significant role in this decline, there is evidence that many internal consulting groups had been poorly conceived and managed (Baranto, 1990). There is reason to believe that poor management of the ICGs might have contributed to their decline.

It is our purpose in this paper to discuss the management of an ICG and to suggest a framework for professional ICG management. In the next section we briefly discuss the changing internal and external environment of host organizations, and in section III we discuss emerging trend of outsourcing. In section IV, we discuss management practices that could be beneficially used by ICGs in this new organizational world. We introduce the concept of internal markets in section V, and in section VI develop some general principles for ICG management. Our conclusions are discussed in the last section.

### **Changing Organizational Environment**

In North America and Europe, the growing concern of business enterprises is to remain competitive in the face of accelerated globalization. As a result, using information technology as an enabler, these organizations are restructuring their old-style command-and-control organizations and replacing them with information-based organization structures. Newer management concepts are emerging based on the empowerment of employees, organizational flexibility, collaborative effort, and responsiveness to customers. These concepts are challenging widely held views that ownership through horizontal or vertical integration is essential for control: the search is on for equal measures of control through alliances, partnerships, and joint ventures with customers and suppliers, with the whole structure held together by common interests and information linkages. Electronic data interchange is enabling the creation of "virtual" organizations in which suppliers and customers alike are active stakeholders. For

example, in the auto industry just-in-time inventory management concepts have been used to design a production system where raw materials are delivered to the assembly line in time to coincide with the arrival of the partially completed vehicle at the next stage of assembly. This requires a close coordination of work activities between supplier and manufacturer but has increased productivity by reducing inventories and improving logistic processes. It has also greatly enhanced the ability of an organization to control a process without necessarily owning each step in the supply, production, and sales chain. These relationships can bind the customer, supplier, and the competitors in a unique organizational system designed to serve their mutual interests. When a firm develops such linkages its boundaries expand and according to Davidow and Malone (1992) ". . . appear more edgeless, with permeable and continuously changing interface between company, supplier, and customers." Such changes in structure open major opportunities to ICGs.

Organizations are becoming more flexible, leaner, less layered, more customer-centered, and less controlling. The wider use of information flows facilitates organizational control and is leading to the redundancy of middle-management levels and the flattening of the classic hierarchical pyramid of the industrial era. Organizations are integrating internal functions into processes that focus on outputs and customers. As a result, functions such as design, engineering, purchasing, manufacturing, distribution, sales, and so on are frequently merging into one of three main processes: product development, product delivery, and customer service. Such integration increases the capacity of organizations to respond quickly and effectively to market forces and to the requirements of their customers.

Finally, intense global competition is also putting extreme demands on business structures. To succeed, corporations must focus on core business, continually innovate, and organize to be flexible and responsive to changing customer demand and competition.

Outsourcing, which has become a megatrend and a powerful tool for reshaping organizations, has major implications for the managers of ICGs. Over the years, as businesses became increasingly complex (multi-product, multilevel, multinational), their organizations developed specialized functions such as manufacturing, engineering and design, human resources, information technology, logistics and distribution, or sales and customer service. Many created

highly specialized more-or-less peripheral units such as printing, public relations, real estate development, building management, legal services, and so on. The resources of organizations thus became dissipated across such functions and away from the core mission. The outsourcing of functions describes the process by which an organization ceases to provide these services internally in favor of procuring them through autonomous, if closely linked organizations. In this way, the parent organization can focus on the things it does best, the producing products or services that give it a competitive advantage.

Outsourcing has gained greatly in popularity in recent years (Fortune, 1995). It is used widely to ensure the controlled supply of many functions such as information systems, accounting, distribution, customer service, a growing list of human resource functions, internal audit, maintenance services, and so forth. According to recent surveys, in the U.S. \$38 billion was likely to be spent on information technology outsourcing in 1995, representing 8% of total expenditures; \$16 billion on third party logistics, about 4% of the total 1993 freight costs; 67% of hospitals use outsourcing providers for at least one department within their operation; 44% of the companies surveyed are outsourcing some aspect of their customer service, and 5% have completely outsourced this function.

The ultimate expression of outsourcing for many governments is privatization, and in many jurisdictions this is happening in a national economy where no mature external management consulting sector exists. This creates a particular paradox (the acute need for knowledgeable management consulting versus the acute shortage of such resources) to which internal management groups represent a viable solution.

This shift from seeing outsourcing simply as a tool to reduce costs to perceiving it as a strategic requirement to improve business focus and competitiveness is significant. Taken to its logical conclusion, all services consumed by the organization and not considered core competencies can be outsourced. This operational shift, and the paradigm shift from the single, big, all-owning organization to the many interdependent members of a galaxy or system of autonomous organizations, has profound implications for the new and vital role that can be played by modern ICGs.

### **Managing Internal Consulting Groups**

Before considering the implications of the radically changing world of their host organizations on ICGs, it is worth reminding ourselves of the fundamentals of structuring and managing ICGs.

The management of an ICG is similar to that of an external consulting organization, but with significant differences. Those differences are due to the constraints placed on the activities of the ICG because it services primarily, and is an integral part of, the host organization. These constraints affect the structure of the group, its management processes, and its culture. Despite these differences, the marketing of services, recruitment and training of consultants, client relations, project management, etc., are similar to those of any consulting organization. In an ICG, two different cultures must prosper side by side: one defined by the parent organization and the other by the profession of management consulting. The leadership of the ICG often has the difficult challenge of working within these two cultures and reconciling the differences and conflicts that will generally arise.

The precipitous decline of ICGs in the 1980s raises the issue of whether it could have been prevented if the groups had been better structured and more professionally managed. A review of the literature suggests that many ICGs were poorly managed. Baranto (1990), in a recent article, looked at the main difficulties encountered by ICGs in the U.K. and found a profound difference between the performance of successful and unsuccessful groups. He suggests that in unsuccessful ICGs the training and development of staff was poorly organized and technical skills were not supplemented by management or consultancy skills. Many of these ICGs relied heavily on narrow methodologies or management fads that did not survive the test of time. Similarly, many unsuccessful ICGs failed to develop professional working methods and neglected important practical management issues such as project selection, assignment control, and client relationships. Many neglected to monitor their own operational performance, including on-time completion, performance-to-project budgets, consultant utilization, and the like. Others failed to adequately involve their consultants in the implementation of project recommendations, and some neglected any implementation monitoring. Dekon observed that too many ICGs were developed to reward or accommodate individuals, or as a result of a single project, and did not become established in the "corporate soil."

From our own experience with ICGs we believe structural and managerial success factors should include the following:

**Mission and Role** - The ICG (Molnar, 1989) should reflect a careful examination of the desirability of creating it in the first place, considering how an ICG will support corporate strategy by adding value. Second, by examining alternatives to an ICG such as purchasing management consulting services from outside firms or achieving the desired affects through the use of ad hoc groups or teams that can be assembled for specific projects using in-house resources. Consideration should also be given to such operational issues such as service offerings, fee charging, the optional or mandatory nature of services, and relationships with clients, other corporate services, and external consultants. The mandate of an ICG should clearly define its mission, role, program, resources, internal structure, and key linkages.

**Funding** - One of the most vexing problems for managers of ICGs has been funding specifically, should an ICG be funded by charging fees or should it be supported by a budgetary allocation. Some argue that an ICG should be primarily an instrument of corporate strategy and, therefore, should be supported entirely by a budgetary allocation. Others find the administrative burden of fee charging onerous and don't believe that the benefits justify the cost. In our experience, running an ICG on a fee-for-service basis virtually guarantees the ICG will become a competitive, professional consulting organization, whereas support through budget allocations runs the risk of creating "just another administrative unit" whose value to the host organization cannot be measured or justified.

**Control Over Costs** - The ability of ICG leaders to promote cost efficiency and operational effectiveness can be significantly affected by the degree of control they can exercise over their expenses, particularly the costs of paying the people they employ. In many instances, the host organization restricts the freedom of ICG managers in these areas.

**Competition** - Competition, particularly from external consulting service providers, is healthy for an ICG and challenges it to continuously improve quality and efficiency and to continuously adjust its service mix to meet market conditions. A degree of competition, on an equal footing with the ICG, can go part way to achieving these benefits. However, to receive the full benefits

of competition the mandate of the ICG, and the authority of its leaders, must be appropriately crafted.

**Marketing** - The marketing function of an ICG is all too often poorly developed and undernurtured, generally as a consequence of a confused mandate or a lack of normal competitive market discipline. Too many ICGs have interpreted their mandate as giving them the privilege of sitting back and adopting a passive and responsive role toward the needs of the host organization. This myth can be carried to the point where ICGs believe that the marketing or their services is wasteful and an unnecessary overhead. Good management consultants should be change-leaders, stimulating line managers and helping find innovative solutions to apparently intractable problems: most ICG mandates are framed in these terms anyway. An ICG without a marketing orientation is a candidate for dissolution, for it will not add value.

**Assignment Management** - The quality management of consulting assignments is especially important for an ICG, since up to 75% of its assignments should be commissioned by previously satisfied clients. The professional management of assignments should cover the entire consulting process: entry, diagnosis, action planning, implementation, and termination. A quality assignment management process includes at least attentive control of the consulting process, the schedule, resources, and of results.

**Consulting Service Quality** - The typical management consulting assignment is complex and dynamic. Specification of the desired outcome, which consultants describe as carefully as possible in project terms of reference, is only a backdrop to the endlessly complicated relationships that develop between client and consultant as the assignment progresses. Occasionally, a means to measure quality can be introduced directly into the terms of reference, for example in a promise to deliver a working model, but generally quality exists mainly in the eye of the beholder and depends upon a variety of factors in a multitude of combinations. It is in identifying these factors and striving for perfection that opportunity exists for a management consulting organization to deliver a quality of service that will delight its clients.

Quality management is a difficult task in any business field and is particularly challenging in management consulting, given its intangible and unique nature. While a new ICG will always attract a first contract from an inquisitive client, this same client will become a regular customer

only if he is satisfied with the quality of the service. This issue must be carefully considered by the managers of the ICG for each project undertaken. Quality management of quality is essential but is of value only if the results are acted on. This requires group effort which needs to be led from the highest level within the ICG.

Such management practices can be applied by an ICG in a variety of ways depending upon, for example its size, age, and the management practices of the host organization. Some ICGs may be totally revenue dependent while others may recover only a small portion of their project costs. Similarly, the depth and the intensity of a marketing program may vary from one ICG to another. Thus, these management practices can be applied by most ICGs in a way and to a degree that they are not dysfunctional to the ICG or its host organization.

### **The Concepts of Internal Markets**

In any organization, many operational and functional services are required and are provided internally either by common service agencies or corporate units. Examples include: purchasing, logistics, materials management, property management, and functions such as personnel, information technology, operations research, finance. The service providers and the consumers of these services are part of an internal market that is highly structured and regulated by the management of the host organization. Ackoff finds this situation paradoxical in the U.S. which has a market economy, and compares it to the approach of the state-run economy of the former Soviet Union.

Curiously in our country, which has a market economy, most organizations, institutions, and government agencies operate with centrally planned and controlled economies. Their internal economies are more like the national economy that the former Soviet Union is trying to get rid of than the national economy we have. Unfortunately, many, if not most, of our corporate and institutional economies are in decline largely because, like the old Soviet Union, they contain and are constrained by many units that are bureaucratic monopolies.

These monopolistic service and product providers are ineffective mainly because resources are allocated to them by administrative budgets and not through any market discipline based on the

perceived value of the services or products provided. There is also no systematic way of benchmarking the costs and efficiencies of these units.

Ackoff warns that organizations that do not create such internal market economies are destined to experience economic stagnation. Boyett and Conn argue that "this trend toward making support functions look and operate like small entrepreneurial professional service firms is a direct response to dissatisfaction with the performance of support functions in the traditional large organization." They cite many companies that are marketing their expertise to other companies. Examples are Control Data which sells personnel services, Xerox selling distribution services, and Disney selling training services to outside customers. By marketing their expertise to other companies, these groups enrich their experience and grow professionally. Several companies, such as S.C. Johnson & Sons, are encouraging such entrepreneurial ventures by providing seed financing.

### **The Future: A New Paradigm for Internal Consulting**

We believe that internal management consulting groups will help successful organizations meet the challenges of changing economic environments for a long time to come. In the beginning, ICGs were generally managed as support functions and given limited freedom to develop autonomously. Much has changed since then, and modern organizations are devising innovative ways to improve the effectiveness of their management, for example, through converting support units into profit centers. Herein lies the opportunity for existing ICGs to transform themselves from cost centers to fully autonomous, profit-driven businesses, and for new ICGs to be created. To achieve this, internal management consultants need to consider a new paradigm based on the new organizational contexts of their host organization and the concept of the internal market. We suggest that such a paradigm, and its associated principles, can guide the governance of tomorrow's ICGs. We consider each principle to be a desirable component of a model for essentially autonomous, through internal, consulting groups, while recognizing that many existing ICSs will be constrained from implementing every principle right away.

#### **Principle 1**

The activities of an ICG should never impair the essential authorities and responsibilities of their client operating departments or organizations.

## **Principle 2**

Service and control must be sharply differentiated, and the activities of an ICG must focus uniquely on service: specifically, an ICG should exercise no direct control over their clients. Therefore, consulting services should never include activities usually associated with management, such as financial control, environmental audits, formal investigations, performance evaluations of staff, or the like. Extreme care should be exercised not to locate an ICG under a functional position that has organizational control as its prime responsibility: an ICG should not report, for example, to a controller.

## **Principle 3**

An ICG's mandate should allow it to define its service offerings based on client needs. The parent or host organization must accept that there can be several internal providers of certain types of service, and internal managers should have the freedom to retain the service provider best suited to their needs.

## **Principle 4**

An ICG should operate as a free-standing profit center. It should be entirely revenue dependent and control its own fee scales. The ICG leadership should be given spending authority over staff salaries, training, research, business development, hospitality and entertainment, and so on. Surpluses arising from operations should be applied by the ICG to fund research projects, special training programs, capital expenditures, etc. The group should always be free to carry forward its surpluses or profits from one year to another, and to accumulate this surplus within reasonable limits. If a surplus is temporarily needed by a parent, the ICG should be paid interest at commercial market rates under a structured loan agreement.

## **Principle 5**

Client-managers must have full discretion to use external or internal service providers: they must be voluntary clients. Competition must be encouraged. Wherever the contracting procedures of

the parent for engaging external consultants are so cumbersome and bureaucratic as to discourage external contracting, they should be amended to remove any unfair advantage for the ICG.

### **Principle 6**

An ICG must be encouraged and allowed to provide services to external clients, within normal business restrictions. Some restrictions on the nature of clients who may be sought and the appropriate proportion of revenues for an ICG to earn from external clients may be appropriate, not least to reflect the mission and role of the ICG. We believe that the consulting fees charged should be identical for external clients.

### **Principle 7**

An ICG must be given full administrative authority to develop its own human resource management policies and practices. The success of an ICG depends largely on its ability to recruit, promote, pay, train and manage its human resources. It must have the administrative freedom to develop its own people policies, including suitable competitive compensation systems.

### **Principle 8**

An ICG must exploit every opportunity to develop and strengthen synergistic linkages with its parents or host organization/s. The breadth and depth of the work that an ICG undertakes in its client environment gives it its unique perspective and value.

The future success of ICGs depends greatly on the professionalism and quality of their management. It is only through the process of improving management practices that many existing ICGs will secure the autonomy and commercial strength they need and a bright future.

### **Conclusions**

A host of new internal and external influences on organizations are leading to a fundamental redefining of the way work is organized and resources are managed in both developing and developed economies. This massive transformation of organizations and society is enabled by

advances in information technology, and, just as the steam engine changed the way we organized work in the industrial era, computers (the information engines) are changing how we organize work for today and tomorrow. New communication technologies are changing our perceptions of distance and time so that the coordination of work, a major problem in the industrial era, can now be achieved through computer networks. The functionality of information technology has vastly improved and its costs are steadily falling, thus enabling organizations to reduce transaction costs and develop different types of linkages in joint ventures and partnerships of various kinds. All this allows public and private enterprises to develop new organizational structures by integrating functions and outsourcing many services to network partners. Organizations are also having to expand their geographic boundaries for the purpose of selling products and obtaining raw and intermediate materials, increasing world trade and further globalizing the economy.

This redefinition of the way work is organized within an enterprise also leads to the reexamination of the provision of internal corporate services; these could be improved significantly through the application of management consulting disciplines in areas such as quality management, project management, and customer service. The principles of managing the delivery of competitive consulting services have a wider application in the present organizational context: when delivery of internal services can be improved, insourcing becomes a more plausible alternative to outsourcing, and the host organization conserves or enhances its in-house functional capabilities, its ability to continually progress as a learning organization, and its competitiveness.

Internal management consulting grew initially in North American and Europe as a staff function and was used mainly to develop and implement management improvement techniques. The '60s and '70s saw a phenomenal growth of ICGs, followed by a precipitous decline in the difficult economic period of the '80s. Many ICGs failed to prove their worth to their host organizations and failed to survive.

We are at a crossroads once again. There is growing need for consulting services to help change the culture, structure, and management practices of organizations so they can benefit from advantages in information technology and become or remain internationally competitive. An

internal consulting group, with its sharp focus on the requirements of the host organization and its greater environmental competence, can become a great asset to its renewed single or multi-unit host organization. The new paradigm that we have discussed in this paper could revitalize internal consulting groups and make them more effective.

For the second generation of ICGs the distinction between internal and external clients for consulting services is becoming blurred. In the past, the ownership of an ICG was determined by who owned it. Now parent organizations are allying and partnering for many purposes, including service provision, and the host organization (to which an ICG is internal) may well be an association or network of independent organizations. Ownership is less relevant, just as it is for large parent organizations as they shed non-core functions in favor of alliances. We must guard, therefore, against the use of old nomenclature to describe roles in the new organizational word and decouple notions of ownership from notions of control and what is "internal."

A revitalized internal management consulting profession has, we feel, a future more exciting than its past in both developing and developed economies and in both innovative and more traditional modes. Provided groups are run with appropriate professional and commercial disciplines, they will be competitive, profitable, and will add-value for their host organizations and national economies.

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Dr. Prokopenko has extensive experience in the entrepreneurship and management development field and is particularly interested in restructuring, privatization, and globalization. He has conducted workshops in more than 40 countries, serves on the editorial boards of several journals, and has written articles for more than 120 publications. Mr. Cooper, who has over 30 years' experience in change-management consulting, specializes in the facilitation of organizational and individual change. He speaks frequently on change management and has published on this and related topics. Dr. Johri has extensive worldwide experience with internal consulting, including advising governments and businesses, and has published widely on consulting groups, risk management, and public-sector practices. Now in private practice, he was formerly director of the internal management consulting group of the Canadian Federal Government.