Consulting after Enron

Enron's collapse gained the kind of media and water-cooler attention usually reserved for blockbuster movies. But why, when there have been auditing scandals in the past, did this one prove capable of bringing down a major accounting firm and tarnishing the reputation of the industry as a whole? And what — one year later — are the long-term implications for consultants?

IN *The Tipping Point*, Malcolm Gladwell identifies three factors — context, impact and evangelists — that "tip" a small change into a big change, whether that is an obscure book into a number one best-seller or a few occurrences of a virus into a full-blown epidemic. These same factors explain why the repercussions of the Enron scandal have been so significant. It is doubtful whether Enron would have riveted the world as it did had we not already been in a recessionary environment complicated by international tension and the threat of war. Although the scale of Enron's collapse was remarkable, its prominence was increased by the need to find a convenient public scapegoat for the precipitous decline in the financial markets and the impact that had on individuals' pensions and investments. While the resonance and scale of the Enron scandal guaranteed some level of public interest, it was the fact that the cause of investors was taken up in the US Senate that has guaranteed the scandal's prominence and longevity.

Moreover, the Enron scandal is not unique. These same three factors are evident if we look back at the major financial scandals of the twentieth century. It is therefore both reasonable and necessary to ask whether such factors also apply to the consulting industry today, to ask whether there is a risk that a scandal involving a single consulting firm could take on the proportions of that which engulfed Andersen, with ramifications of the industry as a whole.

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Surveying the anecdotal feedback from clients typically carried in the media, we might be mistaken for finding it nonsensical. Why are so many clients cynical about consultants, *and yet* continue to hire them? Questioning more clients in more depth suggests that there are two areas in which consultants do add considerable value: on large-scale change projects where momentum needs to be created and sustained; and on specific, specialised areas where in-house expertise is scarce and where a consultant has in-depth knowledge and a wider range of experience to draw upon.

Against this backdrop, there are a multitude of minor criticisms, most of which are longstanding, none of which will come as a surprise to experienced consultants — about lack of innovation, uncertain value for money and lack of practical use. To date, such carping has remained a strictly sideline activity, but two factors suggest that this may not continue to be the case: recession and the impact of a generation of client managers who have grown up working with consultants, rather than just hiring them.

Economic downturn has meant not just that clients are demanding better value for money, but that they are much more sensitive to aggressive selling by consulting firms which are also under financial pressure. Moreover, many surveys of clients focus on the person who foots the bill, the all-important budget owner whose influence over the decision to hire consultants and the choice of consulting firm is critical. This approach concentrates on short-term issues — the current market — and in doing so ignores the fact that tomorrow's budget holders are the people who, today, are working side by side with the consultants their bosses bring in. What senior executives perceive to be "momentum", "kick-starting" a large-scale project, or even specialist input, often translates into disenfranchisement and disappointment among those involved on a day-to-day basis.

Most clients surveyed also felt that the value contributed by consultants was only realised with effective management from clients themselves. As one client put it, "Our management processes have checks and balances such that consultants would need to be in league with our prime [contractors] and sub-contractors to provide a misleading picture for a serious scandal to take place." It follows from this that most clients believe the main barrier to an Enron-scale consulting scandal is their decision-making process: "I don't believe there could be an Enron-style episode affecting management consultants, since the implementation of a consultant's recommendations is always (even if by default) a company management decision — this is very different from an auditor's scrutiny of accounts." "It's up to the buyers to make sure they are getting what they are paying for," agreed another client.

This does not, however, mean consultants are off the hook. "I could see an Enron-like scandal occurring in the consulting industry," said one executive, "if a consultant was brought in to manage a big enough and critical enough project and wasn't subject to sufficient monitoring. All of a sudden, big money is committed to something that can only be delivered by spending more than can be afforded. The client goes under, and the consultant becomes a pariah.”

Some clients simply do not accept the “let the buyer beware” philosophy. Many believe that it would be possible for a failed project to generate Enron-like shockwaves if it could be shown that the consulting firm involved had knowingly and deliberately sold work a client did not need or could not afford. “Yes, there could be such a scandal,” argued one client, “especially in a tighter market. A company could be brought down by, for example, financial over-commitment to a mis-planned IT strategy.” “Yes, of course,” responded another, “because their need to generate revenue results in an opportunistic approach of accepting orders from ‘important’ clients, even though there may be no clear business case.”

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The perceived risk of a consulting firm being able to circumvent this barrier — in effect, to bypass clients’ decision-making process — increases the greater the range of services a firm is trying to sell. This applies both to the audit/consulting relationship, which Enron threw into such clear relief, and to broad-based consulting firms. “Rather than any single event,” said one client, “I’d see a scandal emerging from the exposure of dubious practices that have made consultants extend billable time with clients. This would destroy reputation and lead to loss of repeat business or failure of cross-selling.”

Clients also believe a scandal is more likely to occur the further removed the consultants are from the client’s site: “Since the client controls the relationship with the consultant, theoretically nothing on the level of an Enron scandal should occur without the company’s knowledge,” commented another client. “This could only happen if the consulting team were working offsite.” The length of relationship is also seen to increase the risk. “Consultants have to be careful not to be captured by the entity for which they work,” was how one interviewee put it. “They must maintain their independence even at the cost of not doing business with the client again.”

“I do think [an Enron-scale scandal in the consulting industry] will happen and, to some degree, I’d welcome it,” said one executive, “because the message to both consultants and clients needs to be hammered home. Consultants would be forced to think more carefully about whether they truly believe their own marketing speeches and clients would be forced to take more control of consultants.”

Clients are remarkably consistent about the kinds of changes they would like to see take effect in the consulting industry. Top of their agenda is better information about what consultants do. It is recognised that it is not just the consulting firms that are at fault here: clients themselves have been insufficiently proactive in demanding better information. “Clients should push more aggressively for reference sites and case studies, and then contact them,” argued one respondent. “Most do not follow up on the references provided, although this is crucial if they’re to be more informed and in control. I also think that consultants should be forced to be more honest about what they can’t do. Expectations need to be clear on all sides.”

For some clients, market forces could resolve this problem: “The market for consultants is competitive enough for no need for any form of regulation — it is, after all, a ‘reputation’ business,” said one. Yet many believe that some form of external validation is also required. “I’d like there to be some kind of third-party review of what consultants do, so that I can assess this without being hassled by sales people from the consulting firms themselves,” said one company executive.

Item two on clients’ agenda is a code of practice to correct the distortion many clients see. Particularly during a recessionary period, consultancies are perceived as being under pressure to maintain the growth rates of the previous decade and may be tempted to sell clients work they do not need and cannot afford. “I’d like to see codes of practice,” said one respondent, “governed by a central but independent body and a method by which past experience and specific skills areas can be assessed and independently verified before a client commits to a particular consultancy.”

Item three is accountability: according to one executive, “consultants should have a similar level of professional liability as, say, lawyers, surveyors and accountants for their advice.” “There has to be greater recognition by consultants that they have a responsibility for the ultimate outcome of their work, rather than just for advice which may lead to an outcome,” said another. However, the underlying concern here is about clarity of ownership. Concern is directed at those instances where accountability is unclear, where clients think consultants are ducking the issues. Most clients acknowledged the complexity of the issue, but were simultaneously cynical of what they perceived to be reluctance on the part of the consulting industry to engage with this issue.

In the absence of any resolution to these issues, the main reason why the consulting industry has not yet fallen victim to an Enron-like scandal lies in the lack of individuals or pressure groups willing to pursue reform, rather than in anything the consulting industry has done to protect itself. If this changes — if clients start exchanging or discussing their use of consultants more widely and openly, or if a small number of people (the trade associations of particular sectors, for example) could see the opportunity to force change (and be credited for it), then the collective reputation of the consulting industry would come under real threat. ◆

This is an edited extract from Consulting on the Brink: The Implications of Enron for the Consulting Industry*, by Fiona Czerniawska. For further information, e-mail fionacz@arkimeda.com.*