

TABLE OF CONTENTS

1	INTRODUCTION	1
	1.1 Background.....	1
	1.2 Research Problem and Objectives	4
	1.3 Research Approach and Methods.....	5
	1.4 Scope and Limitations	6
	1.5 Structure of the Dissertation	7
2	A TYPOLOGY OF THE CLIENT-CONSULTANT RELATIONSHIP IN MANAGEMENT CONSULTING.....	9
	2.1 The Evolution of the Management Consulting Service Sector	9
	2.2 The Market for Consulting Services.....	12
	2.3 Management Consulting: Definition, Characteristics and Economic Functions	17
	2.3.1 Definition of Management Consulting.....	17
	2.3.2 The Characteristics of Consulting Services and their Implications for the Client-Consultant Relationship.....	19
	2.3.3 Roles and Functions of Management Consultants	23
	2.3.4 Factors of Competition in the Market for Management Consulting.....	25
	2.4 The Price for Advice in the Client-Consultant Relationship.....	30
	2.4.1 Compensation Schemes in the Consulting Market	30
	2.4.2 Determinants for Outcome-Contingent Compensation.....	34
	2.5 Consulting for Equity as a New Outcome-Contingent Compensation Scheme	37
	2.5.1 The Emergence of Consulting for Equity in the Market for Management Consulting.....	37

2.5.2	Consultants' Value Added in their Provision of Advisory Services for Start-up Firms.....	40
2.5.3	Consequences of Consulting for Equity for the Consulting Firm.....	46
2.6	Conclusions for the Relationship between Clients and Consultants.....	49
3	THE THEORETICAL FRAMEWORK OF THE PRINCIPAL-AGENT THEORY	51
3.1	A Delineation of the Principal-Agent Theory within the New Institutional Economics	51
3.2	The Principal-Agent Theory.....	53
3.3	The Principal-Agent Model: Adverse Selection and Moral Hazard	57
3.3.1	Ex-ante Information Asymmetries and Adverse Selection	57
3.3.2	Instruments to Reduce Adverse Selection Problems.....	61
3.3.2.1	Signaling.....	61
3.3.2.2	Screening	63
3.3.3	Ex-Post Information Asymmetries and Moral Hazard.....	67
3.3.4	Instruments to Reduce Moral Hazard Problems	70
3.4	The Applicability of the Principal-Agent Theory to Analyze Consulting for Equity	72
4	CONSULTING FOR EQUITY UNDER ADVERSE SELECTION AND MORAL HAZARD	75
4.1	Information Asymmetries in the Client-Consultant Relationship.....	75
4.2	Aligning the Interests of Consultants to those of their Clients.....	77
4.3	Hidden Action of the Consultant.....	80
4.3.1	The Entrepreneur-Consultant Relationship under Moral Hazard	80
4.3.2	The Model	83

4.3.3	Implications for the Applicability of Consulting for Equity under Moral Hazard.....	98
4.4	Unobservable Quality of the Consultant	101
4.4.1	The Entrepreneur-Consultant Relationship under Adverse Selection.....	101
4.4.2	The Model	105
4.4.3	Implications for the Applicability of Consulting for Equity under Adverse Selection.....	116
4.5	Consultant Moral Hazard and Unobservable Quality of the Start-up Firm.....	117
4.5.1	The Emergence of New Incentives under Consulting for Equity ..	117
4.5.2	The Model: Ideas and Basic Structure	120
4.5.3	Consulting for Equity under Symmetric Information	129
4.5.4	Consulting for Equity under Asymmetric Information	131
4.5.4.1	Pure Fixed-Fee Contracts	131
4.5.4.2	Pure Equity Contracts.....	132
4.5.4.3	Combination of Fixed Fee and Equity Share	135
4.6	Implications for the Applicability of Consulting for Equity under Moral Hazard and Adverse Selection.....	140
5	CONSULTING FOR EQUITY IN GERMANY: EMPIRICAL EVIDENCE	145
5.1	Overview	145
5.2	The Design of the Empirical Study	146
5.2.1	Methodology.....	146
5.2.2	The Definition of the Sample	147
5.2.3	Interviews	149
5.2.4	Questionnaire.....	150
5.3	Empirical Results.....	151
5.3.1	Characteristics of the Sample	151

5.3.2 Consulting for Equity in Germany: General Results	153
5.3.3 How Consulting for Equity Arrangements Change the Client- Consultant Relationship	161
5.3.4 Possible New Conflicts of Interest under Consulting for Equity	164
5.4 Conclusions	167
6 SUMMARY AND OUTLOOK	169
REFERENCES.....	175
APPENDIX.....	189

LIST OF FIGURES

Figure 2.1:	Per Annum Growth Rates of the Consulting Sector, Global and Germany	12
Figure 2.2:	Market Volume by Functional Service Lines in Germany 2003.....	14
Figure 2.3:	Sectoral Split of the Demand for Consulting Services in Germany 2003.....	14
Figure 2.4:	The Role of Reputation as a Proxy for Quality.....	28
Figure 2.5:	Compensation Methods in the German Consulting Market 2003.....	32
Figure 2.6:	Typology of Consulting for Equity in the Market for Risk Capital	45
Figure 3.1:	The Timing of a Principal-Agent Relationship with Adverse Selection	58
Figure 3.2:	The Timing in Signaling Models	61
Figure 3.3:	The Timing in Screening Models	64
Figure 3.4:	The Screening Game Tree: The Participation Constraint	66
Figure 3.5:	The Screening Game Tree: The Incentive Constraint	67
Figure 3.6:	The Timing in Models with Moral Hazard.....	68
Figure 4.1:	The Structure of our Theoretical Analysis of Consulting for Equity	80
Figure 4.2:	The Entrepreneur-Consultant Relationship as a Classical Principal-Agent Problem.....	83
Figure 4.3:	The Timing of the Entrepreneur-Consultant Relationship	84
Figure 4.4:	The Contractual Relationship between the Entrepreneur and the Consultant under Moral Hazard	85

Figure 4.5: The Relationship between the Agent's Effort and the Outcome	89
Figure 4.6: The Construction of the Optimal Compensation Scheme for a Given Outcome x	95
Figure 4.7: The Construction of the Optimal Compensation Scheme for Different Outcome Levels	97
Figure 4.8: The Timing of the Model with Unobservable Ability of the Consultant	106
Figure 4.9: The Contractual Relationship between the Entrepreneur and the Consultant under Adverse Selection	107
Figure 4.10: The Zero-Profit Curves of a High- and a Low-Ability Consultant	110
Figure 4.11: Discriminating between High and Low Types of Consultants	113
Figure 4.12: The Contractual Relationship between the Entrepreneur and the Consultant under Adverse Selection and Moral Hazard	122
Figure 4.13: The Timing of the Model	123
Figure 4.14: The Extensive Form of the Game	125
Figure 4.15: A Separating Menu of Contracts that is Incentive Compatible	140
Figure 5.1: The Perceived Importance of Consulting for Equity for the Consulting Firms' Business (n=75)	154
Figure 5.2: Reasons for the Supply of Consulting for Equity (n=37)	157
Figure 5.3: The Perceived Process Chain of Consulting for Equity	160
Figure 5.4: Average Lock-up Period for the Acquired Equity Positions (n=13)	161

LIST OF TABLES

Table 2.1: The German Consulting Market in 2003.....	13
Table 2.2: Implications of the Service Characteristics for Consultants and their Clients.....	21
Table 2.3: Important Institutions and Factors of Competition in the Market for Consulting Services	27
Table 3.1: The Key Elements of the Principal-Agent Theory.....	54
Table 4.1: Notations Used in the Model.....	124
Table 5.1: The Top 15 Management Consulting Firms in Germany 2002/2003	148
Table 5.2: Response Patterns of the Questionnaire	152
Table 5.3: Sample Characteristics of the Questionnaire and the Interviews.....	153
Table 5.4: Consulting for Equity Activities of the Interviewed Management Consulting Companies.....	155
Table 5.5: Consulting for Equity Activities of the Surveyed Consulting Companies.....	156
Table 5.6: Key Features of the Consulting for Equity Activities of the Surveyed Consulting Companies	158