McKinsey & Company's Go-to-Market Strategy as a Startup

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Market — What was happening in the world that created the business opportunity?

By 1920, when only a third of homes in the country had electricity and only one in five had a flush toilet, the country's business establishment was embarking on a course of radical, unprecedented expansion. This brought with it a dilemma that has preoccupied business leaders ever since: how to grow big while maintaining control over the enterprise. Moving from a single-product, owner-run enterprise into a complex and large-scale national one is a difficult task. First, you have to build production facilities massive enough to achieve the desired economies of scale. Second, you have to invest in a national marketing and distribution effort to ensure that sales have a chance of matching that scaled-up production. And third, you have to hire, train, and trust people to administer your business. Those people are called managers, and in the first half of the American Century, they were in very short supply. The benefits to successful first-movers were gigantic. In industries where only one or two companies took the plunge early, they dominated their field for a very long time to come; this group includes well-known names like Heinz, Campbell Soup, and Westinghouse. A ten-year merger mania, from 1895 through 1904, also brought the creation of a number of corporate entities the likes of which the world had never seen — 1,800 companies were crunched into 157 megacorporations, including stalwarts like U.S. Steel, American Cotton, National Biscuit, American Tobacco, General Electric, and AT&T.

The key business problem identified during this transition — and one that underwrote McKinsey's success for several decades — was that a single, central office could no longer adequately administer such far-flung empires. Power had to be ceded to the extremities. The question was how. It was a quandary that beguiled some of the great thinkers of the time, including political scientist Max Weber, who argued that a systematic approach to marshaling resources through bureaucracy was a necessary and profound improvement over pure charismatic leadership.

In his book American Business, 1920–2000: How It Worked, Harvard professor Thomas McCraw pinpointed the issue: "In the running of a company of whatever size, the hardest thing to manage is usually this: the delicate balance between the necessity for centralized control and the equally strong need for employees to have enough autonomy to make maximum contributions to the company and derive satisfaction from their work. To put it another way, the problem is exactly where within the company to lodge the power to make different kinds of decisions." Companies such as DuPont, General Motors, and Sears Roebuck were the first to address this problem systematically. According to Chandler, DuPont sent an emissary to four other companies experiencing similar issues — the meatpackers Armour and Wilson and Company, International Harvester, and Westinghouse Electric — to ask what they were doing. And the answers were remarkably similar: The innovators moved from the centralized system to a multidivisional structure with product and geographic breakdowns. The concept left

operating division chiefs with total control over everything except funding resources. Top managers took a more universal view of the business, monitoring the divisions and allocating capital accordingly.

Unwittingly, the federal government did its part to create the modern consulting business. Starting in the last part of the nineteenth century, Washington made periodic regulatory efforts to curb the power of big business, including the 1890 Sherman Antitrust Act, the Federal Trade Commission Act and Clayton Act of 1914, and the Glass-Steagall Act of 1933. The intended effect of these measures was to prevent corporations from colluding with one another to fix prices and otherwise manipulate the markets. The unintended effect, according to historian Christopher McKenna, was to accelerate the creation of an informal — but legal — way of sharing information among oligopolists. Who could do that? Consultants. Regulatory efforts paid another rich benefit to the likes of McKinsey: Restricted from cutting backroom deals with each other, firms were thus obliged to actually compete, which meant they needed to make their operations more efficient. Here again, consultants were the answer. But perhaps the circumstance that most aided the creation of the consulting industry was the entry of a new, key player into business itself. Empire builders with names like Carnegie, Duke, Ford, and Rockefeller had built huge, vertically integrated companies, but they had neither the time, the talent, nor the inclination to create and carry out management systems for those entities. These were the conquerors of capitalism, not its administrators. And yet, as Chandler pointed out, "their strategies of expansion, consolidation, and integration demanded structural changes and innovations at all levels of administration."

Into the breach stepped a new economic actor who was neither capital nor labor: the professional manager. Gradually, he replaced the robber baron as the steward of American business. Alfred P. Sloan, the legendary president of General Motors, was the first nonowner to become truly famous for his managing skills. His decentralized, multidivisional management structure gave GM the agility to outmaneuver the more plodding Ford Motor Company and snatch the industry lead. Ford may have revolutionized manufacturing, but Sloan realized that the car-buying market had become big enough to be segmented into people who bought Buicks, Cadillacs, Chevrolets, Oldsmobiles, and Pontiacs. By the late 1920s, the car market was maturing, and people wanted choice. Sloan also gave them the ability to buy a car on credit — a groundbreaking idea at the time. Before the decade was over, GM had surpassed Ford as the market share leader, a position it didn't relinquish until the 1980s.

Sloan and his ilk were perfect customers for McKinsey: Lacking the legitimization of actual ownership, professional managers felt great pressure to show they were using cutting-edge practices. And who better to bring those practices to their attention than consultants who were talking to everyone else? This was the beginning of a decades-long separation of ownership from control in corporate America, and the consultant was an able ally to the professional manager in this tug-of-war — an ally who wasn't gunning for the manager's job. Thus began the era of managerial capitalism. For more than two centuries, economists had argued that companies operated in some sense at the mercy of Adam Smith's "invisible hand" of the market. But the revolution in management thinking in the United States offered up an alternative idea: the "visible hand" of management, which made things happen, as opposed to merely responding to external market forces.

As the managerial class grew in size, so too did the demand for consultants. Between 1930 and 1940 — while the country was in the grip of the Depression — the number of consulting firms grew from 100 to 400. By 1950 there were more than 1,000 such firms in existence. This kind of growth — far in excess of

the overall economy — makes sense for an emerging profession. What's remarkable is that the consulting industry outgrew the economy for pretty much the rest of the twentieth century too. Critics of the field have long lamented what they consider the fundamental question at the heart of consulting: whether its contributions to corporate growth and innovation justify its own growing piece of the economic pie. Stewart's argument is that it doesn't actually matter whether Taylor and his immediate descendants provided genuine value. Consultants saw demand and sought to satisfy it — what else is there to business? "Their specialty, at the end of the day, [was] not the management of business, but the business of management," wrote Stewart. "[And] as in any business, what separates the winners from the also-rans isn't independently verifiable expertise; it is the ability to move product." Over the next four decades, no firm moved this product as well as McKinsey & Company.

Product/Service — What was their unique value proposition?

As a young academic, McKinsey was a prolific writer, if not an especially engaging one. His first four books were dry tomes on the nitty-gritty of accounting and taxes: Federal Incomes and Excess Profits Tax Laws (1918), Principles of Accounting (co-written with A. C. Hodges, 1920), Bookkeeping and Accounting (1921), and Financial Management (1922). But with his fifth effort, he broadened his horizons significantly. Budgetary Control (1922) — the first definitive work on budgeting — turned accounting on its head, promoting it as an essential tool of managerial decision making. "Budgetary control involves the following," McKinsey wrote.

1. The statement of the plans of all the departments of the business for a certain period of time in the form of estimates.

2. The coordination of these estimates into a well-balanced program for the business as a whole.

3. The preparation of reports showing a comparison between the actual and the estimated performance, and the revision of the original plans when these reports show that such a revision is necessary.

It seems commonsensical, but McKinsey's new way of looking at the use of the budgeting process sparked nothing short of a revolution. "No other mechanism of management of similar scope and complexity has ever been introduced so rapidly," wrote one commentator just ten years later. "It is estimated that 80 percent of budgets installed in industry have been put in since 1922."

Up to that point, budgeting was a one-way exercise: Accountants added up all of a firm's expenses and then tossed in a sales projection almost as an afterthought. In McKinsey's view, companies should start by developing their business plan, figure out how to achieve it, and then estimate the costs of doing so. In this new context, budgeting wasn't just a ledger activity; it could also be used to identify excellence in performance (i.e., those who outperform their budget), to spot weaknesses (those who underperform), and to take corrective action. "[While] there are many who do not yet plan scientifically . . . ," he wrote, "there are few who will deny the merits of the system."

Two subsequent books fleshed out McKinsey's ideas: 1924's Managerial Accounting and Business Administration. The former taught students how accounting data could be used to solve business problems. Using the data of traditional recordkeeping, he suggested the possibility for much greater control over a company's destiny, including the establishment of standard procedures (how things should be done and to whom information should be reported), financial standards (ways to judge operating efficiency), and operating standards (including nonfinancial measures, such as quality). To today's business student, this kind of comprehensiveness seems obvious. But at the time, the idea of planning, directing, controlling, and improving decision making by means of regular and rigorous reporting of company results was novel. The latter book contained the seeds of McKinsey's General Survey Outline — a thirty-page system for understanding a company in its entirety, from finances to organization to competitive positioning. It became part of his consultants' toolkit sometime in the early 1930s.

Niche — What market segment provided their first customers?

Intellectual underpinnings aside, the firm's real-world roots were in red meat. McKinsey's first client was Armour & Company, one of the country's largest meatpackers. The treasurer of Armour had read Budgetary Control and wanted McKinsey to help rethink the meatpacker's approach to budgeting and planning.

The first partner McKinsey brought on board was A. Tom Kearney, who had been director of research at Swift & Company, another Chicago meatpacker. Kearney was a warmer, more congenial complement to McKinsey's formal and pointed demeanor. Another early partner was William Hemphill, the same treasurer of Armour who had hired McKinsey in the first place.

McKinsey continued to teach at the University of Chicago for a time, but he eventually switched full-time to the firm. One reason he seems to have juggled so many responsibilities is that he didn't waste time with niceties at the office. In Hal Higdon's 1970 history of consulting, The Business Healers, one associate recalled him saying: "I have to be diplomatic with our clients. But I don't have to be diplomatic with you bastards." (Marvin Bower later modeled his own approach to constructive criticism after McKinsey's tough love approach.)

McKinsey was blunt, but he was also a quick and agile thinker. He once diagnosed a client's problems just by looking at the company's letterhead. A Midwestern maker of air conditioners had stationery that announced "Industrial Air Conditioning Installations — Coast to Coast from Canada to Mexico." In an era before salespeople traveled by airline, McKinsey observed that travel expenses were probably eating up the majority of the company's profits and that employees should confine themselves to a radius of five hundred miles around Chicago. He was right.

Founders — What was special about this team?

James O. McKinsey's confidence wasn't about something so tangible. Did you have a problem in your business? Let him have a look at it, and he was confident he could help you figure out what to do about it. Not only that, he promised to tell the rich and powerful what they were doing wrong. It was on these

two convictions that he founded the company that eventually became the most powerful consulting firm in the world. It was nervy, and it was new, and in that way it was a distinctly American business that helped shape the history of business itself.

Following his discharge at the age of twenty-nine, McKinsey continued to add to his list of credentials. In the span of a single decade, he managed to obtain a master's in accounting from the University of Chicago, was appointed an assistant professor of accounting at the university, and joined fellow professor George Frazer's accountancy firm of Frazer and Torbet. But that was not all. In 1923 he was named vice president of the American Association of University Instructors in Accounting, and in 1926 he became a professor of business policy at the University of Chicago.

He was a workaholic who was rarely at home. He once claimed that he ate all his lunches, half of his breakfasts, and a third of his dinners with prospective clients. When he was around, his children were not allowed to bother him while he was "working." While he had the ability to be warm and affable, he deployed those qualities only for work. He had no interest in literature or culture. While he joined many local clubs, he did it for professional contacts, not for the social or extracurricular pleasures of the clubs themselves.

Even though McKinsey's death at a relatively young age deprived him of the chance to properly reflect on his own career, he had already made it a long way from his days as a barefoot farm boy in the Ozarks, and he died as one of the most respected businessmen and innovators of his era. He didn't just understand the needs of the giant corporations that were reshaping American society in their own image — he anticipated those needs and helped companies solve problems they didn't even know they had.