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## **Public submission to the Finance and Public Administration References Committee Inquiry into the management and assurance of integrity by consulting services**

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### **Introductory note**

1. We are grateful for the opportunity to submit to the Finance and Public Administration References Committee Inquiry into the management and assurance of integrity by consulting services. We write in our capacity as academics based at University College London's Institute for Innovation and Public Purpose, where our research explores, among other areas, the role of the consulting industry in government and the economy, public sector capacity, and public sector procurement.
2. Professor Mazzucato is Professor in the Economics of Innovation and Public Value at University College London (UCL), where she is Founding Director of the UCL Institute for Innovation & Public Purpose (IIPP). She is winner of international prizes including the Grande Ufficiale Ordine al Merito della Repubblica Italiana in 2021, Italy's highest civilian honour, the 2020 John von Neumann Award, the 2019 All European Academies Madame de Staël Prize for Cultural Values, and 2018 Leontief Prize for Advancing the Frontiers of Economic Thought. She advises policymakers around the world on innovation-led inclusive and sustainable growth. Her current roles include being Chair of the World Health Organization's Council on the Economics of Health for All, Co-Chair of the Global Commission on the Economics of Water, a member of the South African President's Economic Advisory Council, the Scottish Government's Council of Economic Advisors, the European Space Agency's High-Level Advisory Group on Human and Robotic Space Exploration for Europe, and the United Nations High-level Advisory Board (HLAB) on Economic and Social Affairs, among others.
3. Our acclaimed recent book, *The Big Con: How the Consulting Industry Weakens our Businesses, Infantilizes our Governments and Warps our Economies*, explores issues with how governments around the world contract management

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consultancies, including the risks of conflicting interests in these arrangements. The book focuses on the 'Big Three' (McKinsey, Bain & Company and Boston Consulting Group) and the 'Big Four' (Deloitte, KPMG, EY and PwC). We provide responses to the terms of reference below.

**a. The management of conflicts of interest by consultants**

4. The risk of conflicting interests in government contracting of management consultancies has long been recognised in academic research. However, it remains an underexplored challenge within most government settings. In *The Big Con*, we identify three forms that conflicts of interest can arise in government contracting.
5. The first arises when a company contracted to undertake financial advice in government, for example, on debt restructuring or privatisation, is positioned to directly benefit financially from that advice. Although this is rare among the 'Big Three' and the 'Big Four', as only McKinsey has an investment arm (MIO Partners), it is important for governments to be aware of. In 2021, for example, the US Securities and Exchange Commission (SEC) fined MIO Partners \$18 million after finding that the company was 'investing hundreds of millions of dollars in companies that McKinsey was advising', and that some McKinsey partners had overseeing the investments also had access to material nonpublic information as a result of their McKinsey consulting work. These clients included the Oversight Board, a body set up by the US government to supervise the bankruptcy process in Puerto Rico.
6. The SEC found that in January and February 2017, active McKinseyPartners who had access to material nonpublic information were on the Investment Committee of MIO Partners, overseeing investments including the sale of \$1 million of Puerto Rico Bonds. Until at least June 2017, the fund also invested in the territory's debt via its separately management accounts and other funds. The SEC concluded that "considering the nature of MIO's business, including the Investment Committee's oversight of MIO's investment decisions, the risk of misuse of material nonpublic information was real and significant".<sup>1</sup>
7. The risk of conflicting interests arising indirectly can occur when consultancies are contracted to provide policy advice that benefits or can be seen to protect the material interests of their clients.
8. For example, in 2021, the Australian government was met with criticism from the academic community and the media after it transpired that McKinsey had been

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<sup>1</sup> Securities and Exchange Commission, "Investment Advisers Act of 1940, Release No. 5912, Administrative Proceeding File No. 3-20656, In the Matter of MIO Partners, Inc." (2021), <https://www.sec.gov/litigation/admin/2021/ia-5912.pdf>.

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contracted to provide analysis as part of the national net zero strategy. It was suggested that the modeling underpinning the strategy had a number of shortcomings, with one analyst finding that the plan would ‘fall 215 metric tons short of reaching only an 85% reduction [in emissions] by 2050’. In light of this, commentators questioned the role that conflicting interests within McKinsey had played in the advice provided to the Australian government, pointing out that the consultancy had previously been contracted to advise 43 of the 100 biggest carbon polluters.<sup>2</sup>

9. Risks of conflicting interests may also arise because information derived from providing government contracts may be considered material by the consulting company.
10. In 2013, an inquiry by the parliamentary Public Accounts Committee in the United Kingdom found that Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers had all seconded staff to the Treasury to ‘provide tax technical input and commercial experience’. In tax law on transfer pricing, there were ‘four times as many staff working for the four firms than for HMRC’. The Public Accounts Committee inquiry was concerned ‘by the way the four firms appear to use their insider knowledge of legislation to sell clients advice on how to use those rules to pay less tax’. Its final report cited the example of KPMG, whose staff had been involved in developing ‘controlled foreign company’ and ‘patent box’ rules at the Treasury, following which KPMG had produced marketing brochures for potential business clients highlighting the role they had played in developing the law.<sup>3</sup>
11. A related issue that we explore in *The Big Con* is the practice of underbidding for government contracts that large management consultancies have engaged in to gain access to government departments. We are concerned about the occurrence of this when policies to reduce government spending on consultancies have been introduced, as happened in the United Kingdom during the 2010-2015 Coalition government. At this time, several multinational consultancies continued to provide services to central government departments pro bono or at a significantly reduced rate.<sup>4</sup>

**b. Measures to prevent conflicts of interest, breach of contract or any other unethical behaviour by consultants;**

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<sup>2</sup> Ketan Joshi, “Scott Morrison’s Net Zero Modelling Reveals a Slow, Lazy and Shockingly Irresponsible Approach to ‘Climate Action,’” *The Guardian*, November 12, 2021, sec. Environment, <https://www.theguardian.com/environment/2021/nov/13/scott-morrison-net-zero-modelling-reveals-a-slow-lazy-and-shockingly-irresponsible-approach-to-climate-action>.

<sup>3</sup> Rajeev Syal, Simon Bowers, and Patrick Wintour, “‘Big Four’ Accountants ‘Use Knowledge of Treasury to Help Rich Avoid Tax,’” *The Guardian*, April 26, 2013, sec. Business, <http://www.theguardian.com/business/2013/apr/26/accountancy-firms-knowledge-treasury-avoid-tax>.

<sup>4</sup> Mariana Mazzucato and Rosie Collington, *The Big Con: How the Consulting Industry Weakens Our Businesses, Infantilizes Our Governments and Warps Our Economies* (Allen Lane, 2023), 26.

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**c. Enforcement measures taken in response to integrity breaches, such as the inadequate management of conflicts of interest, breach of contract or any other unethical behaviour by consultants;**

12. Management consultancies, for their part, contend that internal processes are in place to prevent conflicts of interest. As in the case of the SEC investigation described in point 6, however, regulatory bodies have reached different conclusions.
13. National rules on government use of individual consultancies have also been introduced in the wake of findings of unethical behaviour. For example, in August 2022, the government of the United Kingdom announced that it would bar Bain & Company from tendering for UK government contracts after its alleged role in a corruption scandal in South Africa. This was overturned in March 2023.
14. Individual management consultants are subject, of course, to domestic laws governing criminal and fraudulent activity.
15. However, unlike in other professional services of auditing and law, management consulting is not a protected or regulated profession. Despite attempts in the twentieth century to introduce governing standards and norms for management consultants, there remains no international binding standard. As a consequence, unlike in auditing, for example, management consultants cannot formally be stripped of their title in case of unethical behaviour. Auditing firms and individuals can be sanctioned by regulators for failing to meet the standards required for an audit, but this is not the case in consulting.
16. Issues related to breach of contracts can be challenging in government consulting contracts, although efforts have been made in countries like the United Kingdom to remedy these.
17. A key challenge relates to the identification and quantification of risk. In the case of some contracts, such as in public services outsourcing, a firm can be made liable to pay a penalty for failing to provide a service for a period within the agreed contract term. But often, the risks of outsourcing can be difficult for governments to identify in advance, owing to commercial secrecy within the contractor. Even when the nature of the risks is accounted for in a contract, quantifying the costs to the client of them coming to fruition presents a further cost.
18. A further challenge for governments seeking to manage breach of contracts with management consultancies relates to the (often) qualitative and ambiguous nature of consulting services contracts. The interactive nature of consultants' relationship with clients can make it challenging for clients to convincingly pinpoint blame.

**d. The management of risks to public sector integrity arising from the engagement of consultants;**

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**e. The transparency of work undertaken by consultants, and the accountability of consultants for this work; and**

19. We are concerned about issues of accountability and public sector integrity that arise from issues with the transparency of work undertaken by consultants in government.
20. In democratic societies, it is important for citizens and government organisations to know about the potential conflicts of interests that another organisation has when it enters into a contract with them. This is so that they can be addressed and mitigated, if that is possible. The government organisation may also assess that the risk of a conflicting interest undermining public integrity or the public value objectives of the government is so great that it is not worth engaging with a consultancy.
21. As it stands, there are no rules mandating consulting companies to disclose information about who they work for. Some companies' financial reports describe the amount of revenue that is received within a particular industry or geographic region.
22. In other areas, citizens and businesses concerned that these issues could arise have lobbied governments to publish information about their contracts with third parties, and many transparency platforms are now in place. In the United Kingdom, access to information about consulting and procurement contracts during the COVID-19 pandemic has enabled civil society groups and journalists to scrutinise potential conflicts of interests. We suggest that a similar platform could be expanded to cover all consulting contracts in government. We also propose that companies providing consulting advice could be mandated to disclose conflicting interest risks to clients.
23. To mitigate the risks related to consultancies providing services pro bono or at rates below market rates, we also suggest that, when seeking advice from other organisations, public sector clients should calculate the appropriate economic value for the contract in advance, while still seeking a competitive price.

**f. Any other related matters.**

24. While we wholeheartedly agree that conflicts of interest pose a risk in governments' use of consultancies, we would also like to highlight the critical risk to public sector capacity that can arise when government organisations become dependent on external consultants as a source of capacity. We recognise that this risk is particularly acute in the public sectors of Anglo-Saxon economies, where the public sector reform programme of New Public Management has, at crucial times, led to the increase of outsourcing. As we discuss in *The Big Con*, the use

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of consultancies at scale and scope and undermine the evolution of capacity internally within organisations, which can render it more challenging for them to adapt in response to evolving policy challenges. Crucially, it may also undermine capacity for evaluating the claims of tendering consultancies and managing contracts with them.

25. We recognise that it is necessary for governments to work with knowledgeable and experienced organisations in order to develop relevant capacity to meet democratic, environmental and social needs. The collective intelligence that is necessary for confronting the greatest challenges of our time – from the climate crisis to the COVID-19 pandemic – is created across our economies when governments are able to identify and work mutualistically with these organisations.