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Panel 2d: The Politics of Policy Making and Policy Advice

The management consultancy effect: privatisation, inefficiency and sub-optimal use of external advice

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Introduction

- Use of management consultants (MCs) ubiquitous in the public sector (Laspley and Oldfield, 2001; Saint-Martin, 2012)
- Global demand for MC advice from governments has grown exponentially (Markham and O'Mahoney, 2013; Stone and Ladi, 2015)
- In the UK, contracts with the public sector amounts to 25% of total fee income (MCA, 2017)

- Transaction Cost Economics (TCE) suggests that, in certain conditions, this is rational and functional (Coase 1937; Williamson 1975, 1985), but is this true?

TCE

- Production costs vs. Transaction costs (TCs)
- Make (in-house) vs Buy (market) decision

  When is it rational to use MCs?

- Low asset specific human capital, low uncertainty and low frequency
- MCs are capable of reducing TCs because of economies of scale and scope

Moral hazard

- Opportunism of MCs (Canback, 1998; Armbruster, 2006):
  - Maximise transferability
  - Reduction in asset specific investments
  - Commodification strategies

- Project fit risk?
- Poor implementation?

Critique of TCE

- Critical perspectives:
  - Need for legitimacy (Meyer and Rowan, 1977; DiMaggio and Powell, 1983)
  - Role of social ties (Granovetter, 1985; Powell, 1990)
  - Clients' conscious decisions (Sturdy et al., 2009; Sturdy, 2011)

- Demand for MCs is not (wholly) rational but inflated:
  - Influenced by processes of social interaction (Uzzi, 1993)
  - Inflated by the agency of MCs

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Main hypotheses

H1: Social embeddedness will inflate demand for MCs services

H2: Inflated demand for MC advice will have a combined pejorative effect on efficiency

- Focus on privatisation practices
  - MCs have been very active in this space
  - Example of advice not human capital asset specific

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Research context

- English Acute Care Hospital Sector (85% public - NHS)
- Four years of data (2009/10-2012/13)
- Unbalanced panel of 120 hospital trusts
  - In 2012/13 572,900 FTE employees
  - 11.7 million patient admissions
  - Total expenditure of £39 billion
  - £166.8 million spent on MCs
    - Over the four years £590.5 million in total
    - average £1.2 million per hospital trust

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Key variables

- MC use = annual expenditure for consulting services
- Privatisation practices
  - Outsourcing of non-clinical services to a third party
  - Contingent (variable) finance costs on Private Finance Initiative (PFI) contracts
- Organisational efficiency
  - Reference Cost Index (RCI) = average unit cost
  - Adjusted cost efficiency = Total expenditure adjusted for hospital trust size

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Are MCs agents of privatisation practices?

	Model 1	Model 2
	Dependent Variable	
	Contracted-out services	Contingent PFI finance costs
	Random Effect	Tobit
Consultancy services	0.0013**	0.0001*
	(0.0006)	(0.0001)
Teaching status	11.0483	-0.2334
	(6.7282)	(0.6480)
FT status	-4.1818	-0.9034***
	(2.5992)	(0.3185)
Size	0.0038	0.0012*
	(0.0065)	(0.0006)
Activity	0.6135**	-0.0886***
	(0.2746)	(0.0308)
Operational slack	-24.0025	-1.8161
	(16.0081)	(1.9908)
Structural complexity	0.1700*	-0.0303**
	(0.0989)	(0.0150)
HHI	0.0014	0.0000
	(0.0049)	(0.0005)
Market forces factor	7.1172	0.8025
	(59.4478)	(5.0920)
London effect	27.4947**	0.2877
	(10.7614)	(0.9531)
Population served	-0.0000	0.0000
	(0.0000)	(0.0000)
Year dummies	Yes	Yes
No. observations	442	404
Wald-Chi²/Adj-R^2	0.189	108.84***
F-Test	46.62***	
Hausman test	0.796	

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Do MCs inflate demand for their services?

	Model 1	Model 2	Model 3
	Dependent variable		
	Consultancy services		
Consultancy services t-1	0.5884***	0.5234***	0.5229***
	(0.0684)	(0.0879)	(0.0880)
Contracted-out services t-1	0.0802		0.3088
	(1.6659)		(2.3622)
Contingent PFI finance costs t-1		-32.5336	-35.3960
		(34.2300)	(39.8726)
Teaching status	169.1456	77.5385	75.8214
	(159.7289)	(189.4255)	(187.4653)
FT status	15.5479	-9.7630	-9.4349
	(97.2384)	(108.8386)	(109.1696)
Size	0.4552**	0.5405**	0.5388**
	(0.1801)	(0.2369)	(0.2383)
Activity	-21.6186*	-18.8318	-19.1013
	(12.3711)	(14.2312)	(14.2708)
Operational slack	-541.8862	-1,078.5049	-1,067.9080
	(854.5173)	(1,034.5333)	(1,042.0682)
Structural complexity	-0.0844	2.2179	2.0934
	(5.4801)	(6.4115)	(6.7201)
HHI	-0.1615	-0.2444*	-0.2443*
	(0.1237)	(0.1331)	(0.1330)
Market forces factor	1,142.5266	1,923.1087*	1,905.2916*
	(927.4075)	(1,138.7873)	(1,132.3620)
London effect	16.6809	-67.5673	-74.0701
	(159.8349)	(194.8555)	(203.9975)
Population served	-0.0002	-0.0001	-0.0000
	(0.0003)	(0.0004)	(0.0004)
Year dummies	Yes	Yes	Yes
Observations	408	321	321
R-squared	0.4821	0.4169	0.4169
Wald-Chi^2	286.89***	195.76***	195.82***

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Do MCs use and adoption of privatisation policies affect efficiency?

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	Dependent variable					
	Op efficiency	Op efficiency	Op efficiency	Adj costs eff	Adj costs eff	Adj costs eff
Consultancy services	0.0008***			0.0124***		
	(0.0002)			(0.0038)		
Contracted-out services		0.0222*			0.1612	
		(0.0114)			(0.1534)	
Contingent PFI finance costs			0.5392**			3.0009
			(0.2322)			(3.2613)
Teaching status	0.8873	0.9483	1.3467	77.9677***	75.7694***	84.5251***
	(0.9275)	(0.9749)	(0.9791)	(14.0262)	(14.3313)	(15.2692)
FT status	-1.5829**	-1.4921**	-1.3842**	-32.4419***	-28.8385***	-31.8780***
	(0.6398)	(0.6471)	(0.6575)	(8.8501)	(9.2357)	(9.1062)
Size	-0.0004	0.0002	0.0002	-0.0229	-0.0073	-0.0036
	(0.0010)	(0.0010)	(0.0010)	(0.0155)	(0.0139)	(0.0142)
Activity	-0.2259**	-0.2892***	-0.2549***	-5.2216***	-6.1159***	-5.8000***
	(0.0916)	(0.0944)	(0.0955)	(1.2051)	(1.2348)	(1.2649)
Operational slack	8.5055	8.0315	7.2821	-93.7464	-114.6958	-129.6412*
	(5.4872)	(5.5593)	(5.7388)	(73.6643)	(76.8005)	(77.1536)
Structural complexity	-0.0632**	-0.0771**	-0.0663**	0.4786	0.2896	0.3359
	(0.0313)	(0.0323)	(0.0318)	(0.4048)	(0.4094)	(0.4074)
HHI	0.0009	0.0008	0.0006	0.0009	-0.0008	-0.0002
	(0.0010)	(0.0010)	(0.0010)	(0.0125)	(0.0123)	(0.0120)
Market forces factor	-34.3882***	-32.5864***	-31.4875***	163.7861	201.8582	267.7922*
	(8.1036)	(8.1359)	(8.3120)	(133.5491)	(131.1137)	(137.7332)
London effect	3.2594**	2.6283*	2.9753**	44.6443**	35.4350	34.9774
	(1.3662)	(1.3617)	(1.4086)	(21.8313)	(22.4858)	(22.9176)
Population served	0.0000	0.0000	0.0000	-0.0000	0.0000	0.0000
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0001)	(0.0001)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	402	406	393	403	406	394
R-squared	0.9092	0.9173	0.9101	0.5397	0.5332	0.5365
Wald-Chi^2	99.05***	87.48***	90.45***	460.54***	415.73***	417.04***

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Does inflated demand for MCs have a cumulative, pejorative effect?

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
	Dependent variable					
	Operational efficiency	Operational efficiency	Operational efficiency	Adjusted costs efficiency	Adjusted costs efficiency	Adjusted costs efficiency
Consultancy services	0.0009***	0.0009***	0.0008***	0.0083***	0.0079***	0.0064**
	(0.0002)	(0.0002)	(0.0002)	(0.0031)	(0.0030)	(0.0029)
Contracted-out services	0.0165*		0.0128	0.3176***		0.2572*
	(0.0092)		(0.0125)	(0.1126)		(0.1367)
Consultancy services x Contracted-out services	0.0000*		0.0000**	0.0002*		-0.0001
	(0.0000)		(0.0000)	(0.0001)		(0.0001)
Contingent PFI finance costs		0.4299***	0.3888		6.4976***	7.6897**
		(0.1593)	(0.3004)		(2.2116)	(3.1379)
Consultancy services x Contingent PFI finance costs		0.0004***	-0.0001		0.0044*	0.0001
		(0.0001)	(0.0002)		(0.0025)	(0.0032)
Contracted-out services x Contingent PFI finance costs			-0.0062			-0.1556*
			(0.0075)			(0.0836)
Consultancy services x Contracted-out services x Contingent PFI finance costs			0.0000***			0.0002*
			(0.0000)			(0.0001)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	397	385	385	392	387	391
R-squared	0.9957	0.9958	0.996	0.9413	0.9383	0.921
Wald-Chi^2	162.97***	215.49***	295.29***	1081.40***	1161.04***	1033.83***

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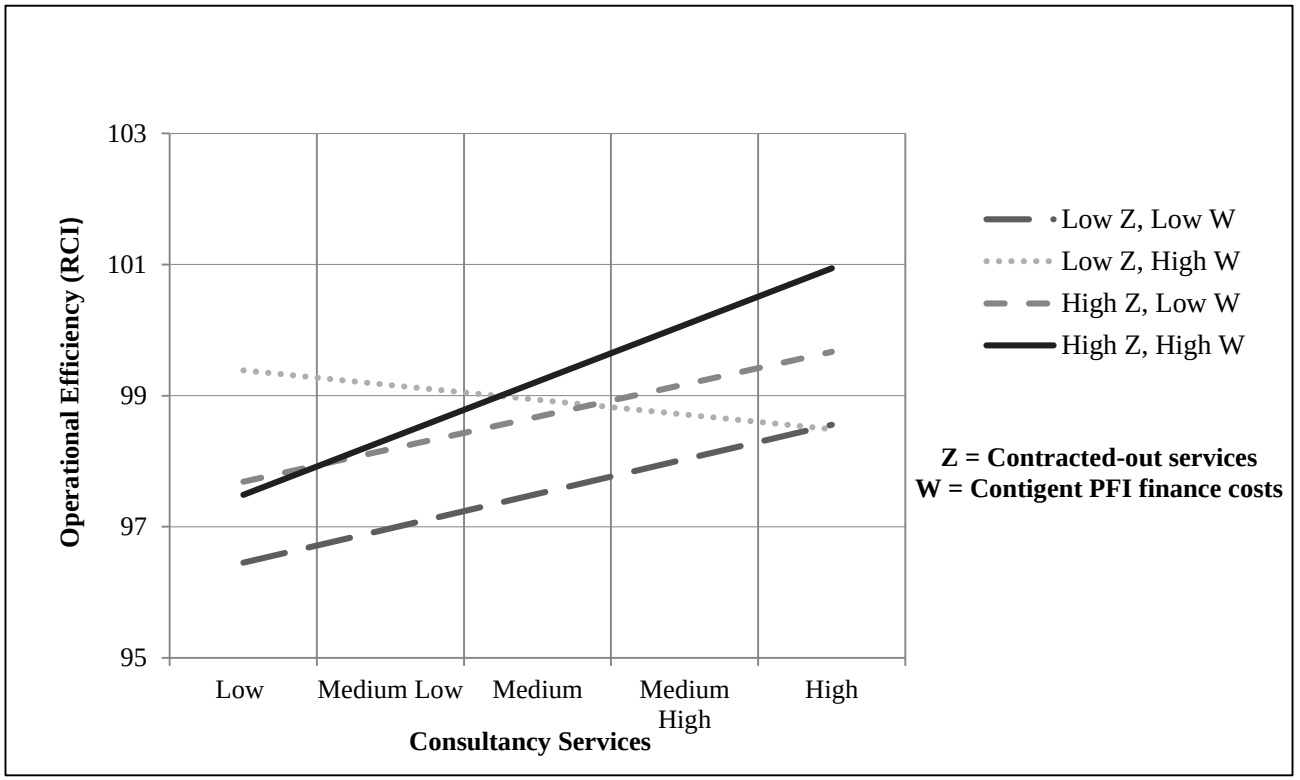
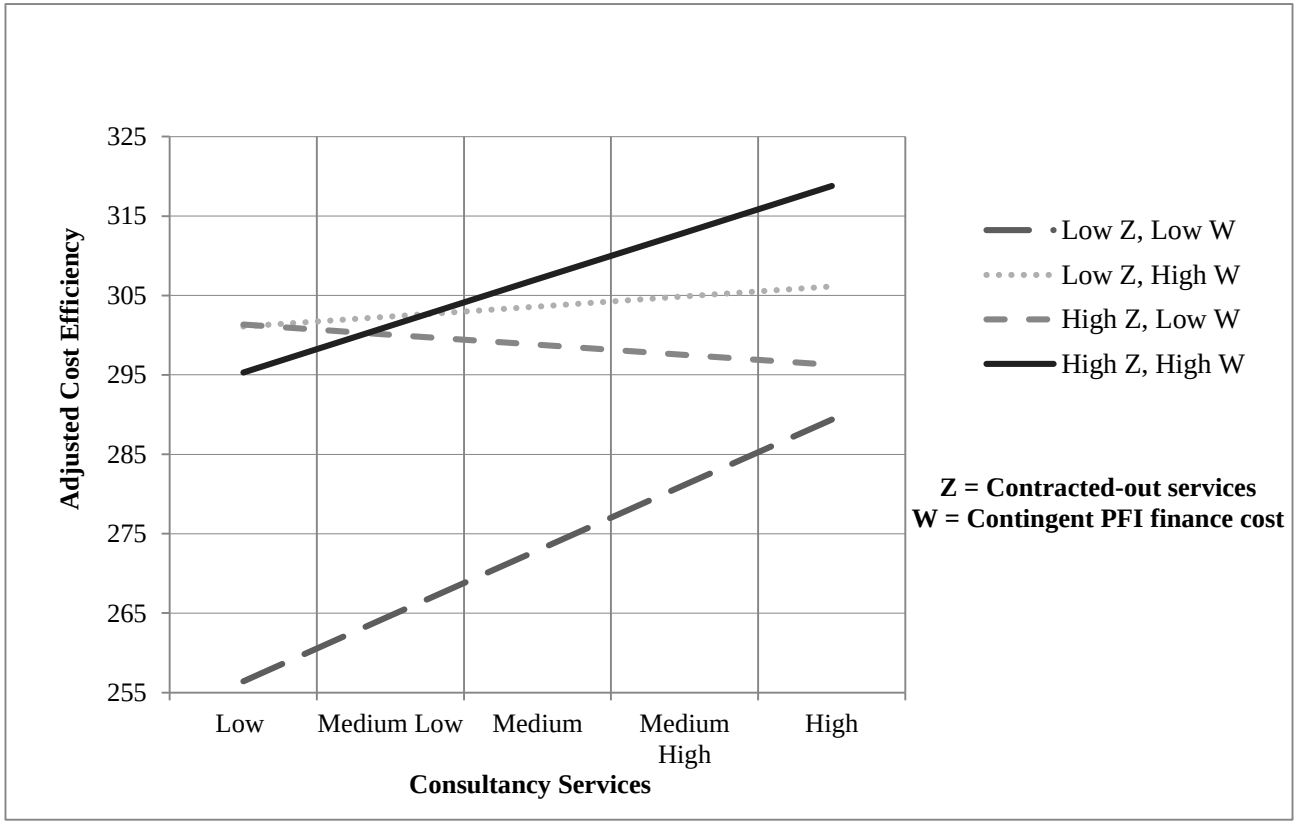
Operational efficiency at different levels of adoption of privatisation practices



Adjusted cost efficiency at different levels of adoption of privatisation practices



Summary

- Adoption of privatisation practices is greater in organisations that spend more on MCs
- Demand for MCs services is socially over-embedded (inflated)
- Inflated demand for MCs advice has a combined pejorative impact on efficiency