By Johan Fourie

MANAGEMENT

Do consultants add value?

Two studies, undertaken years apart and based on the results of an experiment involving several Indian textile companies, provide interesting insights on whether management consulting is effective.

That good managers are vital for corporate success should not come as a surprise. Early economists like Alfred Marshall, back in the 19 century, had noted the importance of good management practices to drive productivity. But because managers' behaviour is such a difficult thing to quantify, economists have struggled to measure how important good management practices are in explaining a firm's success.

In 2008, five leading economists from Stanford University and the World Bank tackled this difficult question. They wanted to know whether investing in good management practices improve productivity and profits, and so, between 2008 and 2010, they conducted a large field experiment in India.

They approached large, multi-plant Indian textile firms and divided them in two groups. One group – the treatment group – was given five months of extensive management consulting by a large international consulting firm. This included a month of diagnosis, where the consulting firm would find opportunities for improvement, and four months of intensive support for the implementation of these strategies.

Successful firms thrive because of good managers. The key is to hang on to them, empower them with the ability to make decisions, and free up their time.

In contrast, the other group – the control group – received only one month of diagnostic consulting, but no intensive follow-up.

At the end of the study, in 2011, the researchers tested the performance of the firms in the two groups. The results, published in *The Quarterly Journal of Economics* in 2013, were quite remarkable. Even with just four months of follow-up, those in the treatment group saw an increase of 11% in productivity, and an increase in annual profitability of about $230 000.

Interestingly, firms also spread these management improvements from their treatment plants to other plants they owned, creating positive spillovers that resulted in returns that far outstripped the initial investment.

What made the difference? The authors suggest two reasons for the improvements: First, owners delegated greater decision-making power over hiring, investment and pay to their plant managers. "This happened in large part because the improved collection and dissemination of information that was part of the change process enables owners to monitor their plant managers better."

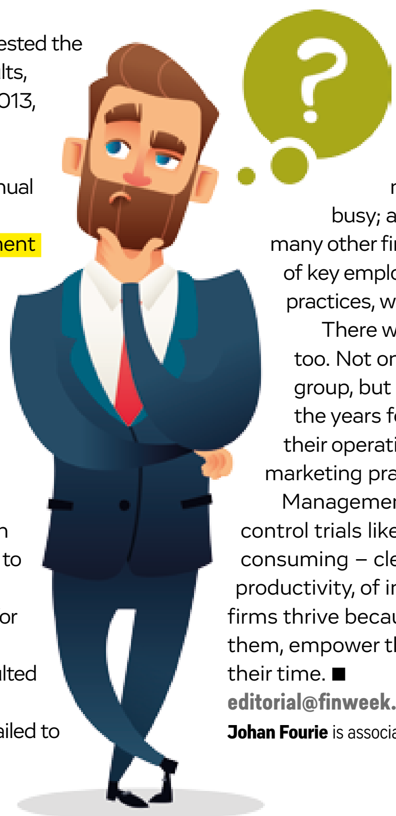
Second, the extensive data collection necessary for quality control, for example, led to a rapid increase in computer use. Better information management resulted in better performance.

The concern with the study, though, was that it failed to measure the persistence in performance. Did the differences between the treatment and the control group wither away as soon as the management consultants left, or did they persist for a month, a year, or even longer?

To answer this question, almost the same team of authors returned to India in 2017 to measure the performance of the firms eight years after the initial intervention. Their results appeared in an NBER working paper in February.

It seems that management practices do persist. Despite the fact that several firms (in both the treatment and control group) dropped some of the management practices that were initially proposed by the consultants, the difference between the two groups were still large – worker productivity is 35% higher in the treatment group compared to the control group.

The spillover effects, in particular, were still there: in fact, in most cases, the plants that did not receive treatment but were part of the same firm were indistinguishable from the plants that did receive management consulting services. As the authors note: While "few management practices had demonstrably spread across the firms in the study, many had spread within firms, from the experimental plants to the non-experimental plants, suggesting limited spillovers between firms but large spillovers within firms".



The authors were also able to collect information on the reasons certain management practices were dropped over the period of eight years. Three reasons were frequently mentioned: the new management practices faded when the plant manager left the firm; when the directors, notably the CEO and chief financial officer, were too busy; and when the practice was not commonly used in many other firms. "The first two reasons highlight the importance of key employees within the firm for driving management practices, while the latter emphasizes the importance of beliefs."

There were other surprising consequences of intervention too. Not only was worker productivity higher in the treatment group, but treated firms continued to use consulting services in the years following the initial intervention, not only improving their operational management practices, but also their marketing practices.

Management consultants often get a bad rap, but random control trials like these – experiments that are costly and time-consuming – clearly demonstrate the advantages, in profits and productivity, of investing in good management practices. Successful firms thrive because of good managers. The key is to hang on to them, empower them with the ability to make decisions, and free up their time. ■

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