Exploring the Use and Usefulness of Governance Mechanisms – The Case of Clients’ Dealings with Knowledge-intensive Suppliers

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Abstract

Research on corporate governance has focused mainly on investigating companies’ internal relations. Every company, however, has several contractual relations with external partners like customers or suppliers. This has prompted Hambrick et al. (2008) to call for research on the mechanisms that govern external relations. Responding to that call, this article investigates the external relations between companies and service providers using the example of the consulting industry, as consultancy has become a service that most companies use as a matter of course. From the perspective of agency theory, we develop a model about the governance approaches of clients to dealing with consultancies, and discuss dependences between expenditure on consulting services and the establishment of consulting governance mechanisms (CGMs). We also discuss the dependence between CGMs and the respondents’ perceptions of problems commonly associated with dealing with consultancies. Our hypotheses are tested on the basis of a survey involving 500 of the largest German companies.

Keywords: agency theory, corporate governance, governance mechanisms, management consulting

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Introduction

Although the issue of corporate governance is as old as social institutions (Kay and Silberston, 1995), debates about corporate governance were first established in the 1990s (Jackson and Carter, 1995). Since then, this topic has gained increased attention in the academic and practical literature (e.g. Aguilera and Cuervo-Cazurra, 2004; Child and Rodriges, 2003; Letza and Sun, 2002; Enriques and Volpin, 2007).

Debates on corporate governance cover primarily two perspectives. The first perspective concerns corporate governance within organisations (e.g. Tirole, 2001; Aguilera and Cuervo-Cazurra, 2004); more specifically, governance relations between shareholders and the board of directors or between the board of directors and top management (Fama and Jensen, 1983; Aguilera and Cuervo-Cazurra, 2004; Sinha, 2006), as well as using governance mechanisms to reduce potential opportunistic behaviour (Baysinger and Butler, 1985; Dalton et al., 1998; Dahya et al., 2002; Pearce and Zahra, 1992). The second perspective concerns external markets for corporate control (e.g. Walsh and Seward, 1990), such as the role of auditing firms on companies’ corporate governance (e.g. DeAngelo, 1981; Farber, 2005). A third perspective, which has not been sufficiently addressed yet, concerns the governance of external relationships: companies have relationships with a variety of external partners (e.g. customers, suppliers), also susceptible to opportunism, which has recently led to a call for more research on governance mechanisms that manage external partners (e.g. Hambrick et al., 2008). Heeding the latter call, here we focus on management consulting as an example of such relationships. The management consulting industry is not only one of the fastest growing industries worldwide (Armbrüster and Glückler, 2007; Engwall and Kipping, 2002; Fincham and Clark, 2003) but also a service that has become routine for many modern managers (Czerniawska, 2005; MacDonald, 2006). Moreover, research has recently paid more attention to governance questions within the consulting context (e.g. Freedman and Stinson, 2004; Höner and Mohe, 2006; Mohe, 2005; Werr and Pemer, 2007). The increasing awareness of how clients approach consultants may spring from the impression that several consulting projects fail (e.g. Appelbaum and Steed, 2005; Czander, 2001; Fullerton and West, 1996; Schaffer, 1997; Smith, 2002; Zackrison and Freedman, 2003) or have sometimes disastrous consequences for the organisation (Byrne, 2002; O’Shea and Madigan, 1997; Sorge and van Witteloostuijn, 2004). Furthermore, because of the extensive use of consultants, clients
themselves have lost their control over the internal ‘consulting landscape’ (Mohe, 2005; Werr and Pemer, 2007).

A review of the sparse literature on clients reveals that research focusing on the client perspective presents an ambiguous picture: on the one hand, clients are portrayed as ‘uncertain and gullible’ (Kitay and Wright, 2004, p. 3), ‘powerless victims’ (Sturdy, 1997), ‘marionettes’ (Kieser, 2002), or ‘passive consumers’ (Fincham, 1999) of consulting services. On the other hand, the passive role of managers is increasingly questioned and the notion that clients are becoming more sophisticated is put forward (Czerniawska, 2005; Fincham, 1999; Haferkamp and Drescher, 2006; Kakabadse et al., 2006; Mohe, 2005; Niewiem and Richter, 2004; Werr and Pemer, 2007; Werr and Styhre, 2003; Williams, 2001). Thus, there is a need to investigate further the perspectives of clients when dealing with consultancies.

In this article, we explore the clients’ approaches to governing consultants both theoretically and empirically. Our theoretical framework is agency theory, which has been widely used in corporate governance debates for discussing different relationships between principals and agents (Lubatkin et al., 2005). Although client–consultant relationships ‘are particularly susceptible to analysis by agency theory’ (Fincham, 2003, p. 72), relevant research has only paid little attention to the consulting context (for the few exceptions see Bennet and Smith, 2004; Fincham, 2003; Gallouj, 1996; Mohe and Höner, 2006; Sharma, 1997) and so far neglected the use of the governance mechanisms that clients use when dealing with consultancies. Thus, substantial studies in this field are rather sparse. The available ones are primarily based on (single-)case studies (e.g. Mohe and Höner, 2006; Reifenscheidt, 2007; Werr and Pemer, 2007). Here, we aim at enriching the debate by providing empirical data from a large-scale survey of the 500 largest companies in Germany. Our overall aim is to identify and discuss consulting governance mechanisms that are currently applied in practice, and thus to explore further hitherto under-researched client perspectives and contribute to the general debate on corporate governance with regard to consulting issues.

Our article is structured as follows: in the first part, we conceptualise the consulting situation from an agency theory perspective and develop hypotheses which are empirically tested in the following section. Subsequently, we discuss our findings referring to agency theory. Finally, we summarise our findings and conclude with an overview of the relevant limitations and implications for future research.
The client from an agency theory perspective

Agency theory focuses on the contractual relationship between the client as principal and the consultant as agent (Eisenhardt, 1989). Because the principal is not able to manage a certain task alone, lacking the time and the ability, he or she delegates authority to the agent, (Eisenhardt, 1989; Shapiro, 2005). Delegating the task to the agent, however, entails certain problems for the principal, which are caused by (1) a divergence of goals and (2) an asymmetric distribution of information between principal and agent.

(1) Normally, principal and agent do not have the same goals, because each party seeks to maximise its individual utility (Fama, 1980; Fama and Jensen, 1983). Since the general utility is assumed to be a zero-sum game, a higher utility for the one side means lower utility for the other. Therefore, the principal’s task is to ensure that the agent accomplishes his or her goals.

(2) Agency theory assumes that information in a principal–agent relationship is asymmetrically distributed, with the agent having an edge over the principal (Eisenhardt, 1989; Pratt and Zeckhauser, 1985). Consequently, the principal is neither aware of the agent’s goals nor able to completely assess the agent’s work. This gives the agent the possibility to act opportunistically against the principal’s welfare (Barney and Hesterley, 2003).

Both assumptions cause specific agency-related, or so called ‘hidden’, problems for the principal. These concern hidden characteristics, intentions, information and action (Arrow, 1985). Through the examples we use to illustrate these general propositions, it becomes obvious that clients are confronted with a broad range of agency problems in their dealings with consultancies. Since a client lacks information on the qualifications and performance of the consultants, and because of the ambiguous nature of consulting services (Alvesson, 2001; Fincham, 2003), selecting consultancies and defining the consulting assignment entail certain problems (e.g. Bennet and Smith, 2004). Because of the consultants’ potentially opportunistic behaviour, clients have to deal also with the problems of contract negotiations and project management. ‘Hidden information’ refers to the possibility that consultants may make use of knowledge that is not open to their clients. If they do so, information asymmetry counteracts knowledge transfer to the client, which makes it difficult for the client to take in and use the consultant’s knowledge. Hence, involving the clients’ employees efficiently in consulting projects could reduce the problems of information asymmetry and enhance the transfer of knowledge. Finally, hidden actions on the part of the consultant may cause problems for the
client with regard to the evaluation and documentation of the consultant’s performance and therefore the company-wide coordination of consulting projects.

According to agency theory, the use of governance mechanisms is supposed to overcome the agency problems the client is confronted with in his or her dealings with consultancies (e.g. Eisenhardt, 1985; Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976; Shapiro, 2005; Szulkin, 1999). In our review of the relevant literature, we found three formal consulting governance mechanisms (CGMs), which are recommended and/or frequently used when dealing with consultancies: (1) establishing preferred suppliers (consultancies) with whom the company has basic agreements, which may include special conditions (Bäcklund and Werr, 2005; Werr and Pemer, 2007), (2) keeping control of the project management, which means that the client maintains overall responsibility for the project, defines its aims and how these will be accomplished (Adams, 2005; McLachlin, 1999), and (3) establishing a specialised central unit within the company, dedicated to dealing with consultants (Freedman and Stinson, 2004; Mohe, 2005; Schiele, 2005).

Besides these formal governance mechanisms, long-term relationships might also serve as a way of reducing agency problems (Eisenhardt, 1989). Such relationships are known to occur in consulting practice (Bäcklund and Werr, 2005; Glückler and Armbrüster, 2003; Kitay and Wright, 2004). The informal character of long-term relationships, however, makes it rather difficult to gather quantitative data, so here we focus on formal governance mechanisms.

Establishing preferred suppliers allows the client to minimise the problems of selecting consultants and drafting contracts, as it is possible to obtain detailed information about the qualification and performance of a consultant over several projects. For instance, contract negotiations are likely to be less of a problem with consultants who are eager to remain in the pool of preferred suppliers and who therefore can be expected to avoid opportunistic behaviour. It can also help minimise the problem of involving employees efficiently, because being part of a pool of preferred suppliers is a certain guarantee of securing project appointments, which can be an incentive for consultancies to share knowledge with their clients. Similar benefits arise when the client maintains overall control of a project. For instance, the establishment of a central unit can be seen as a governance mechanism that could help alleviate all agency problems mentioned above, as it offers several services.
ranging from support in the selection of consultants to their evaluation. Table 1 sums up the discussed agency problems and CGMs.

| INSERT TABLE 1 |

CGMs, however, are not appropriate for all client companies. From an agency perspective, implementing and maintaining CGMs incurs certain agency costs, such as additional time for controlling the project’s progress, paying the managers who run the central unit or the staff responsible for assembling and managing a pool of preferred suppliers. Thus, for a client who engages consultants sporadically, the introduction of CGMs results in additional costs but questionable benefits. Hence, we assume that high expenditure on consulting services which indicates a frequent usage of consultancies is likely to promote the introduction of CGMs.

Against this background, we can develop the following three hypotheses and their respective null hypotheses:

**H1:** The establishment of a pool of preferred suppliers is positively dependent on high expenditure on consulting services.

**H2:** The control of the project by the client is positively dependent on high expenditure on consulting services.

**H3:** The establishment of a central unit dedicated to dealing with consultants is positively dependent on the high expenditure on consulting services.

From an agency theory perspective, the implementation of governance mechanisms aims at reducing agency problems that the principal faces. On the basis of that perspective, the CGMs mentioned above should help clients reduce specific agency problems that occur in their dealings with consultancies, e.g. by increasing control over the consultant and the internal consulting landscape. Thus, a client who has adopted CGMs is likely to attach less importance to such agency problems than a client without such mechanisms in place. With that in mind, we can formulate our next hypotheses:
*H4: Clients with preferred suppliers attach less significance to the problems associated with dealing with consultancies than clients without such suppliers.*

*H5: Clients who remain in control of the project attach less significance to the problems associated with dealing with consultancies than clients who do not remain in control of the project.*

*H6: Clients with a central unit dedicated to consultancy issues attach less significance to the problems associated with dealing with consultancies than clients without such a central unit.*

Figure 1 integrates our hypotheses into our conceptual model:

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**Methodology**

The data we used to test our hypotheses were gathered in a survey of the 500 largest companies in Germany. To identify the 500 largest companies, we ranked them on the basis of the Hoppenstedt database (Hoppenstedt, 2008), a large German provider of information on companies. The rankings in that database, however, are solely based either on turnover or number of employees. Since this would overemphasise either capital-intensive or labour-intensive industries, we combined the Hoppenstedt rankings and assembled a new database, weighting both factors equally.

Our investigation was conducted by means of a web-based survey communicated to the selected companies by email. Online surveys and communication by email have certain advantages. For instance, email offers speed and minimal cost, compared to conventional post (Cook *et al.*, 2000; Truell *et al.*, 2002), and a webpage can be designed so that respondents have the option to skip questions (Fricker and Schonlau, 2002). However, there are also some disadvantages; in particular lower response rates (Anderson and Gansneder, 1995; Cook *et al.*, 2000; Kittleson 1995; Kwak and Radler, 2002; Yun and Trumbo, 2000) or the likelihood
that respondents do not answer the entire questionnaire (Bachman et al., 1996; Paolo et al., 2000; Truell et al., 2002).

To address these problems we followed recommendations we found in the relevant literature, which concern the process and construction of online surveys: as advised by Cook et al. (2000), preliminary contact with the target list of companies was established through several phone calls: firstly, we called the 500 companies on our list and asked to be put in touch with the key member of in-house staff responsible for consultancy matters. Secondly, we called the contacts (‘key informants’) personally to ask them to participate in the survey. During that call, we also stressed that the subject of the survey was of special interest to the respondents (Sills and Song, 2002) and that a management summary of the results would be available on demand. Additionally, we stated that their expert opinions were of particular interest and that their participation, and therefore assistance, highly valuable for the purposes of the survey (Porter and Whitcomb, 2003, 2005).

As a result of the second round of phone calls, we were able to personalise the emails (Porter and Whitcomb 2003) we subsequently sent and include the hyperlink and password for entering the online survey (Cook et al., 2000; Heerwegh, 2005; Heerwegh et al., 2005). The survey itself, however, was conducted anonymously. Additionally, in the email inviting respondents to take part in the survey, as well as in subsequent reminders, the stipulated deadline was stressed (Porter and Whitcomb, 2003). The technical implementation of the web interface made use of the online tool Unipark (Unipark, 2008). To control whether all links were functioning and whether the wording of the survey was clear, we ran pre-test using respondents who were not part of our sample.

The Sample of the Survey

A total of 91 companies refused to participate in our survey during the initial phase. Most of those (85.7%) referred to a general company policy of rejecting any invitation to participate in a survey. Others (7.7%) refused because of an unmanageable amount of requests to participate in surveys (one company stated that they received more than 20 a day), while 6.6% said ‘no’ because the subject was too sensitive. This left us with a sample of 409 companies. Out of those, 161 (39.4%) responded to our questionnaire. This response rate reflects the findings of the meta-analysis of an electronic survey carried out by Cook et al. (2002) where the mean
response rate was 39.6% (standard deviation 19.6%), including responses with incomplete data. From the 161 respondents, 79 companies stated that they either do not use any management consulting services (17.7%) or that questions on the use of management consulting services are handled by their parent company (82.3%). For these companies the questionnaire ended at this stage, because they were not able to provide further information on their dealings with consultants. Eighty-two companies (51.0%) that use consultants responded to our questionnaire. Table 2 presents the sample we compiled, in terms of number of employees and turnover.

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Findings

Our first finding reveals that almost half of the respondents’ companies have already resorted to CGMs to improve their dealings with consultants. Of those, 42.6% have developed a pool of preferred suppliers, while 1.5% were planning to establish this CGM within the 12 months following the survey. With respect to project control the picture was similar. In that case, 42.4% of our respondents stated that they would maintain overall control of the consulting project, 52.5% that they would be partly in control, while 5.1% would delegate project control to the consultants. A central unit dedicated to consultancy issues is already installed in 34.5% of the respondents’ companies, while a further 10.9% were going to establish CGMs within the 24 months following the survey.

As mentioned above, a central unit dedicated to dealing with consultancies can be seen as a governance mechanism, and as such, it may contain several sub-mechanisms. Therefore, we asked the respondents to describe the main tasks of their units. Most of the respondents (81.8%) stated that their central unit supports company managers during contract negotiations with consultants. Support in selecting qualified consultants was offered by 77.3% of such units, and in 68.2% cases those units offer assistance in the evaluation process. Assisting in project management (63.6%) and the coordination of company-wide consulting projects (59.1%) were also mentioned, whereas support in documenting consulting projects, and
integrating company employees in the consulting projects were seldom offered (6.0% in each case).

To test our first set of hypotheses (H1, H2, H3) we asked our respondents to state their expenditure on consulting services in the last fiscal year. According to their answers, one-third (33.3%) had no such information. Another 35.6% of the respondents’ companies had expenditures of less than 10 million euro, 14.4% between 11 and 45 million euro, and a further 14.4% had expenditures of more than 46 million euro.

The hypotheses H1 to H3 were tested by means of a contingency table. We sought to falsify the null hypotheses in order to exclude the possibility that expenditure on management consulting services is independent of the three CGMs – ‘establishment of a pool of preferred suppliers’, ‘project control’, and ‘establishment of a central unit dedicated to consultancy issues’. Typically, a chi-square test is used to establish whether the variables are independent of one another. However, in our case more than 20% of the cells in our contingency table have an expected value of less than 5. Since a chi-square statistic would be influenced by this, we tested the dependence of the variables with the Craddock-Flood chi-square test ($\alpha = 0.05$), which is recommended in this case (Craddock and Flood, 1970). The strength of the dependence between the variables was measured with Cramér’s V ($\alpha = 0.05$).

According to the data in table 3, the likelihood of having CGMs put in place is influenced by the expenditure on consulting services. For the variable ‘establishment of preferred supplier’, the Craddock-Flood chi-square test indicates that the hypothesis H1 can be accepted on the grounds of statistical dependence between the variables ($\chi^2 = 5.986; \text{df} = 2; \ p = 0.05$). Cramér’s V indicates a correlation between expenditure on management consulting services and the establishment of a pool of preferred suppliers (Cramér’s V = 0.361; $p = 0.05$). We repeated the calculations conducted above for H2 to prove the dependence between expenditure on management consulting services and project control. In this case we found no statistical dependence between the variables ($\chi^2 = 3.575; \text{df} = 4; \ p = 0.466$). Finally, we investigated the relation between expenditure on management consulting services and the
establishment of a central unit dedicated to such services (H3). Here, the Craddock-Flood chi-square test indicates acceptance of the hypothesis ($\chi^2 = 9.696; \text{df} = 4; p = 0.046$). The correlation measure between the two variables is Cramér’s $V = 0.344$ ($p = 0.046$).

Because Cramér’s $V$ does not indicate the direction of the correlation, we compared the expected values for the hypotheses H1 and H3 with the observed values. As shown in table 4, the expected values are higher than the observed ones in the case of low expenditure on consulting and lower in the case of high consulting expenditure for both CGMs ‘preferred supplier’ and ‘central unit’. This indicates: the higher the amount of expenditure on consulting services the higher the likeliness of the establishment of preferred supplier programs for consultancies and the establishment of a central unit dedicated to consulting services.

So far, the three CGMs have been treated as dependent variables. To prove our next set of hypotheses (H4, H5, H6), we have to treat the CGMs as independent variables in order to investigate the respondents’ attached significance to the problems associated with dealing with consultancies. Because the scores were not normally distributed, we used a Mann-Whitney-U-Test to identify possible significant differences (see table 5). Since the aggregated variable ‘problems’ comprises eight different sub-variables (as summarized in table 5), we controlled the dependence of each variable with the specific CGM.

Firstly, we took the group ‘preferred supplier’, which is divided into respondents with a preferred supplier (‘yes’-group) and respondents without a preferred supplier (‘no’-group). Our hypothesis H4 was that there is a significant difference between the means of these two groups. We can confirm this hypothesis only for the company-wide coordination of consulting projects. In this case, the group without preferred supplier programs assesses the problem of coordinating company-wide consulting projects as less significant than the group
with preferred suppliers \( (Z = -2.354) \). For the CGM-variable ‘project management’ we tested the groups ‘yes’ and ‘partly’, as the ‘no’ group included only three respondents. Here, our data reveal no significant difference between the means of the two groups. Hence, our hypothesis H5 cannot be accepted. For the CGM-variable ‘central unit’ we found significant differences between the means of the ‘yes’ and ‘no’ groups, which concerned the selection of qualified consultancies \( (Z = -2.152) \) and contract negotiations \( (Z = -2.674) \). Thus, we can accept hypothesis H6 in these two cases. In both cases, as a comparison of the means indicates, respondents with a central unit dedicated to consultancy matters evaluate the problems of selecting a consultancy and of contract negotiations as significantly less important than respondents without such a unit.

To recapitulate our findings: we can confirm hypotheses H1 and H3 but have to reject hypothesis H2, whereas for H4 and H5, our data show that there is no significant difference between companies with and without CGMs, except where the variable ‘preferred supplier’ and the problem ‘company-wide coordination of consulting projects’ are concerned. Regarding the CGM ‘central unit’ we can confirm H6 in the case of the problems ‘contract negotiations’ and ‘selection of a qualified consultancy’, but have to reject it in the case of the other six problems. Figure 2 integrates our findings into our conceptual model (see Figure 2).

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\[ \text{INSERT \hspace{1mm} FIGURE \hspace{1mm} 2} \]
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**Discussion**

Concerning our first set of hypotheses (H1, H2, H3) our findings reveal that implementing the CGMs ‘preferred supplier’ and ‘central unit’ is positively dependent on company expenditure on management consulting services, but not on project control.

From an agency theory perspective, it is obvious that relatively high expenditure on management consulting services promotes the introduction of CGMs. The implementation and maintenance of CGMs cause additional agency costs for clients. Thus, from the client’s perspective, unless CGMs entail some benefit, they are unprofitable for companies with low expenditure on consulting services. This situation is different for companies with high expenditure. Since a company’s management must account for expenditure on consultants to
the capital owners, by using CGMs the management can arguably demonstrate to the capital owners the responsible handling of capital. The positive dependence of establishing a pool of preferred suppliers (H1) and a central unit dedicated to consultancy matters (H3) on high expenditure on consulting services fits this argument.

In the light of the above, the independence of the CGM ‘project control’ from high expenditure on consulting services (which forces us to discard H2) is striking. A possible explanation is that managers are expected to take control over their projects when dealing with consultancies regardless of the level of expenditure. From an agency theory perspective, the CGM ‘project control’ incurs fewer agency costs for the client, since managers might be expected – to a certain extent – to control their projects anyway. Thus, in the case of project control, agency costs are not as high as in the case of the two other CGMs, which may require e.g. additional co-ordination effort or extra costs to run the central unit. Furthermore, our findings reveal that the CGM ‘project control in the client’s hands’ was considered by the respondents to be an important one (mean of 5.05 on a seven-point scale). This contradicts the common assumptions that consultants are in control of both the project and the relationship with the company (Kakabadse et al., 2006).

Our next set of hypotheses (H4, H5, H6) referred to the relation between CGMs and the problems that companies associate with the usage of consultants. From an agency perspective, it could be assumed that companies with CGMs in place perceive typical problems when dealing with consultancy as less important than companies without such mechanisms. Our findings, however, did not correspond to this assumption. In almost all cases, companies with CGMs in place attach at least as much importance to agency problems as companies without CGMs.

In the case of ‘preferred suppliers’ (H4), our Mann-Whitney-U-Test indicates that, remarkably, respondents with a pool of preferred suppliers attached more significance to the problem ‘company-wide coordination of consulting projects’ than companies without preferred suppliers. Clearly, a pool of preferred suppliers does not necessarily improve the coordination of company-wide consulting projects, as one might expect (Werr and Pemer, 2007). The idea behind such a pool is that the client can secure more favourable conditions when negotiating contracts with consultants. This, however, does not necessarily lead to a better overview of the consulting projects at hand. Concerning the remaining problems, our
Mann-Whitney-U test does not indicate significant differences in the means between the two groups. This is also remarkable, because one might expect that a pool of preferred suppliers would make e.g. the selection of a qualified consultancy and the negotiation of contracts less of a problem.

The CGM ‘project control’ has obviously also no influence on how respondents attach significance to agency problems (H5). Again, this is striking because in agency theory control plays an important role in reducing or overcoming agency problems (Eisenhardt, 1985; Jensen and Meckling, 1976; Fama and Jensen, 1983). However, this might indicate that managers are more aware of problems relating to management consultants when frequently dealing with consultants. We will come back to this argument later.

With regard to establishing a central unit dedicated to consultancy matters (H6), our assumptions were confirmed only in the cases of ‘contract negotiations’ and ‘selection of qualified consultancies’, in which the means differ significantly between companies with and without such a central unit. We can explain these differences on the grounds of the characteristics that these units have. A company’s central unit has specialised employees who support the company’s dealings with consultancies. The task of the professionals who run this unit is to gain as much information as possible about consultants (Freedman and Stinson, 2004; Mohe, 2005), e.g. through comprehensive market screening aimed at identifying qualified consultants. This reduces the client’s uncertainty about the qualities of a consultant and improves his or her position in contract negotiations.

Surprisingly, our findings indicate that companies without CGMs do not attach greater significance to the problems associated with the dealing with consultancies than companies with CGMs in place. Since these findings contradict agency theory assumptions, to interpret this we have to widen the discussion, turning to the concept of selective perception: several studies have shown that the perceptions of managers are highly influenced by their experiences (Beyer et al., 1997; Geletkanycz and Black, 2001). Since all companies included in our final sample have had several experiences in working with consultants, we can assume that the introduction of CGMs may indicate either that the experiences with consultants were negative, or a high awareness of the problems that occur when dealing with consultancies. It is possible, then, that companies without CGMs have had positive experiences with consultancies and are thus less aware of such potential problems and their importance.
Nevertheless, our findings also lead us to ask how effective CGMs are in solving agency problems.

To answer this question, firstly, we could argue that CGMs are ineffectively used. If we take a company that has just begun introducing CGMs, it may be that their effectiveness has yet to be proved. Consequently, the relevant problems will be initially perceived as acute, and may only come to be perceived as moderate later on. Another case is that of companies that have CGMs in place, but do not apply them effectively, e.g. the central unit is staffed by employees who are not familiar with the consulting business. Empirical studies put forward alternative arguments that question the effectiveness of CGMs: for example, introducing CGMs does not automatically imply that these are actually used (Lindberg and Furusten, 2005; Mohe and Höner, 2006; Werr and Pemer, 2007). This can happen when managers do not accept, and therefore do not apply, CGMs e.g. because they fear they might lose their individual power, or feel that bureaucratic rules are not appropriate for the process of engaging consultants. Consequently, these managers see no need for CGMs and are likely to resist them, or they might just get frustrated, fall back on their personal ties to certain consultants and try to bypass or ignore those measures in order to secure the selection of their preferred consultants. A final argument concerns CGMs as such: although agency theory argues for the usefulness of CGMs in reducing agency problems, it is possible that these mechanisms are in fact not appropriate for tackling such problems.

Although we cannot prove that the responding companies with CGMs in place might have rated the problems associated with the dealing with consultancies as more acute than they would have done if they had not applied CGMs, a further question remains, i.e. why companies use CGMs if they are not appropriate for reducing the problems that those companies identify. This question challenges fundamental assumptions of agency theory as outlined before. Possible explanations are instead provided by neo-institutional theory: according to one of that theory’s basic assumptions, organisations strive for legitimacy by decoupling their official and unofficial structures, agendas and activities in order to meet certain (external) expectations to get legitimacy (Oliver, 1991; Tolbert and Zucker, 1983; Suchman, 1995; Zucker, 1987). If we transfer this assumption to our context we can argue that companies might introduce CGMs in order to gain legitimacy by their external environment. Since corporate governance implies increased shareholder-orientation and a responsible handling of the company’s capital (Daily et al., 2003) companies could claim that
they apply certain CGMs in order to justify to shareholders their use of consultants and the fees they have spent on hiring them. In that sense, CGMs could provide ‘facades of rationality’ (Nyström and Starbuck, 1984). Claiming that ‘effective’ CGMs are in place (e.g. for the selection of qualified consultants) helps in itself to suppress any suspicions that a company has been careless in its use of consultancy, and to create a sense of immunity to criticism. Thus, clients may (mis)use CGMs to give their dealings with consultancies a patina of rationality. This reflects a further and interesting thought, i.e. the possibility that CGMs are introduced in purpose, as a demonstration of power on the part of the client, aimed at influencing the relationship with the consultants. In this case, CGMs might function as a means of ‘impression management’, which has so far been discussed only with relation to consultants (e.g. Clark, 1995; Gardner and Martinko, 1988).

Conclusion

The discussion on corporate governance has gained increased attention in management theory and practice during the last few years. However, debates on the topic focus on the ‘inside’ view, i.e. investigate relationships within organisations. Our article was a response to calls for exploring governance mechanisms in external partnerships (Hambrick et al., 2008). For this purpose, we drew on the client–consultant relationship as an example of a common company–supplier relationship. Accordingly, we used agency theory to develop a conceptual model with six hypotheses concerning the use of CGMs. We tested our hypotheses by means of a large-scale survey of client companies based in Germany.

Our main findings reveal an interesting and partly unexpected relation between expenditure on consulting services, the introduction of CGMs, and the problems perceived to arise in the relationship between clients and consultancies. More specifically, we found that the CGMs ‘preferred supplier’ and ‘central unit’ depend positively on the expenditure on management consulting services. On the contrary, ‘project control’ is independent of this variable. We explained the latter result on the grounds that modern managers are expected anyway to control their projects to a certain extent, and on the basis of the argument provided by agency theory, i.e. that project control incurs lower agency costs compared to the other two CGMs. Furthermore, we found that the CGMs ‘project control’ and ‘preferred supplier’ have no positive influence on the agency problems in clients’ dealings with consultancies, while the CGM ‘central unit’ lowers the agency problems only with regard to ‘contract negotiations’ and the ‘selection of a qualified consultancy’.
Since those findings opposed basic agency theory assumptions, we developed alternative interpretations. More specifically, we inferred that the interdependence described above may be the result of using CGMs ineffectively, e.g. because of time and staff restrictions or resistance on the part of managers. Drawing on the ideas of neo-institutionalism, we identified the need of managers to introduce CGMs in order to legitimate their use of consultants and justify the attendant fees as an additional explanation. Finally, our findings provided room for speculations about the overall appropriateness of the discussed CGMs in the dealings of clients with consultancies. Thus, our findings open up new paths for future research and offer insights into the client–consultant relationship, which are of interest to both clients and consultants.

This article contributes firstly to the debates on corporate governance by analysing the relationships between companies and their external partners. Despite the practical importance of that topic, the relevant literature has so far rather neglected outside perspectives of corporate governance. Excepting a few studies that have analysed corporate governance from an external viewpoint, this is the first quantitative study that discusses the governance of consulting relationships from the perspective of corporate governance. Our findings enrich the general debate on corporate governance by providing important implications for the way in which governance issues with relation to external (especially knowledge-intensive) service providers are conceptualised.

Secondly, this article also contributes to the literature on agency issues in that it explores the perspective of clients, as well as the measures they implement to govern their relationship with the consultants they hire. Agency theory allows us to investigate external and internal relationships when dealing with consultancies (see e.g. Gallouj, 1996 and Fincham, 2003 on the client–consultant relationship, and Mohe and Höner, 2006 on the board–manager relationship). Up to now, however, these two perspectives have rarely been integrated, although this would help explore internal governance approaches when dealing with knowledge-intensive suppliers. The present study adopts both perspectives by exploring the internal governance approaches of clients when dealing with external consultants. In addition, our study contributes to agency theory in another respect, as some of our findings hint at certain limitations of agency theory. More specifically, agency theory assumes that the very existence of governance mechanisms more or less automatically helps solve agency problems;
however, our data dispute this. Agency theory does not question whether such governance mechanisms might fail in practice (e.g. because they are perceived as bureaucratic or even useless), or whether they may have been implemented and be supervised by the ‘wrong’ persons, or whether they are a poor compromise instead of an optimal solution, or indeed whether they should fulfil micro-political functions like strengthening the power position of certain departments or persons (Astley and Zajac, 1991; Burns, 1961).

Thirdly, our study expands the current research on consultancy issues in that it investigates clients and their approaches to governing the use of consultants, which have so far been neglected in the relevant literature. Concerning the first topic, the available literature presents a rather inconsistent picture of clients, who are described as anything from passive to active. Although our study did not aim to clarify that ambiguity, it provides evidence that clients are not as passive as they are often thought to be. As there are only few qualitative studies on the clients’ governance of consultants (Bäcklund and Werr, 2005; Lindberg and Furusten, 2005), our research also enriches the relevant debate by providing empirical data from a large-scale survey in clients’ dealings with consultancies and raises new questions concerning the governance of consultants.

Despite its contributions, this study has certain limitations, which are related to agency theory. One of the central implications of agency theory is that the principal should eliminate or at least reduce goal divergence between principal and agent to avoid agency problems (Eisenhardt, 1989; Jensen and Meckling, 1976). However, agency theory does not sufficiently differentiate between the actors’ actual and perceived goals. Consequently, it can only explain situations in which the goals of the principal and the agent are clearly seen to be different. In the case of actual goal congruence and perceived goal divergence, the client is likely to overstate the opportunistic behaviour of the consultant (e.g. Perrow, 1986). Some of the assumptions of agency theory, then, ‘are likely to encourage overbearing contracts and unnecessary structural constraints’ (Arthurs and Busenitz, 2003, p. 149). This possibility cannot be excluded also in the case of the present study. From an agency perspective, a client has to be conceptualised as a ’strong principal’ who is in control of the internal consulting situation and of the consultant as well. Thus, the client might extensively implement CGMs that counteract the relationship to – and the performance of – the consultant, e.g. a client’s too bureaucratic approach dampens the consultant’s creativity. Moreover, we have to take into account that agency theory has a rather rational approach to human nature. In practice, in
certain situations human beings – even managers and consultants – when left to their own devices behave loyally or co-operatively, e.g. because of social ties, own moral beliefs, norms, values etc. However, agency theory is not able to take this sufficiently into account. Thus, Daily et al. (2003, p. 372) recommend applying multitheoretical approaches to corporate governance research: ‘many of these theoretical perspectives [applied in corporate governance literature] are intended as complements to – not substitutes for – agency theory. A multitheoretical approach to corporate governance is essential for recognising the many mechanisms and structures that might reasonably enhance organizational functioning.’ This suggests that it might be valuable to apply theories that emphasise social mechanisms like trust, instead of formal mechanisms like contracts. Examples are stewardship-theory, which stresses co-operative relationships (e.g. Donaldson and Davis, 1991), or social network theory (Granovetter, 1985; Uzzi, 1997), which highlights the social ties among the actors involved (e.g. Bäcklund and Werr, 2005; Werr and Styhre, 2003).

Further limitations concern our methodological approach. Our survey design means that a certain bias towards ‘key informants’ cannot be excluded (e.g. Bagozzi et al., 1991; Hurrele and Kieser, 2005; Kumar et al., 1993). It has to be noted that each company selected its own ‘key informants’. Also, we cannot exclude the possibility that some parts of our survey might have left room for individual interpretations on the part of respondents. Furthermore, although the survey was anonymous, it is possible that some respondents were nevertheless too keen to protect their anonymity and therefore too cautious with their answers. In particular, this might be the case with the CGM ‘project control’ since managers are likely to see themselves in a control position – even if they are not.

Overall, this study indicates the need for future research on governance mechanisms for managing a company’s external relations. As we have shown, the effectiveness of these mechanisms in the management of consultants is to some extent questionable. Therefore, we suggest that future research focuses on analysing which CGMs are appropriate for solving specific agency problems, and how CGMs can be developed so that they are effective in reducing agency problems. Additionally, it would be interesting to investigate what influences the clients’ perception of the problems that arise in their dealings with consultants. Future research could also investigate possible correlations between perceived problems when dealing with consultancies and perceived satisfaction with the implementation of CGMs, which we have not covered in our study. Finally, it would be useful to identify and analyse
CGMs that are used in practice, but have not yet been formally acknowledged in the relevant literature.

Finally, because we obtained our data from one ‘key informant’ per company, we suggest that in future studies it would be useful to seek information from several persons within the same organisation so as to capture better the (different) attitudes and approaches to dealing with consultancies. The tendency of managers to demonstrate and assert their power is thought to have an effect on how consultants are employed (Bäcklund and Werr, 2005; Fincham, 2003), so, in the light of that, it would be interesting to identify how micro-politics within the client organisation influence the relationship between client and consultant.

References
Bachman, E.; Elfrink, J.; Vazzana. G. (1996): Tracking the progress of e-mail vs. snail-mail, in: Marketing Research, 8, S. 31–35.


<table>
<thead>
<tr>
<th>Agency problems when dealing with consultancies</th>
<th>Possible consulting governance mechanisms (CGMs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>– Selection of consultants</td>
<td>Pool of preferred suppliers</td>
</tr>
<tr>
<td>– Definition of the consulting assignment</td>
<td>Control of the project management</td>
</tr>
<tr>
<td>– Contract negotiations</td>
<td>Central unit dedicated to consultancy issues</td>
</tr>
<tr>
<td>– Project management</td>
<td></td>
</tr>
<tr>
<td>– Efficient employee involvement</td>
<td></td>
</tr>
<tr>
<td>– Effective evaluation and documentation</td>
<td></td>
</tr>
<tr>
<td>– Company-wide coordination of all consulting projects</td>
<td></td>
</tr>
</tbody>
</table>

Table 1: Agency Problems in Dealing with Consultancy and Possible Governance Mechanisms (CGMs)
The client remains in control of the project
Establishing a central unit dedicated to consultancy issues
Establishment of a pool of preferred suppliers
Low rating of problems when dealing with consultancies
High expenditures on consulting services

Figure 1: Conceptual Model of the Expected Dependencies between the Variables
<table>
<thead>
<tr>
<th>Turnover (in billions of euro)</th>
<th>Sample (%)</th>
<th>Respondents (%)</th>
<th>Number of Employees</th>
<th>Sample (%)</th>
<th>Respondents (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;1.5</td>
<td>82 (16.4)</td>
<td>60 (36.6)</td>
<td>&lt; 5,000</td>
<td>112 (22.4)</td>
<td>57 (35.0)</td>
</tr>
<tr>
<td>1.6 to 2.5</td>
<td>156 (31.2)</td>
<td>38 (23.2)</td>
<td>5,001 to 10,000</td>
<td>149 (29.8)</td>
<td>36 (22.1)</td>
</tr>
<tr>
<td>2.6 to 5.0</td>
<td>113 (22.6)</td>
<td>29 (17.7)</td>
<td>10,001 to 20,000</td>
<td>115 (23)</td>
<td>34 (20.9)</td>
</tr>
<tr>
<td>5.1 to 15</td>
<td>83 (16.6)</td>
<td>15 (9.1)</td>
<td>20,001 to 35,000</td>
<td>54 (10.8)</td>
<td>14 (8.6)</td>
</tr>
<tr>
<td>15.1 to 40</td>
<td>34 (6.8)</td>
<td>10 (6.1)</td>
<td>35,001 to 50,000</td>
<td>28 (5.6)</td>
<td>8 (4.9)</td>
</tr>
<tr>
<td>40.1 to 75</td>
<td>15 (3)</td>
<td>5 (3.0)</td>
<td>50,001 to 100,000</td>
<td>31 (6.2)</td>
<td>9 (5.5)</td>
</tr>
<tr>
<td>&gt; 75</td>
<td>17 (3.4)</td>
<td>7 (4.3)</td>
<td>&gt; 100,001</td>
<td>14 (2.8)</td>
<td>5 (3.1)</td>
</tr>
</tbody>
</table>

Table 2: Data on the Survey Sample and the Respondents’ Companies
<table>
<thead>
<tr>
<th>Expenditure on Consulting Services</th>
<th>Craddock-Flood Chi-Square</th>
<th>df</th>
<th>p</th>
<th>Cramér’s V</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferred supplier is dependent</td>
<td>5.986</td>
<td>2</td>
<td>0.05</td>
<td>0.361</td>
<td>0.05</td>
</tr>
<tr>
<td>Project control is dependent</td>
<td>3.575</td>
<td>4</td>
<td>0.466</td>
<td>0.199</td>
<td>0.467</td>
</tr>
<tr>
<td>Central unit is dependent</td>
<td>9.696</td>
<td>4</td>
<td>0.046</td>
<td>0.344</td>
<td>0.046</td>
</tr>
</tbody>
</table>

Table 3: Craddock-Flood chi-square and Cramér’s V for the Relation between Expenditure on Consulting Services and CGMs
Table 4: Expected and observed values for the establishment of preferred supplier programs and a central unit dedicated to consulting services

<table>
<thead>
<tr>
<th>Expenditure on Consulting Services</th>
<th>Preferred Supplier</th>
<th>Central Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>1-10 mio. Euros</td>
<td>expected value</td>
<td>12.4</td>
</tr>
<tr>
<td></td>
<td>observed value</td>
<td>9</td>
</tr>
<tr>
<td>11-45 mio. Euros</td>
<td>expected value</td>
<td>4.8</td>
</tr>
<tr>
<td></td>
<td>observed value</td>
<td>5</td>
</tr>
<tr>
<td>More than 46 mio. Euros</td>
<td>expected value</td>
<td>4.8</td>
</tr>
<tr>
<td></td>
<td>observed value</td>
<td>8</td>
</tr>
<tr>
<td>Project Aspect</td>
<td>Preferred Supplier</td>
<td>Central Unit</td>
</tr>
<tr>
<td>----------------------------------------------------</td>
<td>--------------------</td>
<td>--------------</td>
</tr>
<tr>
<td></td>
<td>Yes (n=23)</td>
<td>No (n=35)</td>
</tr>
<tr>
<td>Selection of a qualified consultancy</td>
<td>Mean</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5.48</td>
<td>5.83</td>
</tr>
<tr>
<td></td>
<td>Z</td>
<td>-1.036</td>
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<tr>
<td></td>
<td>Mann-Whitney-U</td>
<td>366.5</td>
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<td>Clear definition of the consulting assignment</td>
<td>Mean</td>
<td>5.43</td>
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<td></td>
<td>Z</td>
<td>-1.010</td>
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<td></td>
<td>Mann-Whitney-U</td>
<td>367</td>
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<td>Contract negotiations</td>
<td>Mean</td>
<td>5.23</td>
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<td></td>
<td>Z</td>
<td>-0.199</td>
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<tr>
<td></td>
<td>Mann-Whitney-U</td>
<td>401.5</td>
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<tr>
<td>Evaluation of the consulting performance</td>
<td>Mean</td>
<td>5.22</td>
</tr>
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<td></td>
<td>Z</td>
<td>-0.758</td>
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<td></td>
<td>Mann-Whitney-U</td>
<td>372.5</td>
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<tr>
<td>Integration of the employees in the consulting</td>
<td>Mean</td>
<td>5.26</td>
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<tr>
<td>projects</td>
<td>Z</td>
<td>-1.843</td>
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<td>Mann-Whitney-U</td>
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<td>Project management</td>
<td>Mean</td>
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<td>Documentation of the project findings</td>
<td>Mean</td>
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<td>Company-wide coordination of consulting projects</td>
<td>Mean</td>
<td>5.04</td>
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<tr>
<td></td>
<td>Z</td>
<td>-2.354*</td>
</tr>
<tr>
<td></td>
<td>Mann-Whitney-U</td>
<td>278.5</td>
</tr>
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</table>

Table 5: Mann-Whitney-U Test for Group Differences (* p ≤ 0.05)
Figure 2: Summary of the Empirical Investigation