

MICHEL W. LANDER

# Profits or Professionalism?

On Designing Professional Service Firms



## **Profits or Professionalism?**

On designing professional service firms



# **Profits or Professionalism?**

On designing professional service firms

## **Winstgevenheid of Professionaliteit?**

Het ontwerpen van professional service firms

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To everyone

*"A coeur vaillant, rien d'impossible"*

*Ferdinand Cheval*

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Paris



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# Chapter 1. Introduction

Organizational sociologists and management scholars have long been interested in the status and position of professionals in organizational collectives and society at large (Schön, 1983; Sorensen & Sorensen, 1974). Yet until relatively recently, these scholars have primarily dedicated their research attention to a better understanding of the professions (Abbott, 1988; Goode, 1957; Parsons, 1939): autonomous vocations into which professionals are selected on the basis of specialized educational training. In contrast, research on professional service firms (PSFs) – commercial businesses “whose primary assets are a highly educated (professional) workforce and whose outputs are intangible services encoded with complex knowledge” (Greenwood, Li, Prakash, & Deephouse, 2005: 661) – did not come off the ground until relatively recently.

This lack of attention on the part of academics is surprising given that PSFs form an integral part of the contemporary knowledge-based economy without which “business as we know it, would come to a grinding halt” (Sharma, 1997: 758). Organizations draw on law firms to broker commercial transactions and accounting firms ensure the veracity of their disclosures (Greenwood, Suddaby & McDougald, 2006). In recent years the Fortune 1000 firms have increased their demand for the services of PSFs. Where in the 1980s global revenues for PSFs amounted to \$107 billion, this increased to \$911 billion by 2000 (Lorsch & Tierney, 2002). There are three reasons for their prominent role in the post-industrial economies.

First, some of the PSFs are among the largest and most affluent business enterprises (Ahroni, 1993; Greenwood et al., 2006). In 2011, PriceWaterhouseCoopers was the largest accounting firm in terms of employees and located in 154 countries worldwide. Linklaters, the world’s largest law firm, is significantly smaller compared to the largest accounting firms, but still had revenues of \$1,90 billion and operated in 19 countries.

Second, the influence of PSFs is not limited to their own industries, but extends to others as they disseminate their innovations and set working standards through their client firms (Alvesson, 1995). Through the application of professional knowledge to unique organizational problems (Hansen, Nohria & Tierney, 1999; Løwendahl, Revang & Fosstenløkken, 2001) as well as through the publication of books and articles PSFs can be considered the knowledge engines for other businesses (Lorsch & Tierney, 2002).

Third, besides their business acumen, PSFs also have a public professional objective by serving vulnerable clients and third party interests. As so-called “gatekeepers” (Coffee, 2006: 2), they are entrusted with monitoring the compliance of organizations with regard to the law, financial statements and disclosures. As reputational intermediaries, they vouch for the “signal sent by the corporate issuers” by staking their reputation (Coffee, 2006: 2). When gatekeepers fail in their public function, this can have serious economical and societal repercussions. Whereas well-documented cases like Ahold, Enron, and WorldCom are prime examples of gatekeeper failure, unprofessional behavior in PSFs is often of a more mundane form. It tends to take the shape of overcharging clients or transgressing against firm, professional or governmental rules and regulations.

Although over the last decade we see an increase in the study of PSFs, a definitive definition of them as an organizational form is still lacking. Instead, authors often avoid providing a precise definition, and simply refer to examples of firms in industries such as law, accounting, consulting or advertising (e.g. Greenwood & Empson, 2003). Additionally, the term PSF is often used interchangeably with that of the Knowledge Intensive Firm (KIF; Morris & Empson, 1998). Although these types of firms also employ expert knowledge in the delivery of their services, their knowledge is not professional in nature. Therefore a KIF may not be a PSF, even though all PSFs are KIFs (Starbuck, 1992). In this dissertation, an organization is considered a PSF when: (1) the majority of its members are professionals; (2) professionals define and achieve the organizational goals; (3) administrative authority lies within the firm, even when authority in professional matters lies with the professional associations (Hall, 1968; Montagna, 1968). In this dissertation I will focus on two of the canonical examples of PSFs: law and accounting firms.

Notwithstanding the lack of a precise definition, recent work has identified the PSF as a distinctive organizational form facing specific challenges, which derive from the nature of the services it delivers, its distinctive resource dependencies, and the highly institutionalized environment in which it operates (Greenwood & Empson, 2003; Von Nordenflycht, 2010). First, PSFs deliver knowledge-intensive and intangible services (Løwendahl, 2005) that are highly customized through intensive client consultations (Hansen et al., 1999), making the knowledge they exploit difficult to codify and commodify. Second, because of the resulting inalienability of professional knowledge from its human carriers (Dow, 2003), PSFs are human capital intensive (Hitt, Bierman, Shimizu & Kochnar, 2001), while they have little need for external

financial capital (Von Nordenflycht, 2010). Third, as many PSFs are routinely involved in the provision of (quasi) public and gatekeeper services, which facilitate complex market exchange by assuring the quality, legality, and integrity of transactions (Coffee, 2006; Kraakman, 1986), they operate in highly institutionalized environments. Here, both public authorities and professional associations set and enforce constraints on the services provided and on the professionals providing these (Greenwood, Suddaby & Hinings, 2002).

To cope with these challenges, PSFs are characteristically owned internally by a subset of their members (Dow, 2003; Hansmann, 1996; Hart & Moore, 1996; Richter & Schröder, 2007), and organized as professional partnerships (Greenwood & Empson, 2003). Through extensive empirical research on Canadian accounting firms, Greenwood, Hinings and Brown (1990) were able to retrieve the essential properties of such professional partnerships, which are sometimes simply referred to as 'P<sup>2</sup>' organizations. The core observation of Greenwood and his associates is that the P<sup>2</sup> organization comprises an organizational form in its own right, to be distinguished from other forms of enterprise organization by features like its limited size, weakly developed strategic capabilities, and consensus-oriented decision-making (Greenwood et al. 1990).

Although the P<sup>2</sup> has historically been the dominant form of enterprise organization in classic professions such as law and accounting (Greenwood & Empson, 2003), changes in economic and social trends, government policies, and client preferences (Hitt, Bierman, Uhlenbruck & Shimizu, 2006; Løwendahl, 2005; Maister, 2003; Nachum, 1996) have led to the spread of a commercial ethos in the professions (Cooper, Hinings, Greenwood, & Brown, 1996), which challenges traditional P<sup>2</sup> organizational practices (Cooper, Greenwood, Hinings, & Brown, 1998; Empson, 2007). Many PSFs are therefore now adopting face-changing strategies and practices, and are expected to move in the direction of a new organizational template coined the 'Managed Professional Business' (MPB; Cooper et al., 1996). In principle, the adoption of new managerial practices should enable PSFs to grow in terms of size, develop stronger strategic capabilities, and experiment with other, more centralized forms of decision-making. And indeed, a number of recent empirical studies have documented the diffusion of these new properties across various populations of contemporaneous PSFs (Cooper et al., 1996; Greenwood & Suddaby, 2006; Pinnington & Morris, 2003).

This shift from the professional logic to the commercial logic is the backdrop of this dissertation and underlies my overarching question: what are the effects of the

changing logic from professionalism to commercialism on PSFs? This question will be addressed through a number of sub-questions in the following chapters. First, how do PSFs perceive the current institutional changes and what are their organizational responses to the resulting clash of the professional with the commercial logic?

Second, although prior literature has documented the introduction of novel-to-context strategic and governance practices alongside the traditional drivers of PSF performance, their actual implications are as of yet, unknown. Therefore a related second research question is: what are the performance effects of the novel organizational practices as compared to the original drivers of PSF performance?

Third, the professional or so-called “social trustee definition of professionalism subordinates self-interest and commercial gain in favor of ideals of service and public welfare” (Greenwood, 2007: 191). When these ideals of service and public welfare are subordinated in favor of commercial gain and self-interest, this could be quite detrimental to professional behavior (Greenwood, 2007). As novel practices in the MPB-configuration are developed to that aim, the question becomes: What are the effects of both novel organizational and traditional PSF practices on professional misconduct?

In the final chapter I combine the novel and traditional practices by analyzing causal configurations of PSFs. Using set-theoretic methods I analyze what the effects of specific combinations of practices within PSFs are on substantive and symbolic performance as well as on professional misconduct. An interesting question that is dealt with in this chapter is: can we empirically identify theoretically coherent configurations of organizational practices that allow for the simultaneous maximization of both profits and the professionalism in PSFs?

## **1.1 Shifting logics and PSF configurations**

The traditional PSF industries were governed by a professional/trustee logic (Suddaby & Greenwood, 2005) where professional values and a feeling of societal guardianship were integral. Although normally professional industries are characterized by their stable nature, recent shocks in the PSFs’ environment have brought an end to the era in which PSFs were “an oasis of organizational stability” (Gilson & Mnookin, 1988: 567).

First, technological developments have had significant impact on the audit process. Computer aided audit systems have reduced the complexity and labor intensity of the audit process (Brock, 2006), resulting in accountancy firms needing to

seek ways to generate profits in a different way. On the client side, the increased emphasis on costs and the internet and mobile technologies that allow for shopping around, put even more pressure on the fees of the audit and law delivery process (Aharoni, 1999). Secondly, due to globalization, law and accounting firms now have to deal with international standards and practices of their international clients more often (Nanchum, 1996), leading to new knowledge requirements. Third, statutory protection for providing services has been reduced or removed (Hart, Schlesinger & Maher, 1992). This resulted in growing intra- and inter-professional competition (Gray, 1999). Fourth, the implications of the Sarbanes-Oxley act as well as the shift from principle-based to rule-based accounting has changed the way in which the large accounting firms have structured their organizations (Greenwood & Suddaby, 2006), reducing the importance of the individual accountant. Finally, accountancy firms also face changes in client demands. Here the role of the traditional accountant is slowly being shifted towards that of an advisor to the firm, clients are not only more critical towards the service they receive, but also demand more and different services. All these developments pushed PSFs to rationalize their service delivery process, adopt more efficient structures, broaden their activities in consultancy services, and actively engage in marketing campaigns (Greenwood & Suddaby, 2006). In all, the combined changes in economic and social trends, legislation and government policies (Løwendahl, 2005; Maister, 2003; Nanchum, 1996) as well as the product market, financial and factor pressures (Cooper et al, 1998; Greenwood et al., 1990) have put strain on the trustee logic, and have lead many PSFs to complement or supplant it with a more commercial logic (Suddaby & Greenwood, 2005).

These two logics underlie what in the literature on PSFs are discerned as the two main organizational configurations. The classic P<sup>2</sup> configuration documented by Greenwood et al. (1990) hinges on the idea that professional firms rely on a different set of controls as compared to regular organizations, due to their specific organizational challenges. As professionals apply an esoteric body of knowledge—which is difficult to code into knowledge systems—to complex problems they enjoy high levels of discretion and autonomy in the delivery of their services (Greenwood et al., 1990). Additionally, senior members who typically own and manage the firms, continue to contribute to the delivery of the service. They are often responsible for their particular practice areas and hence place priority hereon in favor of the entire organization. In practice this means that the strategy of the firm can be described as the aggregate of the partners' individual interest (Pinnington & Morris, 2003). In terms

of organizational systems and practices, the P<sup>2</sup>-configuration relies primarily on informal and collegial control mechanisms at the expense of more formal and hierarchical systems (Greenwood et al., 1990). Additionally they employ credentials-based hiring practices (Hitt et al., 2001) and use merit-based, tournament type promotion practices (Gilson & Mnookin, 1988; Malos & Campion, 1995).

The second documented configuration of organizational practices within PSFs can be described as being more consciously managed (Cooper et al., 1998). The underlying values of the PSF have shifted from the application of expertise in the interest of public service to a focus on efficiency and value added provision of the services rendered by the firm (Pinnington & Morris, 2003). In comparison to the P<sup>2</sup>-configuration, MPB-organized firms complement their existing P<sup>2</sup> practices with “more formal strategic planning, controls over quality of work and productivity of staff, greater emphasis on coordinated marketing activities and more elaborate and centralized financial systems (Morris & Pinnington, 1998: 76) in order to avoid strategic drift (Lorsch & Tierney, 2002). Within the accounting sector, Greenwood and Suddaby (2006) coined this form the Multidisciplinary Practice, whereas Cooper and colleagues (1996) within the law industry termed it the Managed Professional Business. Although different in name, the logic behind the two forms is similar; they both operate on the basis of a more commercial ethos (Cooper et al., 1996).

## **1.2 Profits or professionalism?**

The fundamental questions raised above will be addressed in the subsequent chapters starting with the first set of questions: how do PSFs perceive the current institutional change and what are their organizational responses to the resulting clash of the professional with the commercial logic?

### ***1.2.1 Heterogeneous organizational responses to changing institutional logics***

In PSF research, generalizability is an important issue (Von Nordenflycht, 2010). Although there is indeed little evidence that generalizing across industries is possible; our knowledge even within the traditional PSF industries remains limited. For instance, the change from a professional logic to a more commercial logic has been documented for large law and accounting firms, however the implications for the remaining actors in these industries are unclear.

Institutional logics – defined by Thornton and Ocasio (1999: 804) as “the socially constructed, historical patterns of material practices, assumptions, values and beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meaning to their social reality” – shape how organizations and individuals behave in specific organizational fields. Organizational structures and processes are the expressions of these institutional logics (Greenwood, Diaz, Li & Lorente, 2009). In the professional industries, as discussed above, the trustee logic was until recently the dominant paradigm. However, as major shocks had a detrimental impact on the profitability of PSFs, the logic shifted towards one with a more commercial focus (Suddaby & Greenwood, 2005). In this chapter I will first focus on the institutional changes faced by the mid-tier firms and if they feel similarly pressured to respond to the changing logics.

Literature on institutional logics shows four possible outcomes of the clash between logics: the introduction of elements of a new logic into the dominant one (e.g. Glynn, 2000), the hybridization of elements of both the old and new logic (e.g. Purdy & Gray, 2009; Colyvas & Powell, 2006; D’Aunno, Sutton & Price, 1991), a shift from the old dominant logic to the newly introduced logic (e.g. Thornton, 2002; Zilber 2002) or the permanent co-existence of both logics (e.g. Lounsbury, 2007; Marquis & Lounsbury, 2007; Reay & Hinings, 2005, 2009; Scott, Ruef, Mendel & Caronna, 2000). Given that the mid-tier accounting firms face the same shocks as the big 4 firms and although they have a different client base as compared to the big 4—they too have to address the changing demands of their clients (ING, 2010). As organizational responses, given conflicting institutional logics are unlikely to be similar (Oliver, 1991; Pache & Santos, 2010), the question becomes: which strategic responses do mid-tier accounting firms use to balance the tension between the professional and commercial logic? This will be addressed in the second part of this chapter.

In this paper I draw on a sample of eleven out of the twenty-two accounting firms ranked directly behind the big 4 in terms of revenue. Through interviews with partners and professionals with decision making authority I sought to answer three questions: (1) What forces for change are mentioned by the firms; (2) which structures and practices of the firm did these pressures influence; and (3) what organizational responses did the firm show given the pressures exerted on their firm? In order to document “changes in structures and systems” and “the ways in which these changes coincide with institutional templates” large scale comparative studies are necessary (Greenwood & Hinings, 1996: 1047). They are necessary as changes involve difficult

measure concepts (e.g. resistance) and radical changes take lengthy periods of time. Hence I opted for a qualitative, multiple case study (Eisenhardt, 1989). I first conducted a within-case analysis. Subsequently, a cross-case analysis (Eisenhardt, 1989) was used to determine the conflicting demands that emanate from the drivers for change and whether the organizational responses to these conflicting demands were similar.

By exploring the ways in which the mid-tier accounting firms deal with the tensions between the traditional trustee logic and the commercial logic in the field of accounting, we make three contributions. First, I contribute to the literature on institutional logics and change. Fundamental changes in environmental conditions of organizations are frequently noted to lead to organizational change (Romanelli & Tushman, 1994). Within the accountancy sector, changes such as increased regulation, automation of services, and changing client demands have recently punctuated a long period of stability in the field, and have forced mid-tier firms to respond to the overarching shift from the trustee to the commercial logic. These significant environmental jolts (Meyer, 1982) are hypothesized in prior literature to result in revolutionary transformations of organizations rather than their evolutionary development (Greenwood & Hinings, 1996; Romanelli & Tushman, 1994; Tushman & Romanelli, 1985). Yet, this is not what we observe in our group of mid-tier firms. These firms do not show a comprehensive transformational embrace or outright rejection of the novel commercial logic. Rather, the mid-tier firms respond by addressing separate and specific strategic and structural issues, which are invoked by the new logic and relevant for their organization in terms of resource dependencies or autonomy challenges, in an incremental way. This is caused by their embeddedness in the existing trustee logic. As such, embeddedness provides a significant force for stability and causes resistance to change (Granovetter, 1985; Greenwood & Hinings, 1996; Maguire, 2007; Oliver, 1997) with regard to the demands of the new logic.

The source of resistance is located internal to the firm and this insight forms my second contribution. In my study, I observe a fragmented implementation of elements of the new logic. Mid-tier firms thus do not respect the internal coherence of the commercial logic by adopting all of its constitutive elements simultaneously, but use it rather strategically and opportunistically by selecting only those elements that have the perceived potential to resolve concrete managerial challenges regarding specific strategic issues. The diffusion process of the commercial logic in the field segment populated by mid-tier firms therefore looks more like a process of

institutional bricolage (Aldrich, 2010), especially because of the enduring influence on mid-tier actors' behavior of the traditional trustee logic. The continued influence of this logic causes a piecemeal acceptance of elements comprising the new logic as well as variation in the way new systems are adopted and implemented. The trustee logic continues to exercise its effect through the embedded action of managing partners as well as non-partnered accountants, whom are unwilling to forgo their professional traditions and norms, in no small part because of their vested interests. To deal with these internal sources of resistance, the majority of mainstream accountancy firms, adopt and adapt practices that are in the 'zone of acceptance' (Ansari, Fiss & Zajac, 2010; Lewis & Seibold, 1993; Radnor, Feller & Rogers, 1978). Studying these internal sources of resistance therefore contributes to our understanding of when and what strategic responses are likely to form. It informs the diffusion literature by showing the dynamics of "interrupted, incomplete, or even failed diffusion processes (Johnson, 2009), an area which have so far received very little attention" (Ansari et al., 2010).

My third contribution is to the literature on PSFs by addressing the issue of generalizability of this literature's extant findings to other (segments of) professional fields (Von Nordenflycht, 2010). The change in institutional logics identified and documented by Greenwood and Suddaby (2006) in their longitudinal qualitative study of the big 4 accounting firms in Canada cannot straightforwardly be extrapolated to the rest of the actors in the accounting industry. While Greenwood and Suddaby's big 4 firms are dealing with multinational clients in a supra-national arena, my mid-tier firms are well-established in their national setting, engaging primarily with local clients and experiencing greater influence of national professional organizations. My findings indicate that the commitment to the traditional trustee logic is considerably stronger within this group of more locally grounded firms. While I observe that the group of mid-tier firms respond to the previously mentioned challenges by adopting elements of the commercial logic, they do not embrace the latter logic consistently, let alone wholesale. Thus, Greenwood and Suddaby's (2006) finding that group of elite firms pushes a comprehensive and consistent agenda propagating the commercial logic simply does not translate to the group of mid-tier firms. This suggests that organizational responses to conflicting or changing logics may differ systematically across the different demographic strata into which organizational fields tend to be segmented.

### ***1.2.2 Drivers of professional service firm performance***

In my third chapter I take a closer look at the effect of organizational practices on firm performance. More specifically, I examine the effects of both traditional and novel organizational performance drivers given the presence of organizational contingencies.

In delivering their services, PSFs face a number of discretionary choices about their organizational design (Greenwood & Empson, 2003; Von Nordenflycht, 2010). As these choices are to some extent interdependent, they can repeatedly be observed across populations of PSFs in the form of archetypical configurations of properties (Greenwood, Hinings, & Brown, 1994; Malos & Campion, 2000). Historically, the organizational design of most PSFs resembled that of the professional partnership. The archetype of this organizational design was first codified by Greenwood, Hinings, and Brown (1990), who identified four of its properties. First, senior members of such partnerships continue to be involved in the actual delivery of professional services. Second, all professional members routinely apply difficult-to-codify knowledge to complex problems. Third, these members enjoy levels of autonomy in organizing their work processes that are not commonly observed in other organizations (Hall, 1968; Montagna, 1968). Fourth, decision-making in professional partnerships is decentralized, to foster the tailoring of professional services to specific client demands (Greenwood et al., 1990). As all four of these properties critically hinge on the quality of the professional staff, the performance drivers identified by students of professional partnerships primarily involve human capital (Hitt et al., 2001) and the reputational capital necessary to recruit top talents in the labor market and signal their quality to clients (Greenwood et al. 2005).

In more recent years, however, a subset of PSFs has begun to challenge the dominant features of the professional partnership archetype, in response to demands for greater efficiency spurred on by intensified competition and deregulation (Malhotra & Morris, 2009). A choice set of firms in the fields of both accounting (Greenwood & Suddaby, 2006) and law (Pinnington & Morris, 2003) has adopted a different but likewise coherent set of properties facilitating professional service delivery, which center on a greater commercial orientation and more conscious management. This alternate archetype was first codified and labeled the managed professional business by Cooper, Hinings, Greenwood, and Brown (1996). It similarly has four core properties. First, while its senior members remain at least nominally competent in performing the productive labor of those they supervise (Freidson, 1984),

they increasingly take on purely managerial roles. Second, while the delivery of complex knowledge remains its core activity, the managed professional business increasingly strives to commodify that knowledge, thereby reducing it to a routinized and codified product (Suddaby & Greenwood, 2001). Third, organizations adopting this archetype encroach upon the autonomy of the individual professional, as their management in general becomes more heavy-handed and increasingly establishes formal bureaucratic control over professional work (Leicht & Fennell, 1997). Fourth, in managed professional businesses the decision authority related to issues like client activities and resource allocation becomes increasingly centralized, limiting the decision powers of non-managing members (Malhotra & Morris, 2009). As these four properties are all part of a process whereby lateral, peer-based controls are being supplanted by hierarchical managerial controls, the hallmark of managed professional businesses is the adoption of formal systems in the areas of organizational governance and strategy implementation (Cooper et al., 1996; Pinnington & Morris, 2003).

In practice, however, we do not readily observe the wholesale replacement of the professional partnership by the managed professional business. Rather, we observe sedimentation: “the persistence of values, ideas, and practices, even when the formal structures and processes seem to change, and even when there may be incoherence” (Cooper et al., 1996: 624). Yet the issue of sedimentation raises important but as of yet unanswered questions about the performance of contemporary PSFs. First, is the diffusion of organizational features associated with ‘elite’ managed professional businesses across a wider population of PSFs conducive to their performance? At present, this question is still very much open. This is not only because a systematic test of the contribution of formal governance and strategic planning to PSF performance is still lacking. While these features are sometimes assumed to contribute to PSF efficiency (Cooper et al., 1996), they may alternatively jeopardize performance by disgruntling professionals through an assault on their autonomy (Von Nordenflycht, 2010) and by upsetting the fragile balance of understanding between various groups of internal stakeholders (Empson & Chapman, 2006). Second, how important are the various drivers of PSF performance relative to one another? Various groups of scholars have theorized and occasionally tested the effects of important performance drivers in isolation. Third, which organizational characteristics determine the contingent value of these performance drivers to PSFs (cf. Greenwood et al., 2006; Hitt et al., 2001)? Structural contingency scholars (Donaldson, 2001) would likely predict that formal governance and strategic planning are more important as drivers of performance in

larger, more diversified PSFs. Yet the applicability of contingency theory to PSFs is uncertain. PSFs can have several organizational characteristics, like being organized as a federal structure of semi-autonomous practice areas (Anand, Gardner, & Morris, 2007) and utilizing a core technology that is strikingly similar across organizations of different sizes (Greenwood et al., 1994), that make them less susceptible to contingency-theoretical explanations. In this chapter I test the influence of four organizational processes on PSF performance. I argue that both human capital and reputation are paramount in ensuring successful PSF performance. The implications of the MPB-related strategy formation and governance practices are yet unknown and I argue, could potentially have a positive or a negative effect on PSF performance. Finally, I posit that in the relation between contingencies such as PSF size and diversification, formalized governance practices and strategic planning will be positively mediated.

Based on survey data from 792 lawyers representing 354 law firms (a response rate of 21.2% at the firm level), I use Structural Equations Modeling (SEM) to test my research model. Hypothesis 1 suggested that human capital would be one of the main drivers of PSF performance, due to the knowledge-intensiveness of the services PSFs deliver. My results support this hypothesis, as human capital has a positive and significant direct effect on PSF performance. Also, Hypothesis 2 stated that PSF reputation would have a positively effect on performance, as the quality of professional services is difficult to observe directly (Von Nordenflycht, 2010). This assertion too was supported by my analyses. Hypothesis 3a predicted a positive effect of formal governance on PSF performance, due to its ability to rationalize business practices and manage possible conflicts of interest, while Hypothesis 3b highlighted the possible negative ramifications of interfering with professionals' autonomy through more formal controls. Hypothesis 3b had to be rejected in favor of Hypothesis 3a, as the positive effects of formal governance on PSF performance clearly prevail. Another set of rivaling hypotheses juxtaposed the possible positive effects of strategic planning (Hypothesis 4a) with its possible negative effects (Hypothesis 4b). Hypothesis 4a clearly prevailed over Hypothesis 4b, as benefits like improved resource allocation and overcoming myopia outweighed costs like practice rejection and working with planning methods that are possibly ill-suited to the nature of professional work. The relationship between PSF size and performance was indeed strongly mediated by formal governance and strategic planning. Similarly, I also found that the relationship between PSF diversification and performance was

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mediated by formal governance and strategic planning. In short, my analyses support Hypothesis 5.

Through my findings I contribute to the literature on PSFs in three ways. My study is the first to empirically assess the effects of novel-to-context organizational practices, and I find evidence that the positive effects of formal governance and strategic planning outweigh their negative performance implications. While this finding is relevant for scholars working on PSF performance, it should also be interesting to PSF scholars working on the diffusion and legitimation of the managed professional business archetype (e.g., Brock, 2006; Greenwood & Suddaby, 2006; Pinnington & Morris 2003; Suddaby & Greenwood, 2005). My study shows that the spread of this archetype is spurred on not only by the rhetorical strategies and institutional entrepreneurship of elite PSFs who have a stake in its social acceptance (Greenwood & Suddaby, 2006; Suddaby & Greenwood, 2005), but possibly also because adopting its features provides substantive benefits to PSFs in general.

Second, prior work aimed at identifying the drivers of PSF performance has largely tested their effects in isolation, as most existing studies scrutinize only a single or maximally two performance drivers. In contrast, my study offers a comprehensive test of four salient drivers of PSF performance, integrating prior research by scholars interested in human capital (Groysberg & Lee, 2009; Hitt et al., 2001), firm reputation (Greenwood et al., 2005), and other drivers. This yields two clear benefits. First, for PSF scholars interested in performance, a salient benefit of my more inclusive test is that it establishes the robustness of earlier findings to the inclusion of several other variables with a known effect on the dependent variable. My finding that these factors continue to have a statistically significant effect on performance in a competitive test validates and highlights the relevance of earlier studies. Second, for practitioners interested in enhancing PSF performance, a clear benefit of my research is that it enables a direct comparison of the regression coefficients in order to see which performance drivers matter most, with reputation being the most important driver.

Third, several scholars have recently made a case for a special theory of the PSF, as the type of services PSFs provide and the organizational design choices they make to facilitate their delivery set them apart from most other organizational forms (Empson & Chapman, 2006; Greenwood et al., 2005, Greenwood, Deephouse & Li, 2007; Greenwood & Empson, 2003; Von Nordenflycht, 2010). An important question for this emerging theory is whether or not it should embrace a contingency-theoretical set-up, such that its core predictions are theorized to be dependent on PSFs' scores on

core contingency variables like organizational size and diversification (Greenwood & Miller, 2010). My results do suggest that contingency elements should be built into the design of the nascent theory of the PSF.

### ***1.2.3 External agency relations and agency problems in professional service firms: A multilevel study***

In chapter four of this dissertation, the focus is primarily on PSF's public or gatekeeper function. As previously described, PSFs are characterized as having a public function of protecting vulnerable client and third-party interests. However with the recent increased emphasis on commercialism, this public function is under strain. In this chapter I try to uncover which organizational practices mitigate – or propagate – professional misconduct on the part of lawyers. The set of organizational practices under examination here are a combination of both practices from the professional logic and from the commercial logic. This is done, in part, by positioning misconduct by lawyers as agency problems deriving from external agency relationships.

Agency relationships arise in almost every form of human cooperation, including vertical delegation relationships (Fama & Jensen, 1983; Klein, Crawford, & Alchian, 1978) and horizontal co-production efforts (Alchian & Demsetz, 1972; Holmstrom, 1982). As most PSFs are held by a subset of their employees (Dow, 2003; Greenwood & Empson, 2003), PSFs do not face agency problems in the classical sense of separation of ownership and control. However, when defining an agency relationship to include: (a) a separation of decision making and exposure to the consequences of those decisions, under conditions of (b) at least partially conflicting interests and (c) knowledge and information asymmetries (Arrow, 1985; Eisenhardt, 1989), PSFs are subject to external agency problems.

The first type of agency relationship is that between professional and clients. This relationship is highly vulnerable to the occurrence of agency problems, not only because of possible conflicts of interest in respect to fees and billable hours (Hayward & Boeker, 1998), but also on account of substantial information and knowledge asymmetries, making it difficult for clients to evaluate the quality and integrity of the professional judgments and actions taken on their behalf (Sharma, 1997). Client vulnerability is historically one of the most salient reasons behind the institutionalization of professions such as law and accounting. Professional-client agency is likely to be associated with agency problems like overbilling, sub-standard service quality delivery, and neglect of professional ethics. When detected, these

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behaviors tend to give rise to complaints filed by clients with the disciplinary bodies of professional associations.

The second form of external agency problems of PSFs I define as professional - third-party agency. In their daily affairs, professionals routinely make decisions that affect a host of other external parties, even though they do not transact with them directly. Paradigmatic examples of such 'third party beneficiaries' (Eisenberg, 1992) are the beneficiaries of a trust made up by a lawyer, and the participants in public equity markets relying on the assurance over the annual accounts of public firms provided by accountants (Goldberg, 1988). The professional association may in all instances be seen as the principal in this agency relationship as it is the primary enforcer of the rules and professional standards that protect third-party interests. These professional-third party agency problems are manifested through breaches of professional rules, standards, or procedures. Both the professional-client as well as the professional-third party agency problems is reported to the professional disciplinary bodies in the form of complaints.

I develop a distinctively organizational, multilevel theory of corporate governance practices in PSFs. In this view, the agency relationships that characterize PSFs as an organizational form merely constitute the 'fault lines' along which agency problems can materialize (Heath, 2009). Whether or not agency problems will actually occur, however, is at least partly dependent on the specific organization-level governance practices that PSFs feature, as well as on individual-level risk propensities that arise from functioning as a professional.

Governance in PSFs has historically been based on informal or 'soft' controls, whose functioning is facilitated by the high degree of face-to-face interaction between professionals in PSFs (Zey-Ferrel & Ferrell, 1982), and founded in their employees' commitment to professionalism (Gendron, Suddaby, & Lam, 2006; Hall, 1968). Two features of the P<sup>2</sup> configuration function as soft controls containing behavioral risks resulting from agency relations in PSFs: professional socialization and the social or 'club' value that the organization provides to individual professionals. The first set of practices are aimed at socialization (Anderson-Cough, Grey & Robson, 2000) of their members with the goal of transferring expert knowledge to junior professionals and demonstrating expectations regarding appropriate behavior (Brief, Buttram & Dukerich, 2001). The second set is practices related to the club value of the PSF. As an organization's climate influences the behavior of employees (Deshpande, George & Joseph, 2000), professionals that feel intrinsically bound to the organization are more

likely to demonstrate appropriate professional behaviors. Stimulating this club value thus will serve to reduce agency problems.

When referring to hard controls I address the more novel-to-context organizational practices introduced through the more commercial ethos. I argue that these controls are likely to increase agency problems. The introduction of performance and strategic planning practices force professionals to prioritize profits over professional ethics. This may result in more calculative behavior and may negatively influence cooperative dispositions (Frank, Gilovic & Regan, 1993) as well the prevalence of unethical behavior (Frank & Schulze, 2000). Additionally, formal governance of ethical programs removes the locus of responsibility from the professional to the organization thus reducing collegial monitoring.

A final set of variables that potentially induce professional misconduct are related to the individual professional's risk propensity. In PSFs, individual professionals are likely to have different propensities to become involved in agency problems due to the differential risk orientations that result from their experience and job roles. One vulnerable category is the non-partnered associate. PSFs feature highly competitive human resource management practices, centered on 'up or out' promotion principles (Morris & Pinnington, 1998), which stage the process of an associate's admission to partnership as an all-or-nothing tournament. In 'up or out' systems, the fruits of several years of deferred compensation, hard work, and relentless dedication are distributed highly unequally between associates (Becker & Huselid, 1992; Eriksson, 1999). The substantial rewards associated with becoming a partner, the disproportional influence of the threat of being denied partnership on decision making (Kahneman & Tversky, 1979), and the single-shot character of promotion to partner decisions all may lead associates to become more frequently involved in agency problems than individuals working in different roles.

Another vulnerable category is the experienced professional. With experience, professionals may become more risk-prone and more frequently involved in agency problems (Elm & Nichols, 1993). More seasoned professionals can become overconfident in their own skills and expertise, and may therefore overestimate the chance of getting away with opportunistic behaviors. More experienced professionals are also less likely to be subjected to collegial correction of beliefs and behaviors, as they tend to work more autonomously. Furthermore, experienced professionals also tend to work on more complicated cases, which increase the chance of them becoming involved in agency problems.

Using hierarchical linear modeling on a sample of 2083 lawyers representing 203 law firms (response rates of 53.5% and 36.5%, respectively) I model the effects at both the individual and the organizational level. My findings suggest that soft controls are better suited in addressing professional agency problems, mainly through socialization processes. The presence of strategic planning on the other hand exacerbates the number of complaints. In terms of individual risk propensity I find that more seasoned professionals are likely to receive more complaints, whereas junior associates receive significantly less complaints.

Based on these findings I contribute to the literature in three ways. First, my study contributes to the emerging literature on the corporate governance of non-publicly listed firms (Daily & Dollinger, 1992; Gómez-Mejía, Takács Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007; McCahery & Vermeulen, 2008; Schultze, Lubatkin, Dino & Buchholz, 2001). Second, after conceptualizing agency problems in PSFs, my findings suggest that the type of long-established informal practices that feature predominantly in PSFs of the P<sup>2</sup>-type (Greenwood et al., 1990) are better attuned to the specific governance challenges of PSFs than the more formal practices characterizing MPB-like PSFs (Cooper et al., 1996). Presumably, this is because these informal practices are better suited to deal with hard-to-observe and difficult-to-monitor professional behaviors than more formal organizational practices (Greenwood & Empson, 2003). While the latter seem better attuned to monitoring economic performance, and have often been specifically adopted for that purpose, they also appear to 'crowd out' traditional professional values from PSFs (Frey & Jegen, 2001). In general, my findings suggest that effective corporate governance practices are likely to be highly specific to an organizational form, and emphasize the need for corporate governance researchers to move beyond the study public firms and research the governance challenges and practices of other organizational forms, even if the data for such studies is difficult to collect.

Third, in this study I show that individual-level risk factors also play a role in the PSF context, where they can put additional strain on the unique types of agency relationships that characterize this organizational form. While we have only just begun to understand the finer-grained mechanisms through which professionals come to accept excessive risk and reduce the self-policing impact of professional norms on their behavior, my findings do point out new avenues for PSF research. In particular, they demonstrate the applicability of demographic (Hambrick & Mason, 1984) and

decision-making (Hitt & Tyler, 1991) theories of organizational action in the PSF context.

#### ***1.2.4 Organizational forms and professional service firm outcomes: A set-theoretic study***

In the final chapter of this dissertation, the main contribution lies in using set-theory to analyze the effects of specific organizational configurations of practices on the two principal objectives of PSFs: maximizing their professional standards and the quality of their professional work, and maximizing their profits and broader commercial performance.

The first step to this aim is to check whether the two configurations previously discerned by the literature – the P<sup>2</sup> (Greenwood et al., 1990) and the MPB (Cooper et al., 1996) – are the only extant configurations in the law industry, or whether there are also different configurations present. Although several landmark studies embracing these two configurations (Greenwood et al., 2002, 2005; Hitt et al., 2001; Suddaby & Greenwood, 2005) set the stage for a productive stream of empirical research on PSFs, they also raised a number of fundamental questions in regard to PSF configurations.

First, as most of the foundational work on PSF configurations is qualitative and interpretative (e.g., Robertson, Scarbrough, & Swan, 2003; Suddaby & Greenwood, 2005) or conceptual (e.g., Greenwood & Empson, 2003; Malhotra & Morris, 2009) in kind, we presently lack a more systematic empirical validation of the P<sup>2</sup> and MPB configurations.

Second, against the backdrop of contingency-theoretical explanations of the substantive and symbolic performance of organizational forms (Donaldson, 2001; Drazin & Van de Ven, 1985), the extant PSF literature raises the question whether the P<sup>2</sup> and MPB configurations are well-fitted and efficient organizational forms, or whether they owe their existence primarily to the competition-reducing institutional peculiarities of the professional environment in which they operate (Von Nordenflycht 2010). All firms need to address the contingencies they face in their environment in order to achieve fit and maximize their effectiveness (Donaldson, 2001; Drazin & Van de Ven, 1985). Consequently, top management of law firms has to decide how to use their resources in order to support their different activities (Penrose, 1959; Løwendahl, 2005). This choice is primarily related to how the firm sees its product/market strategy (Ansoff, 1967), i.e. who are its clients, what will be its geographical reach, and finally, what types of services will it deliver. I argue that P<sup>2</sup> organized firms are uniquely

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suites to deliver specialty services of high quality to local or national clients. This compared to the MPB organized firms that are best at serving international clients that demand generic, one-stop-shop services. Configurations that fall in between the two configurations will not be able to offer these services as efficient as the pure forms. Therefore, I propose that pure configurations will outperform mixed configurations both in terms of substantive and symbolic performance.

Third, and as stated, all PSFs serve at least two objectives. One is the public objective of serving vulnerable client and third-party interests, for example by buttressing the legal system (law firms) or by ensuring the materiality and transparency of information in financial markets (auditing firms). Another is the private objective of generating profits for the owners of the firm. Prior contributors have argued that PSF's public objectives have greater currency in the P<sup>2</sup> configuration, while private objectives are deemed more important in the MPB configuration (Cooper et al., 1996; Greenwood & Suddaby, 2006). Given that firms will rarely – if ever – be able to maximize multiple objectives simultaneously (Jensen, 2002), I argue that the P<sup>2</sup> configuration – which prioritizes the professional objective – outperforms the MPB – which prioritizes the profit objective – and mixed configurations in the degree of violations of client and third-party interests.

I test these propositions on a sample (n = 450) of Dutch law firms. Using survey data I can determine per firm whether it is organized along the P<sup>2</sup> or MPB configuration or whether a firm is a hybrid. Using fuzzy-set qualitative comparative analysis (fs/QCA: Fiss, 2011), I am able to map multi-variate causal complexity and its implication for performance, reputation and misconduct.

First, contributors to the PSF literature have previously documented two organizational configurations, the P<sup>2</sup> and the MPB (Greenwood et al., 1990; Cooper et al., 1996). However, their description has been based on interpretative case studies, and with the notable exception of Pinnington and Morris (2003), the extent of their applicability in the entire domain of a professional industry such as law and accounting has not been researched. Based on the outcomes of my study, my contributions are threefold. First, I find evidence that the MPB is indeed a common organizational configuration, and that it has persisted to this day in much the same form as was originally described by Cooper and his associates (1996). Second, however, my results also show that the P<sup>2</sup>-configuration, while still discernable, no longer exists in exactly the same form as first described by Greenwood and his colleagues (1990). Specifically, I observe that, consistent with the broader societal trend

towards formalization, efficiency, and commercialization (Suddaby & Greenwood, 2005), law firms are also subject to these institutional forces. Originally the P<sup>2</sup>-configuration relied exclusively on informal and collegial manners of supervision and control. Yet I find that especially the reliance on the informal governance practices has been wholly replaced by formal governance and strategy formation processes. However, consensus decision making remains the most adequate form of inter-partner interaction. To highlight this change that has occurred in the P<sup>2</sup> configuration, I dubbed this form the P<sup>2.1</sup>.

Second, I have assessed the causal links between the various types of configurations present in the Dutch law industry and their substantive and symbolic performance. What is noteworthy about these analyses is that I detected that only P<sup>2.1</sup> and MPB configurations are present in the Dutch law industry, but also a number of different hybrid configurations. Whereas such hybrid configurations have been described in the literature as being unstable and inconsistent in their values, systems, and structures (Gray, 1999), my analyses show that they do not necessarily yield poor performance. While I cannot assess whether these hybrids are stable or unstable, their performance and reputation implications are often positive. On the other hand, the MPB configuration in its purest form appears to be the most powerful configuration for generating high substantive and symbolic performance. These results seem to support a generic structural contingency theory-based take on PSF performance, indicating that the success of PSF configurations is dependent on the contingencies these firms face.

My third contribution entails an improved understanding of what produces the darker side of organizational configurations. Specifically, my answer to the question as to what causes PSFs to engage in misconduct (Greve, Palmer, & Pozner, 2010) and jeopardize vulnerable client and third party interests lies in the tradeoffs that PSFs must necessarily make when combining public and private objectives. In general, PSF research treats these two objectives as being separate, while the findings I have reported suggest the necessity of conjoint analysis. What my empirical results show, however, is that it is absolutely critical to assess the private and public objective functions of PSFs simultaneously when vetting the effectiveness and desirability of any PSF configuration in particular. For example, the MPB configuration offers an organizational design that does well in terms of private objectives by ensuring high substantive and symbolic performance, but it does so at the cost of poor outcomes on public objectives: the MPB scores very high in terms of the level of organizational

misconduct it produces. The absence of strong informal governance, through which professionals can collegially correct one another's misdeeds and which is one of the hallmarks of the original P<sup>2</sup>-configuration, is the key ingredient that is missing in these firms. As my analyses suggest, informal governance can be used as a complement to or as a substitute for formal governance when organizational size, complexity, and scope are minimal. However when PSFs grow, diversify, or internationalize, they require more formal governance.

### **1.3 Final remarks and structure of this dissertation**

My overarching question was: what are the effects of the changing logic from professionalism to commercialism on PSFs? In effect should PSFs focus on profits or professionalism? This is an important question for professionals when designing their organizations as the findings in this dissertation suggest that they are difficult to combine with a single configuration. Given the importance of PSFs in the contemporary economy, I contribute to our understanding of the impact of organizational design on corporate objective functions. With this dissertation, I aspire to say something of interest to academics, practitioners and public policy makers alike. Although I have given only a cursory overview of my findings in this introduction, I will address these issues in the remaining chapters. In chapter two I show how accountants at mid-tier accountancy firms perceive and deal with the push towards commercialization. In chapter three I focus on the effects of novel and traditional performance drivers on PSF performance. In chapter four, I again focus on the different sets of practices in order to investigate their impact on misconduct. In the final chapter I look at configurations of organizational practices and at their impact on performance, reputation and misconduct.



# Chapter 2. Heterogeneous organizational responses to conflicting institutional logics<sup>1</sup>

## Abstract

We study how mid-tier accounting firms engage with changes in their institutional environment that results in a shift from a trustee logic to a commercial logic. We find that these mid-tier firms selectively adopt practices related to the commercial logic, while retaining a principal commitment to the trustee logic. Main strategic issues for the mid-tier firms relate to the changing role of the accountant and changes in organizational structure and practices. As these issues fundamentally challenge characteristics of their professional identity, there is internal resistance against this transformation. Non-partnered accountants mainly challenge new roles that upset their extant work routines, whereas partners resist changes affecting their autonomy. These types of resistance directly impact the strategic organizational responses accounting firms undertake. The upshot of our analysis is an enriched understanding of actor engagement in processes of institutional transformation.

## 2.1 Introduction

In prior investigations of processes of institutional change, scholars have pointed to the importance of institutional tension based in the incompatibility of competing institutional logics (Seo & Creed, 2002; Thornton, Jones & Kury, 2005; Thornton & Ocasio, 2008). Institutional logics reflect the socially constructed basis of “historical patterns of material practices, assumptions, values and beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meaning to their social reality” (Thornton & Ocasio, 1999: 804). They shape how organizations and individuals behave and thereby affect organizational structures and processes (Greenwood, Diaz, Li & Lorente, 2009). While logics are fundamental and influential, organizational fields are rarely subject to a

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<sup>1</sup> This chapter is co-authored with Dr. Bas Koene and Shelly S. Linssen, MSc. A previous version of this paper was presented at the EGOS consortium in Lisbon, 2010. This paper is currently under review at Accounting Organizations and Society.

single dominant logic. Rather, firms have to contend with multiple, often contradicting logics that affect institutional stability and change (c.f. Lounsbury, 2007; Marquis & Lounsbury, 2007; Thornton et al., 2005; Raey & Hinings, 2005; Purdy & Gray, 2009).

When external expectations regarding these conflicting logics are unclear, this leaves room for managerial discretion (DiMaggio, 1988; Oliver, 1991; Weaver, Treviño & Cochran, 1999b). Therefore, intra- and interorganizational sociopolitical conflict will affect the adoption processes of practices related to these conflicting logics (Fiss & Zajac, 2004), as practices will not necessarily be in line with the goals and strategies of sets of actors within and between firms (Lounsbury, 2007). It is therefore unlikely that strategic responses to conflicting logics will be similar across all actors populating an organizational field (Pache & Santos, 2010). Following Greenwood et al. (2009), we look at the heterogeneity of organizational responses in a well-documented organizational field: the accounting industry. Greenwood and Suddaby (2006) showed how a new organizational form developed under the auspices of a limited set of elite firms. They described how the development of the big 5 accounting firms and concomitant developments in their international environment led to a tension between the traditional trustee - or fiduciary (Thornton et al., 2005) - logic and an emerging commercial - or corporate (Thornton et al., 2005) - logic. The big 5 accounting firms were instrumental in advancing the commercial logic, as developments both in the internal and external environment disengaged these elite firms from the traditional trustee logic (Greenwood & Suddaby, 2006).

Where most studies focus on the elite (Greenwood & Suddaby, 2006) or the mavericks (Leblebici, Salancik, Copay & King, 1991), the core of an organizational field consists of mainstream firms and studies examining change within this group has remained limited (Hardy & Maguire, 2008). In this paper we investigate the strategic responses (Oliver, 1991) displayed by mid-tier accountancy firms in the Netherlands in the face of conflicting demands of the trustee and commercial logic. These mid-tier firms present an interesting sample for three reasons. First, although still quite large in size (both in terms of employees and revenues), they are less able to directly influence and change their organizational field as compared to the big 4, which could possibly lead to a different set of organizational responses. Secondly, their client base differs, as they tend to serve smaller more local clients than the big 4. Hence, they face different client demands. Third, given the relatively small size of the professional cadre and the relatively easy access to the strategic apex of the firm, non-partnered professionals still have a great deal of influence on its day-to-day operations.

By exploring the ways in which the mid-tier accounting firms deal with the tensions between the traditional trustee logic and the commercial, we make three contributions. First, we contribute to the literature on institutional logics and change. Fundamental changes in environmental conditions of organizations lead to organizational change (Romanelli & Tushman, 1994). Within the accountancy sector, changes such as increased regulation, automation of services, and changing client demands have recently punctuated a long period of stability. These significant environmental jolts (Meyer, 1982) are hypothesized in prior literature to result in revolutionary transformations of organizations rather than their evolutionary development (Greenwood & Hinings, 1996; Romanelli & Tushman, 1994; Tushman & Romanelli, 1985). Yet, this is not what we observe in our group of mid-tier firms. These firms do not show a comprehensive transformational embrace or outright rejection of the novel commercial logic. Rather, the mid-tier firms respond by addressing separate and specific strategic and structural issues, which are invoked by the new logic and relevant for their organization in terms of resource dependencies or autonomy challenges, in an incremental way. This is caused by their embeddedness in the existing trustee logic. As such, embeddedness provides a significant force for stability and causes resistance to change (Granovetter, 1985; Greenwood & Hinings, 1996; Maguire, 2007; Oliver, 1997).

The source of resistance is located internal to the firm and this insight forms our second contribution. In our study, we observe a fragmented implementation of elements of the new logic. Mid-tier firms use it strategically and opportunistically by selecting only those elements that have the perceived potential to resolve concrete managerial challenges regarding specific strategic issues. The diffusion process of the commercial logic in the field segment populated by mid-tier firms therefore looks more like a process of institutional bricolage (Aldrich, 2010), especially because of the enduring influence of the traditional trustee logic on mid-tier actors' behavior. This influence results in a piecemeal acceptance of elements comprising of the new logic as well as variation in the way new systems are adopted and implemented. The trustee logic continues to exercise its effect through the embedded action of managing partners as well as non-partnered accountants, whom are unwilling to forgo their professional traditions and norms, in no small part because of their vested interests. To deal with these internal sources of resistance, the majority of mainstream accountancy firms adopts and adapts practices that are in the 'zone of acceptance' (Ansari, Fiss & Zajac, 2010; Lewis & Seibold, 1993; Radnor, Feller & Rogers, 1978). Studying these

internal sources of resistance therefore contributes to our understanding of when and what strategic responses are likely to form. It informs the diffusion literature by showing the dynamics of “interrupted, incomplete, or even failed diffusion processes (Johnson, 2009), an area which have so far received very little attention” (Ansari et al., 2010).

Our third contribution is to the literature on PSFs by addressing the issue of generalizability of this literature’s extant findings to other (segments of) professional fields (Von Nordenflycht, 2010). The change in institutional logics identified and documented by Greenwood and Suddaby (2006) in their longitudinal qualitative study of the big 4 accounting firms cannot straightforwardly be extrapolated to the rest of the actors in the accounting industry. While Greenwood and Suddaby’s big 4 firms are dealing with multinational clients in a supra-national arena, our mid-tier firms are well-established in their national setting, engaging primarily with local clients and experiencing greater influence of national professional organizations. Our findings indicate that the commitment to the traditional trustee logic is considerably stronger within this group of more locally grounded firms. While we observe that mid-tier firms respond to the previously mentioned challenges by adopting elements of the commercial logic, they do not embrace the latter logic consistently, let alone wholesale. Thus, Greenwood and Suddaby’s (2006) finding that a groups of elite firms pushes a comprehensive and consistent agenda propagating the commercial logic simply does not translate to the group of mid-tier firms. This suggests that organizational responses to conflicting or changing logics may differ systematically across the different demographic strata into which organizational fields tend to be segmented.

## **2.2 Theoretical orientation**

### **2.2.1 *Shifting institutional logics***

Traditionally, the accounting industry was governed by a trustee logic (Suddaby & Greenwood, 2005) where professional values and a feeling of societal guardianship were central to the professional identity. Professional audit practices were the core of the accountants’ activities and as these activities meant applying an esoteric body of knowledge to complex problems, they enjoyed high levels of discretion and autonomy (Greenwood, Hinings & Brown, 1990). Additionally, senior members, who typically own and manage the firms are often responsible for their particular practice areas and

hence place priority hereon. In practice this means that the strategy of the firm can be described as the aggregate of the partners' individual interest (Pinnington & Morris, 2003). In terms of organizational systems and practices, these firms relied primarily on informal and collegial control mechanisms at the expense of more formal and hierarchical systems (Greenwood et al., 1990).

However, recently the accounting industry experienced a number of upheavals that challenged traditional professional practice. First, technological developments have had significant impact on the audit process. Computer aided audit systems have reduced the complexity and labor intensity of the audit process (Brock, 2006). In the Netherlands, the introduction of a standardized software language XBRL meant additionally increases in efficiency and ultimately less billable hours in the consolidation practice (ING, 2010). On the client side, the increased emphasis on costs and the internet and mobile technologies that allow for shopping around, add to the pressure on the fees of the audit process (Aharoni, 1999). Secondly, due to globalization, accountancy practices now have to deal with international standards and practices of their international clients (Nanchum, 1996), leading to new knowledge requirements of accountants. Third, statutory protection for providing services has been reduced or removed (Hart, Schlesinger & Maher, 1992). This resulted in growing intra- and inter-professional competition (Gray, 1999). Fourth, the implications of the Sarbanes-Oxley act as well as the shift from principle-based to rule-based accounting has changed the organizational structure of accounting firms (Greenwood & Suddaby, 2006), reducing the importance of the individual accountant. In the Netherlands, for those firms that perform statutory audits of annual and consolidated accounts, the *Wet toezicht accountantsorganisaties* (Wta; law on the supervision of accounting firms), has been implemented. This law entails that accountancy firms require permits for statutory audits, the allocation of which is determined by a number of stringent quality demands. This has led to a decrease in the number of firms allowed to conduct audits. The Wta has created a large barrier of entry as the costs of these permits, are significant. There are the direct costs of obtaining and maintaining this permit as well as indirect costs stemming from the investments firms have to make in their quality systems (ING, 2010). Finally, firms also face changes in client demands. Here the role of the traditional accountant is slowly being shifted towards that of an advisor to the firm. Clients are not only more critical towards the service they receive, but also demand more and different services. This full service advice is also increasingly demanded by the firms serviced by the mid-tier firms in the Netherlands (ING, 2010).

These developments pushed accounting firms to rationalize their service delivery process, adopt more efficient structures, broaden their activities in consultancy services, and actively engage in marketing campaigns (Greenwood & Suddaby, 2006). Combined, the changes in economic and social trends, legislation and government policies (Løwendahl, 2005; Maister, 2003; Nanchum, 1996), as well as those in product market, financial and factor pressures (Cooper, Greenwood, Hinings & Brown, 1998; Greenwood et al., 1990) have put strain on the trustee logic formerly dominant in the accounting sector and resulted in the propagation of the commercial logic (Suddaby & Greenwood, 2005). Under this logic the large accounting firms can be described as more consciously managed. The underlying values have shifted from the application of expertise in the interest of public service to a focus on efficiency and value added provision of the services rendered by the firm (Pinnington & Morris, 2003). To assure this efficiency and avoid strategic drift (Lorsch & Tierney, 2002) the large accounting firms introduced formal strategic planning and governance, emphasized marketing and work with centralized financial systems (Morris & Pinnington, 1998).

### **2.2.2 Strategic responses**

Changing institutional demands inherently result in a changed organizational field. Literature on institutional logics shows four possible outcomes of the clash between logics: the incorporation of elements of a new logic into the dominant one (e.g. Glynn, 2000), the hybridization of elements of both the old and new logic (e.g. Purdy & Gray, 2009; Colyvas & Powell, 2006; D'Aunno, Sutton & Price, 1991), a shift from the old dominant logic to the newly introduced logic (e.g. Thornton, 2002; Zilber, 2002) or the permanent co-existence of both logics (e.g. Lounsbury, 2007; Marquis & Lounsbury, 2007; Reay & Hinings, 2005, 2009; Scott, Ruef, Mendel & Caronna, 2000). The mid-tier accounting firms face the same upheavals and as a result organizational responses in the face of conflicting institutional logics are unlikely to be similar (Oliver, 1991; Pache & Santos, 2010).

Oliver (1991: 145) points to the lack of “attention to the strategic behaviors that organizations employ in direct response to the institutional processes that affect them.” Drawing on institutional and resource dependence theory she describes how organizations within the field react and behave. To cope with institutional demands firms can employ five different strategic responses: (1) acquiescence, organizations accede to institutional pressures; (2) compromise, organizations try to balance between

inconsistencies between institutional expectations and organizational objectives; (3) avoidance, organizations try to preclude the necessity of conformity; (4) defiance, organizations actively resist institutional expectations; and (5) manipulation, organizations actively try to redefine the institutional expectations. Following the publication of this seminal work, a productive research stream developed to uncover which strategic responses are employed by firms in various settings. This research stream can be classified in three categories of articles.

By far most articles discuss shifts in the organization field of firms and the resulting demands placed upon them by field members. However, these studies often investigate a specific issue facing focal firms to which they need to respond rather than wholesale shifts in logics. Additionally, the possible responses of these firms are limited to mostly acquiescence/adopt or defiance/non-adopt. For example, adoption or resistance has been tested for cesarean surgeries (Goodrick & Salancik, 1996), university recycling programs (Lounsbury, 2001), divisionalization (Thornton, 2002), independent professional money management firms (Lounsbury, 2007), shareholder value orientation (Fiss & Zajac, 2004, 2006), investor relations departments (Rao & Sivakumar, 1999), issue management practices (Greening & Gray, 1994), work family issues (Milliken, Martins & Morgan, 1998), information systems outsourcing (Ang & Cummings, 1997) and TQM systems (Westphal, Gulati & Shortell, 1997). As such, the focus of these studies is on inter-firm differences in responses to specific issues on a field level often explained through firm level variables. A significantly smaller set of papers directly investigates all five strategic responses, however again geared towards specific issues (e.g. Goodstein, 1994; Ingram & Simons, 1995). The final category of papers study organization responses through in-depth case studies that look at field level changes with regard to shifting institutional logics. In these studies, however the focus on the reconfiguration of logics and strategic options of firms are implicitly assumed rather than formally investigated (e.g. Hoffman, 1999; Townley, 2002).

Recently, Pache and Santon (2010) argued that the type of strategic response given by firms is not solely determined by external forces, rather by internal representation. The term internal representation is different from the term dominant coalition (Cyert & March, 1963; Thompson, 1967) as this refers to a particular group that has superior power of the remaining constituents. This is not necessarily the case in terms of internal representation, logics can also not be represented or two equally powerful coalitions may support different logics. Internal representation is determined in part by hiring practices of professionals that adhere to a different set of norms

(D'Aunno et al, 1991). It is also influenced by perceptions of the existing internal audience based on the dominant institutional logic in which they operate (Friedland & Alford, 1991). As compared to the previous studies investigating organizational responses, we focus on a shifting logic to which multiple strategic responses are possible given the influence of internal representation. Therefore our research question is:

*Research Question: Which strategic responses do mid-tier accounting firms use to balance the tension between the trustee and commercial institutional logics?*

## **2.3 Methods**

### **2.3.1 Rationale**

The aim of this research is to elaborate our current theoretical understanding (Lee, Mitchell & Sablinski, 1999) regarding multiple institutional logics and their impact on the heterogeneity of organizational responses. Similar to Greenwood and Suddaby (2006) we use inductive reasoning, to map organizational responses to institutional pressures as perceived in the demographic of mid-tier accounting firms. In order to document “changes in structures and systems” and “the ways in which these changes coincide with institutional templates” large scale comparative studies are necessary (Greenwood & Hinings, 1996: 1047). They are necessary as changes involve difficult to measure concepts (e.g. resistance) and radical changes take lengthy periods of time. Hence we opted for a qualitative, multiple case study (Eisenhardt, 1989) and use event sequencing of historical and contemporary processes (Lee et al., 1999) within and between cases. In order to disentangle the process of organizational change we draw on interview and archival data.

### **2.3.2 Research context: The Dutch accountancy sector**

The accountancy firms included in the sample are drawn from these 22 largest accountancy firms listed directly behind the big four firms. In terms of profits and full-time employees mid-tier firms differ substantially from the big 4 accounting firms. In the ranking of largest accounting firms in the Netherlands the big 4 are followed by three firms with profits in excess of €100 million and employing over 1000 fte. The

following six firms have over €50 million in profits and employ over 500 employees. Finally, the remaining 13 mid-tier firms have profits in excess of €15 million and employ more than 150 employees (www.accountant.nl).

### 2.3.3 Data sources

We define our sample geographically, which is a tried and tested sampling method for professional organizations whose operations are (somewhat) contingent on the jurisdiction in which they are active (Ruef & Scott, 1998; Greenwood & Suddaby, 2006). Our data was collected from 2009 to 2011, in the jurisdiction of the Nederlandse Beroepsorganisatie voor Accountants (NBA; Dutch Accounting Association).

Our primary sources of data are interviews with senior-level informants within 11 mid-tier accounting firms in the Netherlands (see table 1 for firm and informant information). These informants were theoretically sampled on a number of characteristics (Corbin & Strauss, 2008). First, the informants needed to have insight in the strategic plans of the firms. Preferably - and most of our informants were - the informants needed to be (managing) partners and as such have decision making authority. Secondly, the informants represented the different areas of the firm such as the audit branch, the consolidation branch and the fiscal branch.

**Table 1: Informant information**

Firm	Informants
A1	Turnover = € 215.7 million
A2	CEO (20 years at firm)
A3	National senior manager (3 years at firm)
A4	# FTE = 1950
B1	Managing partner (8 years at firm)
B2	OOB licensed
B3	Regional managing partner (25 years at firm)
C1	Turnover = € 115.5 million
C2	Regional managing partner (7 years at firms)
C3	Managing partner audit (9 years)
D1	# FTE = 1160
D2	Managing partner accountancy (2 years at firm)
D3	OOB licensed
D4	Senior policy maker HR (5 years at firm)
E1	Turnover = € 111.7 million
E2	Regional managing partner (9 years at firm)
E3	Director general business affairs (15 years at firm)
F1	# FTE = 1280
F2	Managing partner (28 years at firm)
F3	Regional managing partner (12 years at firm)
G1	# FTE = 866
G2	Managing partner (12 years at firm)
G3	National managing partner & member of the board (21 years at firm)
G4	OOB licensed
G5	Turnover = € 68.8 million
G6	CEO (6 years at firm)
G7	Managing partner & member of the board (40 years at firm)
G8	# FTE = 756
G9	Partner (2 year at firm)
G10	Turnover = € 59 million
G11	Senior relations manager (1 year at firm)
G12	Regional manager tax and international affairs (11 years at firm)
G13	# FTE = 636
G14	Regional manager accountancy (21 years at firm)
G15	Turnover = € 53.5 million
G16	Managing partner & international representative (9 years at firm)

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G2	million # FTE = 465	National managing partner & member of the board (29 years at firm)
G3	OOB licensed	Managing partner (18 years at firm)
G4		Managing partner (22 years at firm)
H1	Turnover = € 43.3	Managing partner audit (15 years at firm)
H2	million	Managing partner accountancy (16 years at firm)
H3	# FTE = 476	Compliance officer and director of education (8 years at firm)
I1	Turnover = € 29.6	Senior Manager (3 years at firm)
I2	million	Managing partner audit, member of the board (5 years at firm)
I3	# FTE = 293	Director Audit (13.5 years at firm)
J1	Turnover = € 21.3 million # FTE = 161	Managing partner (1 year at firm)
K1	Turnover = € 17.4	Regional managing partner (6 years at firm)
K2	million	Regional managing partner (16 years at firm)
K3	# FTE = 180	Regional managing partner (3 years at firm)

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As we study institutional logics conflicts we are tapping into cognitive aspects such as perceptions, thought and interpretation we are at the risk of several biases (Miller, Cardinal & Glick, 1997). In order to mitigate subject biases, we used multiple informants per firm. The added benefit of using multiple informants is that it often results in richer data (Schwenk, 1985). In the first instance, the managing partner or director was contacted and informed about the study's objectives and asked to participate in an interview. Subsequently, using snowball sampling (Kerlinger, 1986), we asked the first informant to specify at least two other potential informants. The interviews ranged from one to one and a half hour in length. We always started by asking the informant background information on the firm as well as the informant. Hereafter, open-ended questions were used to elaborate on five important forces for change in the accounting industry. Open-ended questions lead to higher accuracy in reports (Miller et al., 1997). Examples of questions include: "what are the five most important changes in the firm's environment that led to changes in the mindset of the firm? Why were these changes seen as important in the firm?" Subsequent questions were used to uncover the effects of these forces on the strategy and/or structure in the last five years within the informants' firm. Example questions include: "what were the influences of these changes on organizational structures and practices?" "What is the best response to the changes for your firm in terms of strategies, structures and practices?" "Why was this response (not) chosen?" "Was there any resistance to the changes in the firm?" All interviews were recorded and transcribed. The total number of transcribed pages amounted to 1400 double-spaced pages. In order to minimize retrospective bias (Miller et al., 1997), we asked informants to reflect on real time and retrospective change or non-change events. This motivated informants to tell their

story on (non-)changes in their firm and the substantiation of accounts through instructive examples. We also provided anonymity for both the informants as well as the firms they represent to encourage openness with regard to the strategic responses of the firms (Miller et al., 1997). As these informants are at the heart of organizational decision making, they are exceptionally knowledgeable and reliable regarding the events they were asked to describe (Kumar, Stern & Anderson, 1993; Seidler, 1974). These example events thus referred to structural (e.g. directive decision making), strategic (e.g. extension of services rendered) or changes in practices (e.g. cold acquisition). Subsequently, we compared responses of the multiple informants of the firms, on these change issues. If there exists substantial differences between the accounts of informants of the same firm, retrospective biases are present or our interview protocol is unreliable. This did not prove to be the case as we did not find significant difference between the responses between stories and instructive examples of respondents of the same firm (Seidler, 1974).

We used additional sources of data in order to address potential subject bias (Jick, 1979). Archival data on both changes in the industry as well as changes within firms were consulted when available. We used three different kinds of archival information. First, we used annual reports (2008-2010) of the professional accountancy association in order to determine key trends as well as important legislative changes within the accountancy industry. Secondly, we perused the companies' websites to uncover any press releases (from 2008-2011) for descriptions of major changes the firms have gone through. Finally, we used information drawn from industry journals (e.g. *Maandblad voor Accountancy and Bedrijfseconomie* (MAB; Monthly journal on accountancy and business economics). Information herein was analyzed after the interviews were held and was used to supplement both the information of forces for change in the field, as well as changes that were initiated by various actors in the field. These data were primarily used to corroborate the information drawn from the interviews however at times it was used to supplement our data.

#### **2.3.4 Data analysis**

The data analysis had both a planned and emergent character. During the analysis the authors shifted back and forth between raw data and theory in order to make sense of the effect of conflicting logics on organizational responses (Glaser & Strauss, 1967). In doing so, we focused on three basic questions: (1) what forces for change are mentioned by the firm; (2) what elements of the firm did these pressures influence;

and (3) what were the organizational responses given by the firm? The process involved two distinct steps.

**Stage 1.** Case studies were written for each of the firms in the sample based on informant quotes as well as archival data (Graebner, 2009) and varied in length between 20 to 40 pages. In these case studies, first, the drivers of institutional change that resulted in conflicting institutional logics were coded. Following common inductive processes, we went from broad generic classification of the issues related to the questions above in the first coding round, to more specific categories in coding round two. In the first round quotes that identified drivers for change were coded as such. In the second round of coding, these drivers were classified in more specific categories such as stemming from rules and regulation, or automation of processes. These drivers were subsequently analyzed for their influence on the two existing institutional logics. However, as it is difficult to empirically identify institutional logics we followed Jarzabkowski, Matthiesen and Van de Ven (2009) by searching for indicators of these logics in our data. We looked in particular for evidence of norms, beliefs and values associated with each of these logics such as quality standards, professionalism for the trustee logic and efficiency and profitability for the commercial logic.

For the organizational points of contention we open-coded first, for broad categories (e.g. accountant to advisor, organizational governance, etc). These broad categories were specified to the particular issues pertaining to that category (i.e. for organizational governance: background management & decision making). When coded these organizational points of contention could be grouped in two categories (Table 2) of strategic themes for our mid-tier firms: (1) the changed role of the accountant; and (2) changes to the organization's structure and practices.

**Table 2: Organizational change categories**

<b>Role of the accountant</b>	<b>Organization</b>
<b>Accountant to Advisor</b>	<b>Organizational governance</b>
Core business(Consolidation-Advise)	Background management/board members
Training	Decision making/voting (all-directive)
<b>(Advisory) Services</b>	<b>Performance pay system</b>
Formal business development	Division profits
Range of services, specialist concept	Evaluation functionality
<b>Client acquisition(reactive-proactive)</b>	<b>Organizational structure</b>
Cold Acquisition	(Merging) Number of locations
<b>Mentality professionals</b>	Critical mass
Work/life balance	Separation audit & advisory
Part time employment	Service lines

General mentality	Staff services
<b>Automation of services</b>	<b>Internationalization</b>
Portals/ Online Service	Network
XBRL	Clients/ Services

In the third round we looked for specific examples of the categories. For example, for organizational governance, the authors coded whether a firm engaged in directive or consensus decision making.

The final part in writing the individual case studies was coding the organizational responses to each of the organizational points of contention. We excluded the avoidance strategy, as in all our cases the firms engaged with at least one of the logics legitimating their praxis. Independent of each other, two authors coded these responses and tactics in order to ensure consistency. The interrater reliability score was .84 indicating good reliability (Cohen, 1968). When assigned responses differed, the authors discussed and determined the appropriate coding.

**Table 3: Organizational response strategies and tactics\***

Strategies	Definition
Acquiescence	Adoption of demands
Compromise	An attempt to achieve partial conformity to at least partly accommodate all institutional demands
Defiance	Explicit rejection of at least one to the institutional demands
Manipulation	Active attempt to alter the content of the institutional demands

\*Drawn from Oliver (1991)

For internal representation we coded for two sources of resistance within the firm. Pache and Santos (2010) theorize that the internal pattern of representation of logics affects the eventual strategic institutional response by the organization. In professional accounting firms, internal representation seems to be particularly salient with professionals who have been socialized in their profession and are committed to maintain its values, and is particularly salient in the trustee logic. To capture the impact of internal representation, we coded the internal representation, i.e. non-partnered or partner accountants.

**Stage 2.** Once all case studies were written and coded, we conducted a cross-case analysis (Eisenhardt, 1989). This cross-case analysis served two purposes. First, by comparing the perspectives of the firms, we established an overview of the institutional pressures on these firms that could be related to the trustee logic or the commercial logic. This overview is presented in the first part of our findings section.

Secondly, we analyze the strategic responses to institutional pressures of the firms in our sample for the main strategic issues identified. Given that the firms faced contradicting institutional demands, we document how their responses to the specific strategic issues draw on either trustee logic or the novel commercial logic. The outcomes of this analysis are presented in the second part of our findings.

## **2.4 Findings**

### ***2.4.1 Multiple logics, conflicting demands***

For the mid-tier accounting firms, we see that there is a clash of logics and that the drivers of this clash place divergent demands on the organizations. This results in heterogeneous responses to conflicting institutional demands.

### **The trustee logic**

The original institutional logic present in the accounting industry - the trustee logic (Thornton et al., 2005) - placed emphasis on professional values and technical expertise of the accountants and all organizational systems were geared to accommodate these demands. Firms delivered a narrow range of professional auditing-related services, around which the firm was organized. Consensus decision making was the norm and decision making was done at the local offices. Profits were shared and accountants and partners were not held accountable for their financial performance (Greenwood & Suddaby, 2006). The issue of accountability was directed mostly towards professional norms and values and the quality of the auditing practice.

Several of the pressures faced by the set of mid-tier firms support these values. The more stringent rules and legislation put forward by the professional associations as well as the government reinforce the importance of the technical qualities and fiduciary responsibilities of the accountants. If these quality standards are not met, permits to conduct audits of annual accounts will not be provided. Two such permits exist, the OOB-permit for organizations of public importance (i.e. banks, public firms, as well as stock-listed firms) and are the most stringent. The 'normal' permit allows accounting firms to audit organization that exceed the threshold for mandatory deposition of annual accounts. These pressures forced firms to invest in quality systems. The Dutch Tax Authority similarly requires high quality of the

accounting firms, in order to be allowed to take part in the new high trust tax format. Herein firms are no longer checked yearly by the tax authority, but are trusted upon to provide proper tax figures through their accountant (for smaller companies) or directly. Large firms and accountant organizations (on behalf of smaller firms) are allowed to take part when they have proven to be in control, which entails that they have systems in place to check their financial situation on a regular basis.

Coupled to the assurance of quality through legislation is the automation of the processing of invoices as well as through XBRL systems, which provide real-time information on the company's finances. XBRL output is increasingly requested by banks when deciding to provide loans. Clients also stimulate the trustee logic as they demand that their accountants are available and knowledgeable on their particular situation, as well as locally present. This requires generalist knowledge on the part of the accountant, local decision making capabilities and large number of local offices. Table 4 provides an overview of the drivers that reflect the remaining importance of the trustee logic.

**Table 4: Drivers of the trustee logic**

Drivers	Effect	Example quote
Rules & regulation	More stringent certification demands place emphasis on quality controls and professional values	<p>A1: Lots of rules and regulation has been fired at us. To which we all need to adhere. This has resulted in changes in systems and procedures within our organization.</p> <p>B1: When I think of the factors that can cause change I first of all think of regulation. We need a license from the AFM and in order to get or keep that license, it was important and necessary to change several things within the company. That means we have made a separate entities for our audit and further we also have the clustered the similar clients.</p> <p>E1: Regulation for accountancy firms has changed to such as extend that we have made our audit branch a separate entity. Responsibilities and duties are such that they are in line with AFM demands. We have increased our quality we now have tighter procedures.</p> <p>F3: When you look at the regulatory changes, this has had a tremendous impact on the internal organization of the firm.</p>

		I2: Regulations are mandatory, so you need to work with them and ensure that you reach that level of quality and create the proper internal structure.
Automation & XBRL	Automation and standard reporting language systems place emphasis on quality controls and professional consistency	K2: The license system necessitates us to set up a system that ensures the quality of our services. D1: This forces us to send financial messages via the internet at an agreed standard. A few years ago, the government forced us to sign a covenant to deliver financial statements in XBRL format.
Client Demands	Clients demand local presence and generalist approach of their accountant	A1: We have an international network that others do not have, but we also have a personal approach that fits our customer segments. They demand this of us.  G1: I think that we are quite unique at the moment. We deliver high quality in an international network, combined with small scale and personal approach.  H1: Our clients want their accountant close by, so that if something goes wrong you can quickly react. Because we know the local network we can help in all sorts of ways.
Tax authority	The Dutch Tax authority has shifted to a new form of tax collection governed by high trust. This demands from the accountant an emphasis on quality controls, professional values and consistency	B3: The Dutch fiscal authority using high trust governance, now uses the auditors and bookkeepers to ensure a certain level of quality control on tax returns.  I3: horizontal governance just demands that you have a quality insurance system.

## The commercial logic

Although the drivers of the trustee logic demand a focus on, and an investment in quality standards within the accounting firms they at the same time force firms to be more commercially oriented. The investments in quality systems as well as in automation systems and XBRL demand a certain scale within the organization in order to make investments lucrative. This however puts a strain on existing practices such as collegial decision making and local presence. Additionally, when the core product of the accountant, the consolidation of annual accounts becomes automated, the corresponding profit margins drop significantly. As a result, the accounting firms seek other sources of revenue and we observe that most firms start developing specialized

advisory services. This shift to more advice type of services is also demanded by the clients. In the face of the economic crisis, which is also affecting the business of clients, they want to be advised on ways to improve their bottom line. This again stimulates the formation of advisory services at the expense of the traditional accounting products. Additionally, international firms also demand their mid-tier accounting firms to venture international, which brings about new sets of control and performance management processes to improve coordination at the expense of collegial controls present under the trustee logic. Finally, the economic crisis has also impacted the mid-tier accounting firms forcing them to proactively approach clients and provide a broader range of services that have higher profit margins. Table 5 provides evidence for the presence of these commercial logic drivers.

**Table 5: Drivers of the commercial logic**

Drivers	Effect	Example quote
Rules & regulation	The increased quality demands because requires firms to invest in quality systems and controls, this requires sufficient size (critical mass) to make this worthwhile.	E1: The investment in quality due to increased regulation has cost us tons of money and had a tremendous impact on the organization.  K2: Introducing a quality system costs money and as a result you need to expand.
Automation & XBRL	Automation and standard reporting language systems reduce profits from core product, the annual statement, forcing accounting to engage in different services	B2: Another big change has of course been technology. The invoice processing, which we used to do in the past is disappearing because of computers. This means we need to change our business model from making figures to explaining them. When you go from producing to explaining figures; that demands a different skill set.  E1: XBRL should reduce the administrative burden by being able to quickly connect with the banks, tax authority and chamber of commerce. This should really improve efficiency as is a very exiting development.  H3: I would not be surprised when in 5 years annual reports have disappeared and they are all submitted electronically to the authorities. This means that a large part of our lower qualified work disappears. It is madness to think you can compensate for this with new clients.

Client demands	<p>Clients not only demand an annual statement, but also advice on how to improve their performance. Additionally international clients demand international services.</p>	<p>J1: Increased efficiency in IT will lower the profits from delivering annual reports.</p> <p>A1: Customers are increasingly going international with their business, so we now also need to service those firms that go abroad, as well as the firms that come here.</p> <p>B1: And you see that advisory services are really important. The people who are in contact with our clients are trained to give advice, to be more of a sparring partner for the client.</p> <p>C1: Clients have less interest in looking back, they have got that covered with their bookkeeping software, what they seek is a partner in business that will help them look forward.</p> <p>F2: Clients are no longer interested in the annual statement; they are interested in what they can do with those figures.</p> <p>H3: Clients are much smarter nowadays. They shop around for the best place to buy their services, especially larger clients do.</p>
Labor market	<p>The tight labor market for accountants forces firms to cater to the demands of the new generation of accountants (whom are very different).</p>	<p>K3: Your average entrepreneur is smarter. Their education level is higher and they can Google what they want to know. You now need specialist knowledge in order to be considered of added value.</p> <p>B1: There are less and less accountants available in the market. What we see is that accountancy is not 'sexy'. So it is very difficult to get good people.</p> <p>C1: Once the final crisis is over and the baby boomers start retiring, you need to be attractive enough as an employer to reel these people in.</p>
Economic/market conditions	<p>The dire economic situation in general and the difficult market</p>	<p>I2: You see that you need to find suitable people for advice otherwise you just won't make it.</p> <p>C2: Well what you see is that the crisis actually ensures change takes place</p>

conditions in the accounting sector in particular have pushed firms to place emphasis on new business generation and development, efficiency and change in services.

automatically; you end up with lower profits so you need to do something.

D4: The credit crisis really forces us to engage in business development.

H3: The crisis clearly drives change.

J1: I think the accountancy market will continue to consolidate. It is very scary as it looks like there is overcapacity on the supply side.

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A pressure that is ‘new’ stems from the labor market. Pressures here are the result of a shortage in the labor market and the changing mentality of the professionals, both having a different impact on firms. An interesting observation is, that although the mid-tier seems to be considering implementing strategies and structures that resemble what the big 4 have done, they do not reference the big 4, as a ‘trigger’ to change. In fact most firms consider them to occupy a completely different part of the accounting industry.

#### ***2.4.2 Organizational responses to conflicting demands***

The drivers described above place contradicting demands on how firms organize themselves in terms of strategy, structure, systems and processes. Our findings show that how organizations deal with these demands depends on the extent they feel pressured to comply with pressures from clients, regulators and professional associations. Additionally, the socialization process of their constituency also impacts the extent to which these conflicting demands permeate the organizations. These differences between organizations lead to different organizational responses on specific strategic issues.

These findings will be discussed next, sequentially analyzing organizational responses around the two main themes: the changing role of the account and the implications for organizational structure. As explained before, each firm is assigned a response strategy as defined by Oliver (1991). If firms continue to comply with the demands of the professional/trustee logic, they acquiesce to these demands. If they feel that they need to reconcile demands from both logics, firms are assigned the compromise strategy. If firms choose to follow the new commercial logic on a particular issue, they are assigned the defiance strategy as they are defying the old logic. Finally, if they firms go beyond what is demanded by the commercial logic, we

classify their strategy as manipulation, as they are trying to change the logic to their standards.

In our analysis, we have not assigned firms to either the professional or the commercial logic as they combine elements of both these logics and this differs per firm. At times, they choose to follow the old logic, and on a different issue the new logic. Therefore, we assign firms strategies on each of the choices they have concerning the changing role of the accountant and adaptations to organizational practices and structures. In the description below, we make little use of excerpts from the interviews. In the appendix A the assigned strategy is illustrated by one quote for each issue per firm. At times organizations are not able to conduct the strategy they want, because of internal resistance. However, in some cases firms do conduct their strategies regardless of the internal resistance. The dynamics of resistance are also described below in the aggregate. Support for our conclusions regarding resistance is presented in appendix B.

### **The changing role of the accountant**

The role of the accountant is changing stimulated in part by the new generation professionals. However, the main driver is the diminishing revenue from their core business (consolidation and auditing of annual statements), due to technological improvements and changing client demands. Clients are no longer satisfied with just their annual reports rather they now expect their accountants to advise them on how to improve their business. This shift has been acknowledged by all firms in the sample however, most firms still cling to their traditional business and try to increase their delivery of advisory services. Other more actively move away from the old core business to advisory type services. Related to this changing role, our data show that the firms need to decide: (1) to which degree and how do they want to make the transition possible; (2) what services they want to deliver; (3) how much effort they place in client acquisition; (4) if they want to conform to demands of the new generation of professionals; and (5) how heavily they invest in automation of their services. Table 6 provides an overview of firm responses with regard to the changing role of the accountant. In general there are in three groups of firms that can be clustered together based on their inclination to adopt practices from the new logic. However within and across these groups, most firms describe their change events as stand-alone strategic choices that they deal with on a daily basis rather than as part of

a coherent strategy. This results combinations of elements from both the old and the new logic.

The first group of firms - firms A, F, and J - has fully embraced this new role. They invest heavily in developing new products; offer a wider range of services, complemented with industry specific or product specific specialty services. Additionally, they either retrain their people to be able to fulfill this new role or hire people with suitable credentials and skills. An extreme example is firm F who are the first to have relation managers. These are often non-accountants, who brainstorm free of charge with their clients to discover their needs. Subsequently the back office caters to these demands and delivers the actual services, ranging from accounting, organizational or law related advice. This group of firms also offer its clients portal based access to their files, which are updated regularly. In terms of marketing, this is done more proactively, however cold calling is still not fully accepted.

**Table 6: Firm specific responses relating to the role of the accountant\***

Role of the accountant		Acquiescence	Compromise	Defiance	Manipulation
Accountant to Advisor	Core business	K	B, C, D, E, G, I	A, H, J	F
(Advisory) Services	Training	J, K	C, D, E, G, H		A, B, I
	Formal business development		E, K	A, B, D, H, J	I
	Range of services, specialist concept		B, D, E, G, H, I, K	A, C, F, J	
Mentality professionals	Cold Acquisition	B, C, H, J	F, K	D, G, I	
	Work/life balance		B, C, E, G, H, J	F, I, K	
	Part time employment	D	E, G, H, I, K		
Automation of services	General mentality	C	A, D, G, H		
	Portals/ Online Service		E, I	B, C, H, J	A, F
	XBRL	D, K	A, C, E, I	B, F, J	

\*Firms have not commented on all strategic choices. If that was the case they were not assigned a strategy.

The second cluster of firms - firms B, C, E, G, H & I - is somewhat in between both logics. They perceive the need to change their service portfolio but develop these in an ad hoc manner with their core service, the consolidated account, as basis to

which these advise services are related. They also have not yet developed specialty services to a great extent, although some specialty services for certain industries are present. Similarly, in this group marketing efforts are increased but also here cold calling is not the preferred option. Finally, they do invest in automation of their services but they do not try to lead this change, rather they either choose to be followers or are so by necessity of insufficient size and/or resources.

The final set of firms - firms D & K - still comply predominantly with the trustee logic. Although firm D perceives the need to develop new products and invests in them, it is not investing significantly in automation in order make the creation of annual accounts as efficient as possible. Firm D as well as Firm K, indicate that first thing really have to start hurting before anything will actually change.

A common conclusion that can be drawn across all three categories is that they cater to the demands of the new generation of professionals. They all indicate placing emphasis on work/life balance and allowing part-time employment to some extent.

The primary reason why firms differ with regards to the extent in which they embrace the new role of the account lays in the value they place on the old role. During the interviews, it became clear that strategies in relation to the changing role of the accountant were often adapted in the face of internal resistance by non-partner accountants and in some cases by partners. This is illustrated in table 7.

**Table 7: Locus of resistance to the changing role of the accountant**

Role of the accountant		Accountants	Partners
Accountant to	Core business	A, C, D, E, F, H, I, J, K	K
Advisor	Training	E, G, I, J	
(Advisory)	Formal business	D, K	K
Services	development		
Client acquisition	Cold Acquisition	D, G, H, I, K	G, H, I, K
Mentality	Work/life balance		C, E, H, I
professionals	General mentality	A	E
Automation of	XBRL	B	B, D, K
services			

Partners indicated that non-partner accountants have problems adapting to the new role or actually resisted making this change. This has led a number of firms to compromise by embracing both roles to some extent. Others find ways to deal with this problem, like for example firm F which has created a front and back office.

However, if partners resist this changing role however (e.g. firm K), no change to any real extent is observed. The reason why few firms go for cold acquisition is that both accountant and partners resist this practice. As for work/life balance and the automation of services, partners also have their reservations. In terms of work/life balance and automation of services firms, like firm H, have indicated that this emphasis has gone too far and creates problems in service delivery and filling management positions. Finally, automation of services is often not an integral part of the strategy of a firm, as it requires heavy investments that partners sometimes are unwilling to make. This paints an interesting picture regarding internal representation: Most accountants seem to be hesitant to comply with issues that affect the professional role of the accountant, while some partners resist changes in the role of the accountant that affects their returns on investment.

### **The changing organizational practices**

The conflicting logics do not only have influence on the role of the accountant but also on the organizational practices. Main drivers here are the imposed rules and regulation that demand high control of quality; developments in technology, which ask for a coherent system; the globalization of clients, which has led firms to join international networks, which in their turn demand certain changes in structural arrangements; and the demands of clients for more specialized advisory services has implications for 'critical mass'. In terms of the practices our data show that organizations adapt to respond to the differences in logics in four important ways: (1) Firms can maintain their traditional form of organizational governance through collegial decision making or place the management of the firm in the hands of a non-professional or engage in directive decision making; (2) in order to stimulate the obtainment of new clients and successful delivery of new advisory services, performance-pay systems can be introduced; (3) more stringent quality demands make firms reevaluate their organizational structure; and (4) clients increasingly demand international services to which these firms need to respond. Table 8 provides an overview of firm responses with regards to organizational structures and practices.

**Table 8: Firm specific responses relating to organizational structures and practices\***

Organization		Acquiescence	Compromise	Defiance	Manipulation
Organizational governance	Background management/ board members	A, B, D, F, G, I	C, H, K		E, J
	Decision making/ voting	C, H, K	A, B, D, E, G, I	J	F
Performance pay system	Division profits	A, E, G, H, I, J, K	C	B, D, F	
	Evaluation functionality (Merging)	K	C, F, H, I, J	A, D, E	
Organizational structure	Number of locations	A, B, C, D, E, F, G, H, I, J, K			
	Critical mass		C, D, F, G, H, I, K	A, B, E	J
	Separation audit & advisory	A, K	C	B, D, E, F, H, I	
	Service lines Staff services		A, H C	B, D, G, I A, B, D, F, G, H, I, J	
Internationalization	Network	E, J, K	C, F, H, I	G	D
	Clients/ Services	E, J	B, F	A, G	D

\*Firms have not commented on all strategic choices. If that was the case they were not assigned a strategy.

In terms of adaptations to existing organizational practices, we can discern two clusters of firms in the extent to which they comply with the old or the new logic. Within and between these clusters there again is great divergence in practices these firms adopt and resist. The first cluster of firms - firms E, F & J - has adapted most of their structures to the new commercial logic. Firms E and J have a non-professional managing partner, whereas firms F and J have abandoned collegial decision making in favor of more directive forms. Firm F also works with differential performance-pay systems for partners and has high levels of directive decision making. Firm J has decided to create more and smaller offices throughout their region.

The second cluster, i.e. the remainder of the firms, makes little changes with regard to their organizational practices and continues to adhere to the demands of the trustee logic. Most firms still have partners who manage the firm through collegial decision making processes. These processes however, are slightly more directive to

reduce differences in implementation of strategic decisions. Additionally, they divide the profits evenly, and do not wish to merge their locations. They do however comply with the implications of the increased use of automation and specialization. They either have consolidated locations or try to grow the size of their offices in order to have critical mass. This would ensure returns on automation investments and create the possibility for specialization. They also have professionalized their organization by introducing staff departments and in order to increase their service quality they often separating audit from advice and structure their organization along service lines. Finally some firms decide to cater to the international wishes of their clients, most by joining an international network as they do not want to open up office abroad. The pattern of strategic responses in table 8 shows that our mid-tier firms draw more on the traditional trustee logic when concerned with issues concerning performance pay systems and the governance of their firm, while they relate to the commercial logic when strategic choices pertain organizational structure and internationalization.

The reason why there is relatively little change in the practices and structure of most organizations can again be found in the level of internal resistance. This time however, resistance is solely located on the level of the partners. Especially with regard to the governance of the firm, almost all informants indicated that a non-professional as managing partner would not be accepted as they believed a firm grasp of the profession is necessary to run the firm. Similarly most partners still want a say in the strategic direction of the firms, hence these firms still employ, for the majority, collective decision making processes. The sources of resistance are shown in table 9. Clearly our mid-tier firms are relying on their professional identity to a great extent and are not intending to change the basic structure and identity of their accounting firms.

**Table 9: Locus of resistance to the organizational structure and practices**

Organization		Accountants	Partners
Organizational governance	Background management/board members		A, B, D, F, G, I
	Decision making/voting		A, C, G, I
Performance pay system	Division profits		E, G, H
Organizational structure	(Merging) Number of locations		D
	Service lines		A
Internationalization	Network		D, G

## 2.5 Discussion

In this study we set out to investigate organizational responses in the face of conflicting institutional logics by mid-tier accountancy firms. While most studies describe how institutional changes trigger institutional action by either elite (Greenwood and Suddaby, 2006) or maverick actors (Leblibici et al, 1991), we focused on the impact of institutional changes and the resulting conflicts between the trustee and commercial logic on mainstream actors in an organizational field. Based on secondary material and interviews with 34 top management level informants of eleven mid-tier accounting firms, we contribute to the literature on institutional change and conflicting logics and organizational responses in three ways.

### 2.5.1 *Punctuated fields & institutional bricolage*

First, we documented how significant institutional changes with regard to regulation, automation of services and changing clients' demands have ended a period of stability for the mid-tier accounting firms. These environmental jolts (Meyer, 1982) are hypothesized by prior literature to result in revolutionary transformations of organizations rather than piecemeal evolutionary development (Greenwood & Hinings, 1996; Romanelli & Tushman, 1994; Tushman & Romanelli, 1985). This is however not what we observe in our group of mid-tier firms. Mid-tier firms in our sample respond selectively, and on an independent basis to strategic and structural issues invoked by the new commercial logic. Most firms remain adherents to the old trustee logic in their industry in which they are still heavily embedded, which causes their resistance to change (Granovetter, 1985; Greenwood & Hinings, 1996; Maguire, 2007; Oliver, 1997). The socialization of their professionals, the institutional prescriptions of the context in which the mid-tier firms operate, are reproduced (Anderson-Gough, Grey & Robson, 2000).

While most studies on organization responses as put forth by Oliver (1991) study adoption or non-adoption of specific issues (e.g. Ang & Cummings, 1997; Fiss & Zajac, 2004, 2006; Goodrick & Salancik, 1996; Greening & Gray, 1994; Lounsbury, 2001, 2007; Milliken, Martins & Morgan, 1998; Rao & Sivakumar, 1999; Thornton, 2002; Westphal et al., 1997), we look at all possible strategic responses not to a specific issue but rather elements of two conflicting institutional logics. In our data we see a fragmented implementation of elements of the new logic, not based on the internal coherence of the logics at hand, but dependent on the suitability of the elements for resolving concrete managerial challenges regarding specific strategic issues. As the

managerial challenges can differ between firms, we observe that firms choose elements differently from each other as such, the process of diffusion looks more like a process of institutional bricolage (Aldrich, 2010). Specifically, two main themes permeated discussions of change for the mid-tier firms: the role of the accountant and organizational changes. Because of the perceived independence of the strategic issues, firms drew differently on the elements of the competing institutional logics for each issue leading them to accept and reject different elements of what should be considered logical connected systems and structures. Therefore, in the case of mid-tier actors we do not see a general pattern like a shift from the old dominant logic to the newly introduced logic (e.g. Thornton, 2002; Zilber, 2002); the introduction of elements of a new logic into a dominant one (e.g. Glynn, 2000) or the hybridization of elements of both the old and new logic (e.g. Purdy & Gray, 2009; Colyvas & Powell, 2006; D'Aunno et al. 1991).

### **2.5.2 *Organization strategic responses and internal resistance***

Our second contribution is to the literature on failed diffusion of practices which has received little attention (Ansari et al., 2010) and the results in this study are one of the first to investigate the sources of failed attempts. We find that logics that are considered incompatible with the existing professional norms, or the strategic direction of the firm, result in resistance. The source of the resistance lies internal to the firms and can take two forms. First, when a proposed logic, such as having a non-professional managing the firm, is at odds with the professional norm for autonomy this leads to resistance by partners. As a consequence our informants revert to the trustee logic to develop and support their strategic responses. Additionally, partners in these mid-tier firms have a greater ability to influence strategic actions through collegial forms of governance and decision making. Hence changing these structures and practices is difficult for three interrelated reasons (Greenwood & Hinings, 1988). First, change in organizations is unlikely as its members are caught in the current design and underlying values that the possibility of change is not even considered. Second, when this need for change is perceived however, change will not occur as it is then often subjected to a cost-benefit analysis. The outcome of which mostly results in postponing change until it becomes unavoidable. Secondly, we find indications of differences in alignment of partners and non-partner accountants with the different institutional logics. In some cases top management of our mid-tier firms does see the merit of the proposed change but is unable to align its internal constituency. In case of

issues related to more operational practices firms base their choices in the novel commercial logic. Examples are the separation of audit & advisory skills and the internationalization of clients and services. Non-partnered accountants mainly resist these practices (Cooper & Robson, 2006). In professional services firms, the individual professional's job description and identity are directly informed by the standards of the profession that to a large extent also make up the organization's institutional environment (Freidson, 2001; Greenwood, Suddaby & Hinings, 2002; Suddaby & Greenwood, 2005; Scott, 2008). Furthermore it is part of the professional's identity and responsibility to actively maintain the professional institution, thereby resisting the commercial logic. In their article, in which Greenwood and Suddaby (2006: 44) documented organizational change with the big 4, they asked: "how influential are professional norms when required to stretch across very different organizational members, ranging from elite, central firms, to modestly sized, local firms?" We would argue that they are quite strong for both partnered and non-partnered professionals in mid-tier firms.

### ***2.5.3 Generalizability of PSF research***

Our third contribution is to the literature on PSFs by addressing the issue of generalizability (Von Nordenflycht, 2010). The changes identified by Greenwood and Suddaby (2006) cannot straightforwardly be extrapolated to the rest of the actors in the accounting industry. While the big 4 in Greenwood and Suddaby's (2006) research are operating in an international arena, dealing with multinational clients in a supranational arena, our mid-tier firms are well-established in their national professional arena and our findings indicate that professional norms are stronger with these group. We clearly see the group of mid-tier firms responding to the conflicting institutional logics that have been recognized in previous research on the big 4 accounting firms. However, while these firms had relatively comprehensive / consistent agenda pushing the commercial logic, our study suggests that organizational responses to conflicting or changing logics may be subject to different dynamics across different sets of actors within an organizational field.

In all, our study highlights the complexity and richness of the institutional force field in which mid-tier accounting organizations operate. This makes easy and linear explanations of transitions from, for example professional partnerships to managed professional businesses simplistic. Our findings sensitize us to the incremental nature of institutional change and to the importance of the internal organizational dynamics

for understanding organizational responses to institutional pressures. As such our study is a call for more fine-grained analyses of the dynamics guiding processes of institutional change and evolution.



# Chapter 3. Drivers of professional service firm performance<sup>2</sup>

## Abstract

Current ideas on the drivers of professional service firm performance are largely grounded in a view of those firms as professional partnerships, highlighting the role of human and reputational capital. Over the past two decades, however, PSFs have become significantly larger through mergers and acquisitions and more diversified through internationalization and alliance network creation. To accommodate these changes, many PSFs have adopted features of the managed professional business, formalizing their governance and adopting strategic planning. Our study is the first to assess the ramifications of these developments by offering a concurrent test of the effects of human and reputational capital as well as formal governance and planning on PSF performance. We also highlight the relevance of contingency-theoretical reasoning to the emerging theory of the PSF, as the relative importance of the drivers of PSF performance changes considerably as these organizations grow and diversify. Empirically, our results are based on a study of 354 Dutch law firms, combining both survey and archival data.

## 3.1 Introduction

Professional service firms (PSFs) are organizations which predominantly rely on human and reputational capital, rather than financial or technological capital, to offer their clients customized, knowledge-intensive services (Greenwood & Empson, 2003; Greenwood, Li, Prakash, & Deephouse, 2005; Von Nordenflycht, 2010). PSFs play a pivotal role in modern economies for three reasons. First, several PSFs rank high amongst the world's largest and most affluent businesses (Aharoni, 1993; Greenwood et al., 2005). In service-intensive, post-industrial economies, law firms like Clifford Chance and Baker & McKenzie, and accounting firms like KPMG and

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<sup>2</sup> This chapter is co-authored with Prof.Dr. Pursey P.M.A.R. Heugens and Prof.Dr. J. (Hans) van Oosterhout. A previous version of this paper was presented at the Academy of Management consortium in Chicago, 2010. This paper is currently under review at Journal of Management Studies.

PricewaterhouseCoopers, are the new 'blue chip' firms realizing both stable growth and predictable profits. Second, PSFs are "knowledge engines" (Lorsch & Tierney, 2002: 15) which set work standards for, and disseminate innovations amongst their clients (Alvesson, 1995). They contribute to their clients' value creation processes and alleviate their needs for expert help through the application of professional knowledge to unique organizational problems (Hansen, Nohria, & Tierney, 1999; Løwendahl, Revang, & Fosstenlökken, 2001). Third, PSFs function as "gatekeepers" by mediating complicated business transactions and by providing assurance on other firms' business processes and information disclosures. They do so, more specifically, by acting as reputational intermediaries who vouch for the quality and legitimacy of their client's actions and communications by pledging their reputation (Coffee, 2006: 2). In light of their importance to current business practice, it is unsurprising that a growing contingent of organizational scholars is developing an interest in uncovering the drivers of PSF performance (French, Kelly, & Harrison, 2004; Greenwood et al., 2005; Greenwood, Deephouse, & Li, 2007; Hitt, Bierman, Shimizu, & Kochhar, 2001; Von Nordenflycht, 2007).

In delivering their services, PSFs face a number of discretionary choices about their organizational design (Greenwood & Empson, 2003; Von Nordenflycht, 2010). As these choices are to some extent interdependent, they can repeatedly be observed across populations of PSFs in the form of archetypical configurations of properties (Greenwood, Hinings, & Brown, 1994; Malos & Campion, 2000). Historically, the organizational design of most PSFs approached that of the professional partnership. The archetype of this organizational design was first codified by Greenwood, Hinings, and Brown (1990), who identified four of its properties. First, senior members of such partnerships continue to be involved in the actual delivery of professional services. Second, all professional members routinely apply difficult-to-codify knowledge to complex problems. Third, these members enjoy levels of autonomy in organizing their work processes that are not commonly observed in other organizations (Hall, 1968; Montagna, 1968). Fourth, decision-making in professional partnerships is decentralized, to foster the tailoring of professional services to specific client demands (Greenwood et al., 1990). As all four of these properties critically hinge on the quality of the professional staff, the performance drivers identified by students of professional partnerships primarily involve human capital (Hitt et al., 2001) and the reputational capital necessary to recruit top talents in the labor market and signal their quality to clients (Greenwood et al., 2005).

In more recent years, however, a subset of PSFs has begun to challenge the dominant features of the professional partnership archetype, in response to demands for greater efficiency spurred on by intensified competition and deregulation (Malhotra & Morris, 2009). A choice set of firms in the fields of both accounting (Greenwood & Suddaby, 2006) and law (Pinnington & Morris, 2003) has adopted a different but likewise coherent set of properties facilitating professional service delivery, which center on a greater commercial orientation and more conscious management. This alternate archetype was first codified and labeled the managed professional business by Cooper, Hinings, Greenwood, and Brown (1996). It similarly has four core properties. First, while its senior members remain at least nominally competent in performing the productive labor of those they supervise (Freidson, 1984), they increasingly take on purely managerial roles. Second, while the delivery of complex knowledge remains its core activity, the managed professional business increasingly strives to commodify that knowledge, thereby reducing it to a routinized and codified product (Suddaby & Greenwood, 2001). Third, organizations adopting this archetype encroach upon the autonomy of the individual professional, as their management in general becomes more heavy-handed and increasingly establishes formal bureaucratic control over professional work (Leicht & Fennell, 1997). Fourth, in managed professional businesses the decision authority related to issues like client activities and resource allocation becomes increasingly centralized, limiting the decision powers of non-managing members (Malhotra & Morris, 2009). As these four properties are all part of a process whereby lateral, peer-based controls are being supplanted by hierarchical managerial controls, the hallmark of managed professional businesses is the adoption of formal systems in the areas of organizational governance and strategy implementation (Cooper et al., 1996; Pinnington & Morris, 2003).

In practice, however, we do not readily observe the wholesale replacement of the professional partnership by the managed professional business. Rather, we observe sedimentation: “the persistence of values, ideas, and practices, even when the formal structures and processes seem to change, and even when there may be incoherence” (Cooper et al., 1996: 624). On the one hand, organizational design choices associated with the professional partnership remain important for all PSFs. For example, Morris and Pinnington (1998) have shown that a time-honored human resource management practice like the up-or-out promotion rule is also often observed in managed professional businesses, as it allows them to control salary costs by employing younger professionals more cheaply. Similarly, in a study on the largest U.S. law firms, Hitt and

his associates (2001) found that human capital remains an important performance driver, even though this group of firms simultaneously showed significant strategic prowess in the form of aggressive client, geographic, and service diversification. On the other hand, MPB features – like formal governance and strategic planning – have definitely diffused beyond the ‘elite’ firms that once pioneered these practices (cf. Greenwood & Suddaby, 2006; Suddaby & Greenwood, 2001). Professionals in nearly every conceivable organizational setting are now increasingly confronted with formal bureaucratic controls (Freidson, 1984; Leicht & Fennell, 1997). In short, senior members of PSFs enjoy considerable discretion when making organizational design choices to facilitate professional service delivery, which often results in sedimented organizations combining features of both the professional partnership and managed professional business archetypes (Cooper et al., 1996; Empson & Chapman, 2006).

Yet the issue of sedimentation raises important but as of yet unanswered questions about the performance of contemporary PSFs. First, is the diffusion of organizational features associated with ‘elite’ managed professional businesses across a wider population of PSFs conducive to their performance? At present, this question is still very much open. This is not only because a systematic test of the contribution of formal governance and strategic planning to PSF performance is still lacking. While these features are sometimes assumed to contribute to PSF efficiency (Cooper et al., 1996), they may alternatively jeopardize performance by disgruntling professionals through an assault on their autonomy (Von Nordenflycht, 2010) and by upsetting the fragile balance of understanding between various groups of internal stakeholders (Empson & Chapman, 2006). Second, how important are the various drivers of PSF performance relative to one another? Various groups of scholars have theorized and occasionally tested the effects of important performance drivers in isolation. In particular, prior studies have respectively highlighted the importance of human capital (Hitt et al., 2001), firm reputation (Greenwood et al., 2006), strategic planning (French et al., 2004), and formal governance (Empson & Chapman, 2006). Yet a comprehensive test comparing the magnitude of these drivers concurrently is still forthcoming, even though these features tend to occur in conjunction in sedimented PSFs. Third, which organizational characteristics determine the contingent value of these performance drivers to PSFs (cf. Greenwood et al., 2006; Hitt et al., 2001)? Structural contingency scholars (Donaldson, 2001) would likely predict that formal governance and strategic planning are more important as drivers of performance in larger, more diversified PSFs. Yet the applicability of contingency theory to PSFs is

uncertain. PSFs can have several organizational characteristics, like being organized as a federal structure of semi-autonomous practice areas (Anand, Gardner, & Morris, 2007) and utilizing a core technology that is strikingly similar across organizations of different sizes (Greenwood et al., 1994), that make them less susceptible to contingency-theoretical explanations.

We set out to address these questions through an empirical study amongst 792 lawyers admitted to the Dutch Bar and representing 354 law firms. We combine archival and self-reported survey data, and use maximum likelihood structural equations modeling as our analytical approach. Our study has three intended contributions to the organizational literature on PSFs. We are the first to offer a test of the potential contribution of organizational design features associated with managed professional businesses (formal governance and strategic planning) to PSF performance. This empirically corroborates the efforts of a group of scholars who have previously theorized on the importance of these characteristics to the functioning of contemporary, often sedimented, PSFs (Cooper et al., 1996; Empson & Chapman, 2006; Pinnington & Morris, 2003). Furthermore, we provide a comprehensive test of four of the most salient drivers of PSF performance: in addition to formal governance and strategic planning, we also concurrently scrutinize human capital and firm reputation. This integrates the efforts of prior scholars interested in PSF performance, who have thus far largely tested these factors in isolation (French et al., 2004; Greenwood et al., 2005; Hitt et al., 2001). Third, we develop and test arguments rooted in structural contingency theory (Donaldson, 2001), explaining how the contribution of formal governance and strategic planning is dependent on the size and level of diversification of PSFs. Hereby we contribute to the efforts of researchers to understand the effect of organizational factors on core business and administrative processes in PSFs (Anand et al., 2007; Empson, 2001; Suddaby & Greenwood, 2001).

## **3.2 Theory and hypotheses**

### ***3.2.1 Human capital and PSF performance***

All PSFs, professional partnerships and managed professional businesses alike, depend on human capital – “the knowledge, skills, and abilities residing within and utilized by individuals” (Subramaniam & Youndt, 2005: 451) – for the delivery of high quality customized services to their clients (Greenwood & Empson, 2003; Grosse, 2000;

Hitt, Bierman, Uhlenbruck & Shimizu, 2006; Løwendahl, 2005; Maister, 2003; Nachum, 1996). Human capital is so essential to PSFs because professional knowledge is largely inalienable from its human carriers (Dow, 2003), in spite of ongoing efforts to commodify it (Suddaby & Greenwood, 2001). Professional knowledge consists to a large degree of the ability to apply publicly available knowledge to different individual cases, which involves a significant amount of human creativity and judgment. This makes it a tacit resource (Szulanski, 1996) that is difficult to codify in rules, procedures, or even expert systems. As a result, human capital is a non-substitutable yet vital input for PSFs, as it cannot be replaced by more generic knowledge resources (Von Nordenflycht, 2010).

The dependence of PSFs on human capital is aggravated by the fact that there is significant and difficult to bridge variability in the quality of the human capital employed by PSFs. For example, individuals graduating from elite institutions are perceived as having obtained the best possible pre-experience training (Hitt et al., 2001), the value of which is buttressed by their access to the elite social networks that such credentials provide (D'Aveni, 1989). After their entry into the labor force, these quality differentials increase even further as professionals continue to develop their human capital through on-the-job training, usually in the form of an apprenticeship which allows them to 'learn by doing' (Pisano, 1994). The quality of the mentoring they receive in the initial stages of their career and the challenges deriving from the cases on which they work further increase the differences in value their human capital represents (Hitt et al., 2001). The most talented professionals with the greatest earning potential, often referred to as 'stars' (Groysberg & Lee, 2009; Lorsch & Tierney, 2002) and 'rainmakers' (Anand et al., 2007; Pinnington & Morris, 2003), are therefore also a durably scarce resource to PSFs, allowing only the PSFs that control such resources to take on the most challenging assignments and develop highly lucrative client relationships (Hitt et al., 2001).

In the increasingly competitive environment of the legal profession (Phillips, 2001), the reliance on non-substitutable and scarce human capital creates specific challenges for PSFs. First, these firms compete intensively to hire the best talents from each cohort of recently graduated professionals (Sherer & Lee, 2002). Second, PSFs must proactively maintain their human resource base, because professionals are highly mobile and are therefore often referred to as 'walking assets' (Spar, 1997). Turnover of key professionals can have serious repercussions for PSFs, not only because valuable knowledge leaves the firm with each departing professional, but also because

professionals often take their clients with them when they leave (Alvesson & Robertson, 2006). Because PSFs are differentially successful in acquiring and retaining their human capital base, they also differ in their ability to deliver value to their clients and secure revenues from them. We therefore expect that:

Hypothesis 1: In PSFs, the quality of the human capital base will be positively associated with organizational performance.

### **3.2.2 *Reputational capital and PSF performance***

Another performance driver that is commonly recognized in the PSF literature is firm-level reputational capital (Greenwood et al., 2005; Hitt et al., 2006; Von Nordenflycht, 2010). Firm reputation is a socially constructed evaluation of the firm that emerges as its stakeholders subject it to social comparisons with peer organizations on a variety of dimensions like quality, esteem, and favorableness (Deephouse & Suchman, 2008). Reputation is important to all firms, as it allows them to acquire and manage critical resource dependencies in financial, labor, and product markets (Deephouse & Carter, 2005). Yet it is especially significant in PSFs, due to the intangible nature of the services they provide and the centrality of reputation-sensitive human capital in their organizational resource base (Greenwood et al., 2005).

Reputational capital can explain performance differentials between PSFs for four related reasons (Greenwood & Empson, 2003; Grosse, 2000; Nachum, 1996). First, due to the intangible character of the services provided by PSFs, it is hard for prospective clients to decide which PSF would be able to best cater to their needs. This problem is often referred to as the 'client choice problem' (Goode, 1957). As a result, prospective clients tend to select PSFs on the basis of their reputation rather than on specific knowledge of their abilities. Second, even for existing clients it can be difficult to assess the quantity of inputs provided and the quality of services delivered by PSFs (Alvesson & Robertson, 2006; Gilson & Mnookin, 1985; Starbuck, 1992), due to knowledge and information asymmetries between client and professional. Clients therefore derive their confidence in professionals' efforts and abilities primarily from the reputation of the PSF that employs them, as other forms of 'social proof' (Rao, Greve, & Davis, 2001) of their competence are in scarce supply. Third, having a superior reputation allows PSFs to hire the best newly minted professionals, charge

premium prices for the services they render, and lower their marketing costs (Greenwood et al., 2005; Podolny, 1993, 1994; Teece, 2003). Fourth, as is true for human capital, reputation can explain performance differentials between PSFs (Greenwood & Empson, 2003; Hitt et al., 2006; Maister, 2003) because it represents a firm-specific intangible asset that is hard to acquire and difficult to imitate by competitors (Barney & Hesterly, 1996; Combs & Ketchen Jr., 1999; Mahoney & Pandian, 1992). We therefore expect that:

Hypothesis 2: In PSFs, the quality of the reputational capital base will be positively associated with organizational performance.

### ***3.2.3 Formal governance and PSF performance.***

Changes in economic and social trends, government policies, and legislation (Løwendahl, 2005; Maister, 2003; Nachum, 1996), as well as financial, factor, and product market pressures (Cooper, Greenwood, Hinings, & Brown, 1998), have strained the traditional partnership structure in PSFs (Empson, 2007). Traditionally, collegial decision-making, self-supervision, and face-to-face monitoring by peers were seen as particularly suited for PSFs, due to the nature of their human capital inputs and intangible outputs (Mills & Posner, 1982). As long as professionals realized satisfactory levels of billable hours without getting into trouble, they were largely free to exercise their own judgment and were granted considerable autonomy by senior colleagues (Cooper et al., 1996; Malos & Campion, 2000; Pinnington & Morris, 2003; Sherer, 1995; Wholey, 1985). Insofar as disciplining professionals was necessary, this was done mostly informally by their peers or more formally by professional associations, which typically have the power to strike individual professionals from the formal register with corresponding losses of privileges and livelihood (Freidson, 1984).

Yet increases in the size and level of diversification of PSFs have eroded the functionality of these types of informal governance practices, as they require frequent and intensive face-to-face contact between professionals. Such interactions become increasingly difficult as PSFs grow and diversify, making the professional partnership a progressively unwieldy template for modeling PSFs' governance structure (Greenwood & Empson, 2003). Furthermore, growth and diversification tend to

increase the heterogeneity of partner preferences, which interferes with consensual decision-making (Hansmann, 1996). As a result, a sizeable group of PSFs – which is hard to quantify but which numerically certainly exceeds the relatively narrow ranks of ‘elite’ firms (cf. Greenwood & Suddaby, 2006; Suddaby & Greenwood, 2001) – has begun to implement more formalized governance practices (Freidson, 1984; Leicht & Fennell, 1997). These include formalized decision-making (Cooper et al., 1996), centralized operational and quality controls (Pinnington & Morris, 2003), and management by financial targets (Cooper et al., 1996).

One group of scholars has argued that these formal governance practices are likely to increase the efficiency and performance of PSFs (Cooper et al., 1996; Hitt et al., 2006). For one, as these practices are a substitute for face-to-face governance in large, diversified PSFs, they can safeguard the manageability and accountability of firms that are on a strong growth trajectory (Anand et al., 2007; Hitt et al., 2001). Furthermore, more centralized management by a limited number of managing partners or even a board that includes non-professionals frees up expensive and productive senior workers, as it relieves them of the obligation of being involved in the day-to-day running of the firm (Cooper et al., 1996; Hinings, Brown, & Greenwood, 1991). Finally, although PSFs do not suffer from the type of agency problems resulting from the separation of ownership and control in public firms, they could still benefit from more formal governance practices to curb the type of inter-partner conflicts that are associated with increased partner heterogeneity in growing and diversifying PSFs (Morris & Pinnington, 1998). It might therefore be expected that:

Hypothesis 3a: In PSFs, the adoption of formal governance practices will be positively associated with organizational performance.

Yet the effects of governance on PSF performance are not unambiguous. A different group of scholars has highlighted at least three detrimental effects the formalization of control in PSFs can have on their performance. First, both Løwendahl (2005) and Von Nordenflycht (2010) use the famous ‘cat herding’ metaphor to describe the governance of professional workers. As professionals are trained and socialized to value and protect their autonomy, they can become disgruntled when they are made

to surrender part of it to bureaucratic control systems. A different but related concern is voiced by Frey (Frey & Oberholzer-Gee, 1997; Frey & Jegen, 2001). Many professionals are instilled with a strong sense of professional ethic and intrinsic motivation, due to both self-selection in job choice and prolonged professional socialization. When confronted with control through external interventions like formal monitoring or incentives, their ethical standards and intrinsic drive may erode as their professional motivation is crowded-out. Finally, Empson and Chapman (2006) stress that the type of informal, peer-centered controls used in the professional partnership have evolved over a prolonged period of time to strike a delicate balance between the potentially competing claims of three critical stakeholder groups: owners, professionals, and clients. The introduction of more formal types of governance could put strain on the delicate balance of stakeholder interests and relations in PSFs. This is the case, for example, when professionals defy the call by owners for stronger formal controls or when clients feel that professionals' expert knowledge and independence is compromised by business acumen and strategic prowess. As all three of these concerns might strain PSFs' performance, it might alternatively also be expected that:

Hypothesis 3b: In PSFs, the adoption of formal governance practices will be negatively associated with organizational performance.

#### **3.2.4 Strategic planning and PSF performance**

PSFs have traditionally paid little attention to formal strategic planning activities (Greenwood et al., 1990). In the words of Cooper and his associates, PSFs used to be organizations with "weak strategic capability, coupled with low analytical emphasis" (Cooper et al., 1996: 628). In the absence of more formalized planning, the strategy of a PSF can broadly be understood as the aggregate outcome of the partners' individual pursuits. Important decisions are then made locally, with little eye for the possible benefits of engaging in joint courses of action (Lorsch & Tierney, 2002; Pinnington & Morris, 2003). More recently, however, PSFs have begun to recognize the value of strategic planning and have been rationalizing and centralizing the way they make long-term decisions. Compared to the recent past, PSFs can therefore now be typified by "more formal strategic planning, controls over quality of work and productivity of staff, greater emphasis on coordinated marketing activities and more elaborate and

centralized financial systems” (Morris & Pinnington, 1998: 76). This has turned PSFs into sedimented organizations, in which such rational new practices co-exist with traditional, more informal and collegial practices (Cooper et al., 1996).

Strategic planning has at least three broad advantages for PSFs. First, without conscious planning, organizations become vulnerable to strategic myopia. Unless they routinely engage in practices that help them envision possible future states of the world, and how these will affect their organization as a whole, decision makers tend to overlook the future, non-local environments, and prior failures (Levinthal & March, 1993). Second, strategic planning can help PSFs improve the effectiveness of their resource allocation processes (Hitt et al., 2001). Like other firms, PSFs are most profitable when they put their human and reputational capital to productive use in projects where their expected marginal returns are highest. But leaving such allocation decisions in the hands of individual partners may lead to sub-optimal outcomes, as partners may hoard their best resources to maximize private gains (Lorsch & Tierney, 2002). Third, in lieu of formal planning, the boundaries of PSFs are determined endogenously, as new practice areas emerge and are embedded in PSFs through internal career and growth trajectories (Anand et al., 2007). This can cause PSFs to keep certain activities in house, even if other organizations could perform them at lower cost or more effectively. Strategic planning can then help PSFs concentrate on their core strengths and leverage these profitably by finding alliance partners for activities in geographical areas or stages in the service delivery chain in which they do not excel (Jones, Hesterly, Fladmoe-Lindquist, & Borgatti, 1998; Koza & Lewin, 1999). These reasons lead us to expect the following:

Hypothesis 4a: In PSFs, the adoption of formal strategic planning practices will be positively associated with organizational performance.

But the benefits of strategic planning to PSFs are not undisputed. First, professionals have traditionally perceived of strategic planning “as irrelevant or even detrimental to success of their firms” (Løwendahl, 2005: 77), often under the pretense that it would lead to too much rigidity (Miller & Cardinal, 1994). In highly institutionalized fields such as law and accounting, professionals remain individually

responsible for their acts and omissions within the framework provided by professional associations. The 'political fit' (Ansari, Fiss, & Zajac, 2010) between the practice of strategic planning, which calls for centralization and surrendering local decision autonomy, and professional work, which draws towards decentralization and preservation of autonomy, can therefore be poor, causing the rejection of the practice. But even if political resistance can be overcome, the problem remains that most models of strategic planning are developed for public firms that do not specialize in professional services. Given the substantial differences in terms of work organization, governance, and accountability relationships between 'classic PSFs' (Von Nordenflycht, 2010) and public firms (cf. Greenwood et al., 2007; Von Nordenflycht, 2007), it remains uncertain as to whether extant planning systems can be instrumental to the rationalization of decision making and resources allocation processes in PSFs. These alternate reasons might therefore also produce the following outcome:

Hypothesis 4b: In PSFs, the adoption of formal strategic planning practices will be negatively associated with organizational performance.

### ***3.2.5 PSF size and diversification as critical contingencies***

In response to increased competition, client pressure, and regulatory changes, PSFs have considerably altered their business models over the last two decades (Greenwood & Suddaby, 2006). In pursuit of economies of scale in product development, client handling, and service delivery, both 'elite' and mid-tier PSFs have engaged in aggressive merger and acquisition strategies (Empson, 2001; Greenwood et al., 1994). Furthermore, the client organizations of many PSFs have internationalized considerably in the recent past, and they expected their professional service providers to follow suit. These changing client expectations have lead PSFs to set up offices or search for network partners in new international contexts (Aharoni, 1993; Hitt et al., 2006). Finally, to leverage their core strengths and to retain organizational flexibility in uncertain competitive and regulatory environments, PSFs have also sought potentially reversible associations with peer organizations, resulting in constellations of strategic alliances (Jones et al., 1998; Koza & Lewin, 1999). Together, these developments mark the end of the era in which PSFs were "an oasis of organizational stability" (Gilson & Mnookin, 1988: 567) in the organizational landscape.

But these business model alterations simultaneously put pressure on the informal type of control and decision processes that long typified PSFs (Empson & Chapman, 2006; Greenwood & Empson, 2003). Mergers and acquisitions have made PSFs larger and more heterogeneous than they ever were, making their consensual and collective decision-making routines increasingly unwieldy (Empson, 2001; Greenwood et al., 1994; Hansmann, 1996). To accommodate heterogeneity and prevent it from having negative performance implications, formal governance and strategic planning routines needed to be put in place which concentrated decision-making powers in the hands of a select group of managing partners. Similarly, international diversification has exposed PSFs to multiple and often contradicting institutional logics, and has forced them to do business in contexts and cultures hitherto unknown for them (Cooper et al., 1996; Greenwood & Suddaby, 2006). To maintain the effectiveness of an internationally diversified practice, PSFs had to implement planning systems through which they could obtain appropriate information from locally operating partners and practice groups, and governance systems through which these local actors could be held accountable if they failed to meet their targets (Hitt et al., 2006). Dealing with alliance partners, finally, has forced PSFs to develop policies for curbing unwanted knowledge and client transfers and for dealing with potential partner opportunism, like formal periodic reviews of partners' contribution toward organizational objectives (Jones et al., 1998; Koza & Lewin, 1999). In short, we expect that both the adoption by and the performance benefits to PSFs of formal governance and strategic planning practices will increase with their size and level of diversification. See the following hypothesis:

Hypothesis 5: The relationships between PSF size and PSF diversification on the one hand, and performance on the other, will be positively mediated by the adoption of formalized governance and strategic planning practices.

### 3.3 Methods

#### 3.3.1 *Sample and data collection*

We tested our hypotheses on a representative sample of Dutch law firms. Studying law firms is appropriate in light of the hypotheses we aspire to test, as these firms are ‘classic’ PSFs (Von Nordenflycht, 2010), of which at least a fraction is moving in the direction of sedimented organizational structures through the adoption of formal governance and strategic planning practices (Cooper et al., 1996; Empson, 2007). For Dutch law firms, archival data on organizational variables is difficult to obtain for two reasons. First, like the legal systems of all other countries with a civil law tradition, Dutch law explicitly forbids external ownership of law firms, such that they are subjected to only rudimentary disclosure obligations. In practice, this means that only a summary of an annual report will have to be submitted annually with the Chamber of Commerce. Second, again similar to other civil law jurisdictions, Dutch corporate law does not provide for the legal form of the Limited Liability Partnership (LLP). In practice, most Dutch law firms emulate the LLP form through the construction of a limited holding company consisting of many different limited company daughters, often for the business of each individual partner. This has the unfortunate effect of exempting these limited daughter companies from disclosure obligations altogether. We therefore relied mostly on self-reported data, developing a survey instrument to collect first-hand information on PSFs. Yet for a select set of variables, including our dependent variable, we did manage to obtain archival data, thereby mitigating problems related to common method variance (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003).

We chose an online survey design using Global Park survey administration software ([www.globalpark.com](http://www.globalpark.com)). Our research was endorsed by the Dutch Bar Association ([www.advocatenorde.nl](http://www.advocatenorde.nl)). It provided us with a mailing list of all lawyers admitted to the bar in the Netherlands, which contained the valid email addresses of 7903 lawyers working for 3258 independent law firms. We deleted all 1580 single-lawyer firms from the list, as the organizational practices we intended to study were not relevant for them, leaving us with a sampling frame of 6323 lawyers representing 1678 law firms. We sent out two waves of electronic surveys. The first wave resulted in 440 fully completed responses. The second wave was sent out as a reminder two weeks later, and provided us with an additional 352 responses. Total response was thus 792, accounting for an individual response rate of 12.5 percent. Jointly, these

lawyers represented 354 law firms, leaving us with a 21.2 percent firm-level response rate. The breakdown of this firm-level sample over the various size strata represented in our sampling frame is provided in Table 1.

**Table 1: Sample description**

Organization size	Sampling frame <sup>a</sup>	In sample	Percentage
2 - 5 lawyers	1187	124	10.4%
6 - 10 lawyers	284	99	34.9%
11 - 60 lawyers	183	107	58.5%
> 60 lawyers	24	24	100%

### 3.3.2 Measures

To the largest extent possible, we relied on psychometric scales that were used and validated in prior research, as recommended by several experts (Babbie, 2009; Dillman, 2007). In case appropriate scales were not available in the literature, we relied on canonical scale development processes to ensure construct validity (Hinkin, 1998; Nunnally, 1978; Steenkamp & Van Trijp, 1991). These processes involved: (1) inductive and deductive item generation; (2) content validity assessment and item reduction with the help of an expert panel consisting of 10 academics specialized in strategy and organization and 10 lawyers; (3) internal consistency assessment; (4) confirmatory factor analysis (CFA) for goodness of fit assessment; and (5) convergent/discriminant validity assessment. All multi-item scales were measured with seven-point Likert items, where 1 always represented ‘strongly disagree’ and 7 ‘strongly agree’.

Our survey instrument consisted of 44 items representing 5 latent variables. In survey research using SEM, there are three ways in which items can be linked to latent constructs (Kishton & Widaman, 1994; Williams & O’Boyle, 2008). First, the total disaggregation approach considers all items individually as indicators. Second, the partial disaggregation method combines small sets of items to form indicators known as ‘parcels.’ Third, the total aggregation method combines all items into a single indicator, using reliability information to control for random measurement error. In a recent review article, Williams and O’Boyle (2008) found that 33 out of 75 articles published in journals like *AMJ*, *JAP*, & *JOM* relied on a parceling strategy. This partial disaggregation strategy is preferable for the analysis of large and complex models containing dozens of items, especially when the goal of the research is to understand the relationships between latent variables (Little, Cunningham, Shahar, & Widaman, 2002).

Parceling is a preferable approach for two reasons. First, individual items often have lower reliability and communality as well as smaller common-to-unique variances than parcels (Coffman & MacCallum, 2005; Little et al., 2002). Second, parceling reduces the number of parameters to be estimated, which supports the efficiency of estimation routines (Kishton & Widaman, 1994; Williams & O'Boyle, 2008). Based on the large number of items in our survey instrument, and given that our primary research interest is in the relationship between latent constructs, we opted for parceling. We constructed our parcels using the so-called domain representativeness approach (Kishton & Widaman, 1994), in which individual items are divided over a smaller number of parcels (in our case always three) on the basis of their standardized factor loadings on the first dimension extracted through CFA. The item with the highest factor loading on the first dimension is assigned to parcel 1, the second-highest to parcel 2, the third- and fourth-highest to parcel 3, and so forth. This approach is called the domain representative approach because the parcels thus constructed come to represent the broad domain of content captured by the latent variable, rather than any specific sub-dimension of it (Kishton & Widaman, 1994).

*Dependent variable: Law firm performance.* Because law firms serve the interests of multiple stakeholders simultaneously (Brickson, 2005; Empson & Chapman, 2006), law firm performance is a multidimensional construct. We therefore operationalized it as a latent variable, incorporating archival indicators for those dimensions of performance for which they were available and self-report indicators for those dimensions for which they were not. The first performance dimension we tapped into was the returns law firms generate for their owners, which is commonly operationalized in PSF studies as profits per partner (cf. Greenwood et al., 2005; Malos & Champion, 2000). Archival scores on this indicator were derived from a trade publication (Coppes, 2008), complemented with write-in responses to a corresponding survey item. To reduce the impact of outliers, we used a natural log transformation of this indicator. The second performance dimension we included was organizational growth, measured as the two-year percentage-wise increase (or decrease) in the number of lawyers employed by the firm. Next to profits per partner, organizational growth is a complementary indicator for PSF performance because it captures a firm's ability to increase future business. Because in professional services, increases in business will need to be met by increased employment of professionals able to deliver them, the main strategic challenge for PSFs is to balance growth with profitability (Maister, 2003). Growth is additionally important to retain human capital, because it

determines the opportunities for non-partnered associates to become co-owners of the firm (Malos & Campion, 2000; Morris & Pinnington, 1998). Archival scores for this indicator were obtained from the Dutch Bar Association. Two further performance dimensions we tapped into were the ability of the firm to deliver value to its clients, and the overall efficiency of its organizational processes. To capture these final two dimensions of the law firm performance construct, we developed 8 new survey items (see Appendix A), using both inductive item generation based on conversations with our expert panel and deductive item generation based on treatments of PSF performance in the literature (e.g. Løwendahl, 2005). The resulting 8-item parceled construct showed sufficient reliability ( $\alpha = .73$ ).

**Independent variables: Human capital.** With our multi-item measure of human capital we aim to assess the quality of the expertise, knowledge, and skills present in a law firm. The scale developed by Subramaniam & Youndt (2005), based on earlier work on human capital (Schultz, 1961; Snell & Dean, 1992), proved to be operationally suitable (see Appendix A). CFA empirically confirmed the unidimensionality and reliability of this scale ( $\alpha = .88$ ). Moreover, all standardized factor loadings exceeded .70 and were statistically significant ( $p < .05$ ).

**Law firm reputation.** Firm reputation was measured using the four-item scale developed by Combs & Ketchen Jr. (1999; see Appendix A). CFA confirmed the scale's unidimensionality and reliability ( $\alpha = .89$ ). Three of the four standardized factor loadings exceeded .80 (one item scored .64). All were statistically significant ( $p < .05$ ).

**Formal governance.** Morris and Pinnington (1998) found that PSFs are moving beyond self-supervision towards more formal forms of governance. They found that budgeting and internal control systems, as well as productivity and quality targets, are now frequently incorporated into PSFs' formal governance architectures. Combined, these systems form the basis for our self-developed 7-item scale for formal governance (see Appendix A). After parceling, this scale proved to be unidimensional, with the first factor capturing 68 percent of the variance ( $\alpha = .77$ ). Standardized factor loadings ranged from .70 to .76, and were all statistically significant ( $p < .05$ ).

**Strategic planning.** The strategic planning scale we used contained 20 items (see Appendix A), and was adapted from Rogers, Miller, and Judge (1999). The original scale was comprised of 6 dimensions, of which the final dimension contained two items and was called 'broad analysis' ("Our strategic issues are broad rather than specific" and "Planning focuses on broad plans, not narrow budgets"). Our expert panel advised against the inclusion of these items in the survey, so we removed these

during initial item reduction. Exploratory factor analysis on the remaining items revealed 4 dimensions, because the original 'goals and plans' and 'scanning' dimensions collapsed into one factor. After parceling, the scale became unidimensional and internally consistent ( $\alpha = .95$ ). The standardized factor loadings of the three parcels were .88, .92, and .97, and all were statistically significant ( $p < .05$ ).

*Law firm size.* We used an archival measure of law firm size, operationalized as the number of lawyers employed by the focal firm. Data was provided by the Dutch Bar Association.

*Firm diversification.* To measure firm diversification, we asked our respondents to indicate in which particular practice areas their firm had developed activities. They were presented with a list of 16 practice areas recognized as possible specializations by the Dutch Bar Association: (1) family law; (2) labor law; (3) construction law; (4) contract law; (5) property law; (6) business law; (7) competition law; (8) banking law; (9) public law; (10) tax law; (11) transport law; (12) bankruptcy law; (13) debt collection practice; (14) criminal law; (15) legal representation; and (16) arbitrage. Firm diversification was measured on a 0 – 1 index, constructed by taking  $x/16$ , where  $x$  denoted the number of practice areas selected from the above listing.

*Control variable: Law firm age.* To control for firm age, a variable that can negatively impact firm performance through the liabilities of obsolescence and senescence (Barron, West, & Hannan, 1994), we included a variable capturing the number of years since founding, derived from a write-in item in our survey.

### 3.3.3 Construct validity and reliability

*Convergent/discriminant validity.* A construct is believed to display convergent validity when the multiple indicators used to measure it are positively and significantly related (Carmine & Zeller, 1979). Through SEM, convergent validity is examined by estimating the factor loadings of the individual items on their associated latent variable (Steenkamp & Van Trijp, 1991). As reported, our analysis showed that all factor loadings on underlying latent constructs were large and statistically significant, thus demonstrating the convergent validity of our measures. A set of constructs is said to possess discriminant validity when any given pair of constructs within that set does not correlate highly with each other. This indicates that the latent variables indeed measure different theoretical constructs (Carmine & Zeller, 1979). Discriminant validity can be assessed by comparing the fit of an unconstrained CFA model (in which all correlations are freely estimated) with that of one in which a pair

of constructs is constrained to unity (made to correlate fully by setting the covariance between latent constructs to 1). The set of constructs possesses discriminant validity when the unconstrained model consistently demonstrates a better fit, as measured by a lower chi-square value. We estimated all possible pair-wise constrained models, to test each possible pair of latent constructs for discriminant validity. In all instances, the pair-wise constrained models had significantly higher chi-square values than the unconstrained benchmark, suggesting that all our constructs indeed possess discriminant validity.

*Common method variance.* While we used archival measures for two dimensions of law firm performance and for organizational size, and while two further variables (diversification and firm age) were measured through objective rather than psychometric self-report questions, the majority of our data were obtained from a single data source, which suggests the possible presence of common method bias. We tested for this problem by implementing a number of procedures advocated by Podsakoff and his associates (2003). These procedures entail comparing a measurement model in which all items are related to a single 'method factor' to a full measurement model in which all items are loaded onto their latent variables. The full measurement model yielded an adequate fit ( $\chi^2$  2276.58;  $p < .001$ ; CFI .95; RMSEA .07). Furthermore, the fit of the single method factor model was considerably worse ( $\chi^2$  10074.18;  $p < .001$ ; CFI .81; RMSEA .17;  $\Delta\chi^2$  7797.60;  $\Delta d.f. = 45$ ;  $p < 0.001$ ). We proceeded to estimate a trait and method model, in which a single method factor latent variable is included in addition to the latent variables. When this model shows a better fit to the data, this indicates the presence of common method variance (CMV; Williams, Cote, & Buckley, 1989). The trait and method model indeed fitted the data better ( $\chi^2$  1871.92;  $p < .001$ ; CFI .96; RMSEA .06;  $\Delta\chi^2$  404.66;  $\Delta d.f. = 54$ ;  $p < 0.001$ ). We subsequently determined the amount of variance explained by the common method factor by using the sum of squared loadings to compute the amount of CMV. In our case, CMV accounted for 15.6 percent of total variance, which is well below the 25 percent cut-off point suggested by Williams and his associates (1989).

*Multiple raters.* We relied on an individually administered survey to uncover organizational properties. On average, we had more than two respondents per firm. In order to use all available information without giving disproportionate weight to firms with multiple raters, we took the average score of all raters per multiply rated firm. To establish the appropriateness of averaging, we determined the degree of interrater reliability. For all firms with multiple raters, we computed an intraclass correlation

coefficient for each item included in the survey (LeBreton & Senter, 2008). We then averaged these intraclass correlations within and between firms, yielding an overall intraclass correlation of 0.86. As this value is well above commonly accepted standard values for interrater reliability (Landis & Koch, 1977), we decided that it was appropriate to base our empirical estimates on the averaged score per firm.

## 3.4 Results

### 3.4.1 Model specification

Our analyses involved maximum likelihood SEM, estimated with the help of LISREL 8.80 software. SEM suits our hypothesized web of relationships, as it allows us to test for mediating effects directly (McEvily & Marcus, 2005). Also, with SEM we can correct for indicator measurement error, such that we do not have to make the false assumption that all indicators are measured perfectly. Table 2 presents descriptive statistics for and zero-order correlations between our latent variables, as well as their reliability coefficients.

### 3.4.2 Estimation, fit, and hypotheses results

Our theoretical model, as captured by Hypotheses 1 through 5, fitted the data well ( $\chi^2$  786.48; d.f. = 194; RMSEA .09). In addition to these overall fit measures, the multiple squared correlation coefficient ( $R^2$ ) of the dependent variable and the significance and hypothesized direction of the path coefficients also indicate that the model fits the data well (see Figure 1).

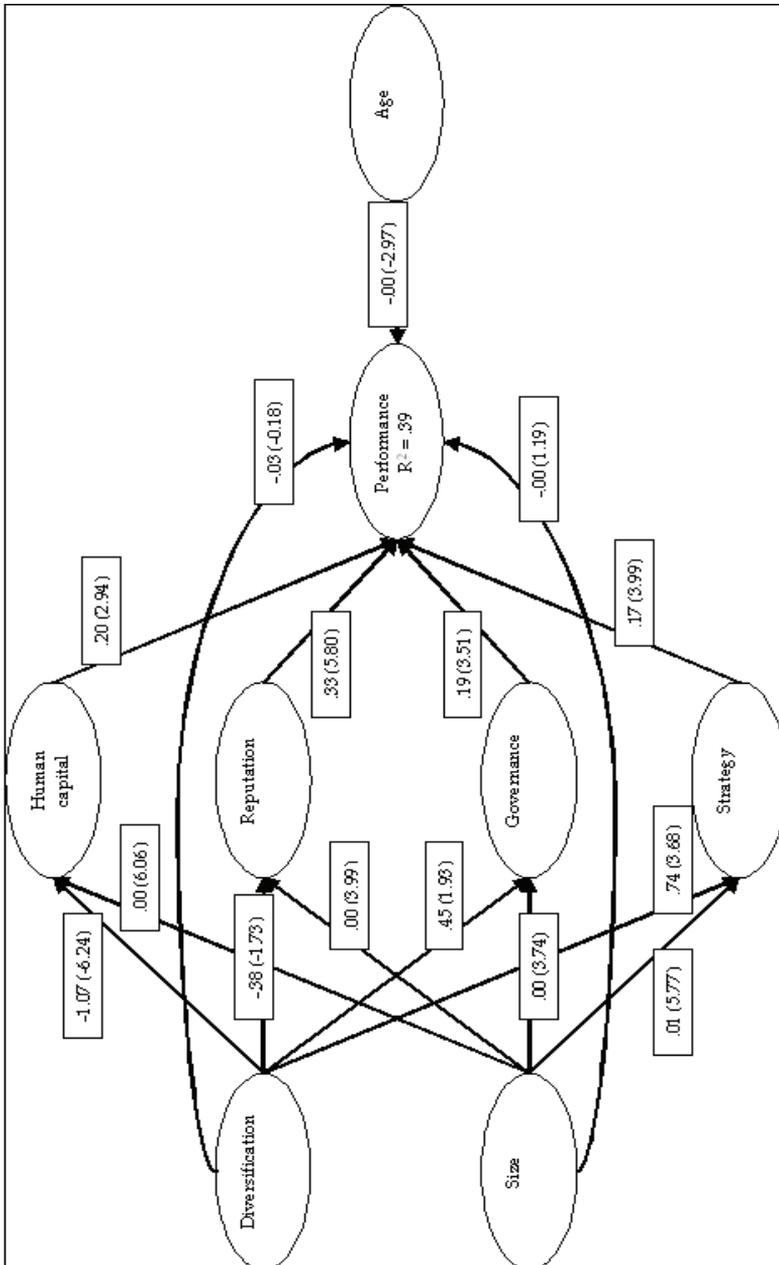
**Table 2: Descriptive statistics, correlations, and reliability coefficients**

Variable	Mean	s.d.	1	2	3	4	5	6	7
1. Organizational Performance	4.95	1.50	(.73)						
2. Reputation	5.65	0.80	.47	(.89)					
3. Strategic Planning	4.31	0.92	.20	.02	(.95)				
4. Human Capital	5.53	0.77	.21	.05	-.04	(.88)			
5. Organizational Governance	4.57	0.83	.25	.01	.09	-.02	(.77)		
6. Organizational Size	22.26	44.81	.04	.11	.34	.10	.19	■	
7. Organizational Diversification	0.46	0.21	-.07	-.05	.30	-.31	.18	.37	■
8. Organizational Age	27.34	30.58	-.11	.04	.23	-.03	.13	.55	.42

Hypothesis 1 suggested that human capital would be one of the main drivers of PSF performance, due to the knowledge-intensiveness of the services PSFs deliver. Our results support this hypothesis, as human capital has a positive and significant direct effect on PSF performance ( $\beta = .20, t = 2.94$ ). Also, Hypothesis 2 stated that PSF reputation would have a positive effect on performance, as the quality of professional services is difficult to observe directly (Von Nordenflycht, 2010). This assertion too was supported by our analyses ( $\beta = .33, t = 5.80$ ).

Hypothesis 3a predicted a positive effect of formal governance on PSF performance, due to its ability to rationalize business practices and manage possible conflicts of interest, while Hypothesis 3b highlighted the possible negative ramifications of interfering with professionals' autonomy through more formal controls. Hypothesis 3b had to be rejected in favor of Hypothesis 3a, as the positive effects of formal governance on PSF performance clearly prevail ( $\beta = .19, t = 3.51$ ). Another set of rivaling hypotheses juxtaposed the possible positive effects of strategic planning (Hypothesis 4a) with its possible negative effects (Hypothesis 4b). Hypothesis 4a clearly prevailed over Hypothesis 4b, as benefits like improved resource allocation and overcoming myopia outweighed costs like practice rejection and working with planning methods that are possibly ill-suited to the nature of professional work ( $\beta = .17, t = 3.99$ ).

Figure 1: Model results for PSF performance



Hypothesis 5 stated that the ability of formal governance and strategic planning to contribute positively to PSF performance would increase with PSF size and diversification. Econometrically, this hypothesis entailed 4 separate mediation effects, which we tested formally with the help of Sobel tests for statistical mediation (MacKinnon & Dwyer, 1993). The relationship between PSF size and performance was indeed strongly mediated by formal governance ( $z = 2.34; p < 0.05$ ) and strategic planning ( $z = 3.29; p < 0.01$ ). Similarly, we also found that the relationship between PSF diversification and performance was mediated by formal governance ( $z = 1.75; p < 0.10$ ) and strategic planning ( $z = 2.58; p < 0.05$ ). In short, our analyses support Hypothesis 5.

Finally, we found a negative significant effect of our control variable organizational age on PSF performance, suggesting that law firms are subject to liabilities of ageing like obsolescence and senescence (Barron et al., 1994).

## **3.5 Discussion**

### ***3.5.1 Performance implications of governance and strategy***

In recent years, a number of scholars have contributed to a growing body of knowledge on the drivers of PSF performance. Hitt and his associates (2001) found that human capital contributes positively to performance in PSFs, especially in the higher ranges of the distribution of that variable, and that PSFs benefit from leveraging the human capital of their partners over a larger number of associates. Groysberg and Lee (2009) relatedly discovered that human capital is more valuable when endogenously developed than when externally attracted, as even stars suffer from a performance decline when they move to a new PSF. Furthermore, Greenwood and his colleagues (2005) found a linear positive performance effect for reputational capital, but a nonlinear effect for leverage, suggesting an optimal ratio of associates to partners beyond which the returns of additional leverage diminish. Other studies have mapped the effect of ownership type. In a sample of large management consultancy firms, Greenwood and his co-authors (2007) found that firms owned privately or through a partnership structure outperformed the reference group of public firms. Von Nordenflycht (2007) likewise found that public ownership amongst ad agencies was bad for smaller firms, but not for larger agencies. Finally, Hitt and his co-authors

(2006) found a positive effect of internationalization on performance, suggesting that PSFs can profitably apply their knowledge base to challenges encountered by their clients in foreign markets.

However, a gap remains in this important body of work. Several scholars have highlighted the emergence of the managed professional business archetype, and have theorized about its characteristic features involving formalized governance and strategic planning (Cooper et al., 1996; Empson & Chapman, 1996; Greenwood & Suddaby, 2006; Pinnington & Morris, 2003). But to date, no study has tested whether these two features are helpful or hurtful to PSF performance, even though arguments can be mustered for either effect. On the positive side, governance and strategy can rationalize the administration of PSFs, improving resource allocation and strategic foresight and reducing the potential for internal conflicts rooted in private interests (see Hypotheses 3a and 4a). On the negative side, the formalization and centralization of control might crowd out professionals' intrinsic motivation while the associated practices might categorically be rejected by professionals in protection of their autonomy (see Hypotheses 3b and 4b). Our study is the first to empirically assess these effects, and we find evidence that the positive effects of formal governance and strategic planning outweigh their negative performance implications. While this finding is relevant for scholars working on PSF performance, it should also be interesting to PSF scholars working on the diffusion and legitimation of the managed professional business archetype (e.g., Brock, 2006; Greenwood & Suddaby, 2006; Pinnington & Morris 2003; Suddaby & Greenwood, 2005). Our study shows that the spread of this archetype is spurred on not only by the rhetorical strategies and institutional entrepreneurship of elite PSFs who have a stake in its social acceptance (Greenwood & Suddaby, 2006; Suddaby & Greenwood, 2005), but possibly also because adopting its features provides substantive benefits to PSFs in general.

### **3.5.2 Comparing performance drivers**

Prior work aimed at identifying the drivers of PSF performance has largely tested their effects in isolation, as most existing studies scrutinize only a single or maximally two performance drivers. In contrast, our study offers a comprehensive test of four salient drivers of PSF performance, integrating prior research by scholars interested in human capital (Groysberg & Lee, 2009; Hitt et al., 2001), firm reputation (Greenwood et al., 2005), and other drivers. This yields two clear benefits. First, for PSF scholars interested in performance, a salient benefit of our more inclusive test is that it

establishes the robustness of earlier findings to the inclusion of several other variables with a known effect on the dependent variable. Our finding that these factors continue to have a statistically significant effect on performance in a competitive test validates and highlights the relevance of earlier studies. Second, for practitioners interested in enhancing PSF performance, a clear benefit of our research is that it enables a direct comparison of the regression coefficients provided in Figure 1 in order to see which performance drivers matter most. In contrast to the disproportionate attention given to human capital in the literature on PSF performance, its contribution is in fact the smallest of all included factors. Formal governance and strategic planning are stronger drivers, although individually their contribution to PSF performance is roughly on par with that of human capital. Given that 'classic' PSFs (Von Nordenflycht, 2010) like the law firms in our sample have only relatively recently embraced these characteristics, and as the diffusion of these features is far from complete, their implementation could well lead to additional benefits for many PSFs. Yet our results also show that firm reputation is by far the most important driver of PSF performance, and its impact is substantially greater than that of any of the other drivers. For practitioners interested in durably improving the performance of PSFs, the first best option is therefore to invest in strengthening their standing relative to their peers in the eyes of relevant audiences.

### ***3.5.3 Contingency elements in the theory of the PSF***

Several scholars have recently made a case for a special theory of the PSF, as the type of services PSFs provide and the organizational design choices they make to facilitate their delivery set them apart from most other organizational forms (Empson & Chapman, 2006; Greenwood et al., 2005, 2007; Greenwood & Empson, 2003; Von Nordenflycht, 2010). An important question for this emerging theory is whether or not it should embrace a contingency-theoretical set-up, such that its core predictions are theorized to be dependent on PSFs' scores on core contingency variables like organizational size and diversification (Greenwood & Miller, 2010). Empirical evidence from prior studies indeed suggests that the effects of certain performance drivers are contingent on size (Von Nordenflycht, 2007) and diversification (Hitt et al., 2001).

Yet the applicability of contingency-theoretical arguments to the PSF setting should not be taken for granted. One reason to be cautious is that PSFs can be organized as federal structures of semi-autonomous practice areas (Anand et al., 2007).

If all these practice areas share is a brand name and perhaps some basic back-office facilities, it should not be taken at face value that their administrative architectures or planning processes should change as they scale up or down. Another ground for caution is that the core technology of most PSFs – the customized application of human and reputational capital in the delivery of knowledge-intensive services – remains very similar as they expand or contract (Greenwood et al., 1994). Substantial revenue growth in the PSF setting obtains mostly from core technology preserving efforts to bring additional human resources into play, and to a far lesser extent from core technology changing investments in financial or technological capital. As core technology is an important contingency variable documented to determine the structural fit of manufacturing and non-professional service firms (Perrow, 1986; Thompson, 1967), the fact that PSFs enjoy little or no variance on this variable appears to make them less susceptible to contingency theoretical reasoning.

In spite of these cautionary notes, our results do suggest that contingency elements should be built into the design of the nascent theory of the PSF. Larger and more diversified PSFs rely on a different mix of drivers to secure their performance than their smaller and less complex counterparts. One important difference is that larger firms rely more on formal governance and strategic planning to foster expedient decision-making and collective action, both of which are difficult to realize through informal and consensual mechanisms in complex environments (see Figure 1). Furthermore, our analyses also allow us to tease apart the contingency effects of size and diversification. In line with the aforementioned arguments about their internal organization and core technology, PSFs continue to draw on human capital and reputation as they grow in size (see Figure 1). This suggests that in the theory of the PSF, growth should be modeled as a process of leveraging the firm's human and reputational resource base over new opportunities (cf. Greenwood et al., 2005; Hitt et al., 2001). Yet as firms diversify through the development of new practice areas (Anand et al., 2007), the relative importance of human and reputational capital lessens as compared to that of formal governance and strategy (see Figure 1). Likely, when firms decide to pursue opportunities in new markets areas, acquiring new talent and leveraging the firm's reputation are not the greatest bottlenecks. Instead, due to the resulting compartmentalization of expertise and increasing inter-professional knowledge asymmetries in diversified firms, better monitoring and planning become the more critical success factors. In sum, as the theory of the PSF that is currently unfolding will begin to approach its final shape, it is likely that its main predictions

will not be universalistic, but rather bounded and contextualized by factors like PSF size and level of diversification.



# Chapter 4. External agency relations and agency problems in professional service firms: A multilevel study<sup>3</sup>

## Abstract

We employ survey and archival data on a sample of 2083 lawyers working for 203 Dutch law firms to test a multilevel theory of the specific corporate governance challenges facing professional service firms (PSFs). We conceptualize the external agency relations characterizing PSFs, and test how agency problems emerge in these relationships under the influence of PSF-specific practices and the risk propensities of individual professionals. Taking complaints filed against lawyers with the bar association as a measure for agency problems, we find that organizational practices like training and strategic planning and individual characteristics like job roles and experience influence their prevalence.

## 4.1 Introduction

Recent work has identified professional service firms (PSFs)—firms “whose primary assets are a highly educated (professional) workforce and whose outputs are intangible services encoded with complex knowledge” (Greenwood, Li, Prakash & Deephouse, 2005: 661)—as a distinctive organizational form facing specific challenges and featuring correspondingly specific practices (Von Nordenflycht, 2010). Yet in spite of a growing literature on PSFs, little is known about the corporate governance challenges facing PSFs and the organizational practices they feature to meet them. Arguably, this is because the field of corporate governance is largely premised on the agency problems between managers and shareholders resulting from the separation of ownership and control in publicly listed firms (Fama & Jensen 1983; Jensen & Meckling 1976). As PSFs are typically owned internally by a subset of their employees

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<sup>3</sup> This chapter has been co-authored with Prof.Dr. J. (Hans) van Oosterhout and Prof.Dr. Pursey P.M.A.R. Heugens. This paper is currently under review at Organization Science.

(the partners), they hardly feature any separation of ownership and control and have therefore largely been off the radar for corporate governance researchers.

Yet the fact that ownership and control are concentrated in the same hands in PSFs does not mean that they are immune to agency problems. The recurrent involvement of PSFs in corporate scandals presents evidence that PSFs are vulnerable to agency problems, albeit of a different kind than those burdening publicly listed firms. Agency problems troubling PSFs operating in traditional professions like law and accounting arise mostly in agency relations with external parties, like clients and third-party beneficiaries of professional services. These parties may have conflicting interests and are often unable to evaluate the quantity, quality, and integrity of professional services rendered to them.

At present, the extent to which the specific organizational features of PSFs are conducive to agency problems appears to be underestimated systematically by scholars and practitioners. While traditional professions like law and accounting have historically been highly institutionalized (Greenwood, Suddaby & Hinings, 2002; Lawrence, 1999), their professional associations primarily provide regulation and enforcement of individual professionals' behavior rather than of PSFs' organizational practices. Furthermore, recent research and policy debates on professional failures have focused almost exclusively on regulatory issues, thereby largely ignoring the distinctive organizational practices of the organizations providing professional services (Coffee, 2006; Kraakman, 1986; Wilkins, 1992). To direct more attention to the organizational aspects of PSFs, this paper develops a distinctively organizational theory of the corporate governance challenges and practices of PSFs.

At the organizational level of analysis, our multilevel theory details hypotheses on how PSF-specific organizational practices can either contain or exacerbate the occurrence of agency problems in external agency relations. We first conceptualize two such agency relations—between professionals on the one hand and their clients and interested third parties on the other—which capture the specific governance vulnerabilities of PSFs. As organization-level explanatory variables, we focus on two sets of governance practices that tend to simultaneously co-exist in contemporary PSFs. First, because PSFs are traditionally organized as professional partnerships featuring mostly informal organizational practices, we investigate the effect of 'soft' controls like human capital development and the 'club value' that PSFs provide to their members. Second, as PSFs are increasingly adopting more formal governance practices, we also investigate the influence of 'hard' controls such as

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strategic and financial planning and formal governance. At the individual level of analysis, our theory aims to explain why certain professionals are prone to be involved in agency problems in the PSF context, due to the differential risk propensities resulting from their differential roles and experience.

Because external agency problems become empirically manifest only through the regulatory and enforcement role of professional associations, we take the complaints filed against individual lawyers with the bar association as a measure for the occurrence of external agency problems. Our data comes from three sources. First, the data for our dependent variable (complaints) is provided by the deacons of the local bar associations of nine Dutch legal districts. Second, the data on organization-level practices derive from a survey administered amongst all licensed lawyers in the Netherlands. Third, archival data on individual-level explanatory and control variables was supplied by the Dutch bar association. To address the hierarchical nature of factors that affect the occurrence of agency problems in PSFs, and to deal with the problem that our individual-level observations are not independent, we rely on hierarchical linear modeling (HLM) techniques (Hofman, 1994; Raudenbush & Bryk, 2002). Our dataset consists of 2083 individual-level observations (lawyers) nested in 203 organizational-level observations (law firms).

Our study has three intended contributions. First, we develop and test a multilevel theory concerning the specific kinds of agency problems burdening PSFs. We thereby contribute to the emerging literature on the corporate governance of non-publicly listed firms, which to date has concentrated primarily on private family-controlled firms (Daily & Dollinger, 1992; Gómez-Mejía, Takács Haynes, Núñez-Nickel, Jacobson & Moyano-Fuentes, 2007; Schulze, Lubatkin, Dino, & Buchholz, 2001). Second, we assess how governance and control practices that are characteristic for PSFs as an organizational form either reduce or exacerbate the likelihood that individual professionals will become involved in agency problems. We hereby respond to recent calls for more research on organizational forms in general (Greenwood & Miller, 2010), and on the specific organizational challenges and practices of PSFs in particular (Greenwood & Empson, 2003; Greenwood et al., 2005; Hitt, Bierman, Shimizu & Kochhar, 2001). Third, we show that the risk propensities of individual lawyers, as shaped by their organizational roles and experience, influence the chance that they will be involved in agency problems and attract complaints from either clients or interested third parties. Analogous to traditional agency-theoretical models (Hitt & Tyler, 1991; Sanders & Hambrick, 2007; Wiseman & Gomez-Mejia,

1998), the theory developed here thus allows us to identify the individual-level factors that make the type of agency relationships that define the PSF as an organizational form vulnerable to emergence of agency problems.

## **4.2 Theory and hypotheses**

### **4.2.1 What are PSFs?**

Recent work has identified the PSF as a distinctive organizational form facing specific challenges, which derive from the nature of the services it delivers, its distinctive resource dependencies, and the highly institutionalized environment in which it operates (Greenwood & Empson, 2003; Von Nordenflycht, 2010). PSFs deliver knowledge-intensive and intangible services (Løwendahl, 2005) that are highly customized through intensive client consultations (Hansen, Nohria, & Tierney, 1999), making the knowledge they exploit difficult to codify and commodify. Because of the resulting inalienability of professional knowledge from its human carriers (Dow, 2003), PSFs are human capital intensive (Hitt et al., 2001), while they have little need for external financial capital (Von Nordenflycht, 2010). Finally, many PSFs offer (quasi) public or so-called 'gatekeeper services,' which facilitate complex market exchange by assuring the quality, legality, and integrity of transactions (Coffee, 2006; Kraakman, 1986). PSFs therefore operate in highly institutionalized environments, in which both public authorities and professional associations set and enforce constraints on the services provided and on the professionals providing them (Greenwood et al., 2002).

To cope with these challenges, PSFs are characteristically owned internally by a subset of their members (Dow, 2003; Hansmann, 1996; Hart & Moore, 1996; Richter & Schröder, 2007), and organized as professional partnerships (Greenwood & Empson, 2003). The traditional PSF organizational archetype, which has become known as the 'P2' (Greenwood, Hinings & Brown, 1990), exhibits unique human resource management and corporate governance practices. Because of their reliance on human capital (Maister, 2003), PSFs typically combine competitive hiring processes with high levels of on-the-job training by senior professionals, and an up-or-out promotion system that regulates admission to firm ownership (Galanter & Palay, 1991; Gilson & Mnookin, 1988; Morris & Pinnington, 1998). The governance of PSFs combines collective decision making by the partners with a high degree of decentralization and mostly informal collegial monitoring practices.

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Although the P<sup>2</sup> has historically been the dominant form of enterprise organization in classic professions such as law and accounting (Greenwood & Empson, 2003), changes in economic and social trends, government policies, and client preferences (Hitt, Bierman, Uhlenbruck & Shimizu, 2006; Løwendahl, 2005; Maister, 2003; Nachum, 1996) have led to the spread of a commercial ethos in the professions (Cooper, Hinings, Greenwood, & Brown, 1996), which challenges traditional P<sup>2</sup> organizational practices (Cooper, Greenwood, Hinings, & Brown, 1998; Empson, 2007). Many PSFs are now adopting face-changing strategies and practices, and are moving in the direction of a new organizational template coined the 'Managed Professional Business' (MPB, Cooper et al., 1996). Compared to the P<sup>2</sup>, the MPB introduces "more formal strategic planning, controls over quality of work and productivity of staff, greater emphasis on coordinated marketing activities and more elaborate and centralized financial systems" (Morris & Pinnington, 1998: 76), which appear to co-exist durably with traditional P<sup>2</sup> practices (Cooper et al, 1996).

#### **4.2.2 External agency relationships in PSFs**

Agency relationships arise in almost every form of human cooperation, including vertical delegation relationships (Fama & Jensen, 1983; Klein, Crawford, & Alchian, 1978) and horizontal co-production efforts (Alchian & Demsetz, 1972; Holmstrom, 1982). The defining features of an agency relationship include: (a) a separation of decision making and exposure to the consequences of those decisions, under conditions of (b) at least partially conflicting interests and (c) knowledge and information asymmetries (Arrow, 1985; Eisenhardt, 1989). In agency relationships, the party making the decisions can use her decision authority to further her private interests instead of those of the party she is making the decision for, which then produces so-called agency problems (Eisenhardt, 1989). In public firms, the most consequential agency relationship arises out of the separation of ownership and control, as professional managers take the bulk of everyday business decisions while shareholders (amongst others) face the consequences of those decisions. The owner-manager agency relationship is vulnerable to agency problems, as owners and managers can have diverging interests, while the latter also enjoy informational privileges over the former (Black, 1990, Easterbrook & Fischel, 1991).

Because in PSFs ownership and control tend to be combined in the hands of a select group of professionals, PSFs hardly feature any owner-manager agency relationships. Yet PSFs paradigmatically exhibit two other agency relationships that

make them vulnerable to equally serious agency problems. These agency problems arise external to PSFs, and burden the agency relations between professionals and their clients on the one hand, and between professionals and interested third parties on the other.

*Professional - client agency.* PSFs feature agency relationships with their clients because clients acquire expertise and services from professionals that they typically do not have and cannot produce themselves. PSF clients therefore surrender part of their decision-making powers to professionals. The agency relationship between professionals and their clients is highly vulnerable to the occurrence of agency problems, not only because of possible conflicts of interest in respect to fees and billable hours (Hayward & Boeker, 1998), but also on account of substantial information and knowledge asymmetries, making it difficult for clients to evaluate the quality and integrity of the professional judgments and actions taken on their behalf (Sharma, 1997). Client vulnerability is historically one of the most salient reasons behind the institutionalization of professions such as law and accounting. Professional-client agency is likely to be associated with agency problems like overbilling, sub-standard service quality delivery, and neglect of professional ethics. When detected, these behaviors tend to give rise to complaints filed by clients with the disciplinary bodies of professional associations.

*Professional - third party agency.* PSFs also feature agency relationships with interested third parties, as professionals routinely make decisions that affect a host of other external parties, even though they do not transact with them directly. Paradigmatic examples of such 'third party beneficiaries' (Eisenberg, 1992) are the beneficiaries of a trust made up by a lawyer, and the participants in public equity markets relying on the assurance over the annual accounts of public firms provided by accountants (Goldberg, 1988). In many instances, it is possible to point out the third parties acting as ultimate principals in this type of agency relationship. When the involved third parties are more difficult to identify, however, the professional association may be regarded as the principal. This is because professional associations are both the author and enforcer of the rules and professional standards that give voice to third party interests. Because third party beneficiaries by definition are not themselves involved in professional transactions and occasionally difficult to identify as interested parties, they are most efficiently protected by rules and regulations (Calabresi & Melamed, 1972). In practice, agency problems in third party agency relationships in the professions tend to become manifest only through the

intermediary role of professional associations, in the form of breaches of professional rules, standards, or procedures, in response to which aggrieved parties tend to file complaints with professional disciplinary bodies.

#### 4.2.3 *An organizational theory of PSF governance*

Due to agency theory's origins in economic theory (Lazear, 2000; Spence & Zeckhauser, 1971), agents in agency relationships are traditionally assumed to pursue their self-interests whenever the benefits of doing so outweigh the costs (e.g. Ghoshal, 2005). Empirical research, however, has demonstrated that human actors are motivationally more complex than how they are portrayed in economic theory (Frey & Oberholzer-Gee, 1997). More specifically, their propensity to act selfishly or unethically is influenced by the organizations they work for (Trevino, Weaver, & Reynolds, 2006).

In line with these findings, we develop a distinctively organizational, multilevel theory of corporate governance practices in PSFs. In this view, the agency relationships that characterize PSFs as an organizational form merely constitute the 'fault lines' along which agency problems can materialize (Heath, 2009). Whether or not agency problems will actually occur, however, is at least partly dependent on the specific organization-level governance practices that PSFs feature, as well as on individual-level risk propensities that arise from functioning as a professional. At the organizational level, Hypotheses 1 through 3 deal with P<sup>2</sup>-like 'soft' controls, whereas Hypotheses 4 and 5 deal with MPB-like 'hard' controls. At the individual level, Hypothesis 6 relates to the effects of experience and job role, which shape professionals' risk propensities.

*'Soft' controls in PSFs.* Governance in PSFs has historically been based on informal or 'soft' controls, whose functioning is facilitated by the high degree of face-to-face interaction between professionals in PSFs (Zey-Ferrel & Ferrell, 1982), and founded in their employees' commitment to professionalism (Gendron, Suddaby, & Lam, 2006; Hall, 1968). Two features of the P<sup>2</sup> archetype function as soft controls containing behavioral risks resulting from agency relations in PSFs: professional socialization and the social or 'club' value that the organization provides to individual professionals.

In recognition of their unique resource dependencies (Greenwood & Empson, 2003; Hitt et al., 2006), PSFs rely on various socialization processes (in addition to stringent selection procedures) to increase the quality and integrity of their human

capital base. Socialization combines formal and informal processes enabling members to function successfully in an organization (Anderson-Gough, Grey, & Robson, 2000; Coffey, 1994; Dirsmith, Heian, & Covaleski, 1997). Socialization not only helps to disseminate difficult to codify expert knowledge to junior professionals, but is also the main mechanism through which expectations of appropriate behavior are communicated (Brief, Buttram & Dukerich, 2001; Treviño, Weaver, Gibson & Toffler, 1999).

Two dimensions of socialization are specifically important within PSFs. First, a sound human capital base requires high degrees of on-the-job training and mentoring. In many PSFs, socialization processes are extensive and intense, such that junior professionals initially enjoy only limited levels of job autonomy, while they have to learn their profession by looking over the shoulder of senior professionals. Other PSFs, however, feature mentoring programs in which coaching and supervision is minimal, and in which juniors are mostly left to themselves. In PSFs of the latter kind, junior professionals are less likely to be infused with relevant norms and values than in PSFs of the former kind, where juniors learn them directly through the leadership behaviors of seniors (Brown, Treviño, & Harrison, 2005). Second, many PSFs have also adopted more formal human capital development strategies, such as off-the-job education and training programs, which also may contribute to the internalization of relevant norms and values and to the reduction of agency problems (Treviño & Weaver, 2003; Weaver et al, 1999a). See Hypothesis 1:

Hypothesis 1: The greater the attention paid to socialization of professionals in a PSF, the lower the propensity of its members to be involved in agency problems.

It is conventional wisdom that the organizational context influences ethical decision-making and behavior within organizations (Butterfield, McCabe, & Treviño, 1998; Treviño, 1986). An organization's ethical climate (Peterson, 2002; Victor & Cullen, 1987) and ethical culture (Treviño et al., 2001) have been found to influence employees' organizational commitment and behaviors (Butterfield et al., 1998; Deshpande, George, & Joseph, 2000; Fritzsche, 2000). In PSFs more specifically, two distinctive

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contextual factors are especially relevant in explaining whether agency relationships will culminate in agency problems.

First, social capital refers to the value of the social network that a PSF provides to individual professionals (Adler & Kwon, 2002; Coleman, 1988). Social capital is important in PSFs, because durable ties with expert colleagues enhance the value of the services that any individual professional can deliver. Frequent face-to-face contacts between fellow professionals are not only an important conduit through which professional knowledge and experience diffuse, but also provide a mechanism through which professionals can monitor the quality and integrity of each other's work. Because agency problems occurring in relationships with external parties put this social capital at risk for any individual professional, the value of the social capital provided by a PSF is likely to be negatively related to the propensity of the professionals employed by it to be involved in such problems. Second, a shared sense of commitment to the organization will reduce professionals' inclination to be involved in agency problems. Such an 'esprit de corps' is widely believed to contribute to a PSF's reputation and brand value, and is therefore often intentionally cultivated within PSFs. Because social capital and a shared sense of commitment to the organization jointly represent the social or 'club' value of PSF membership (Buchanan, 1965), we combine them in a single hypothesis:

Hypothesis 2: The higher the 'club' value provided by a PSF,  
the lower the propensity of its members to be involved  
in agency problems.

A related informal PSF-specific governance mechanism involves the reputation a PSF has in the eyes of its external beholders. PSFs are critically dependent on their reputation to attract and maintain clients and charge premium fees for their services. In markets where the quality and integrity of services are difficult for clients to assess, reputation is a powerful signal for both. This is especially true for PSFs that function as guardians of trust or gatekeepers on behalf of third party interests, as such PSFs pledge the intangible asset of their reputation as a hostage to vouch for the quality and integrity of their services (Coffee, 2006). Reputation is also a critical

resource for PSFs because it is instrumental in hiring and retaining high quality human capital (Fombrun, 1997).

Because reputation is built—and destroyed—through recurrent transactions with clients, it plays a disciplinary role in assuring the quality and integrity of services delivered by PSFs (Dixit, 2004). This is because the shadow from the (discounted) value of future transactions provides powerful incentives not to be involved in agency problems today (Klein & Leffler, 1981). Because professionals employed by firms with better reputations stand to incur greater pecuniary losses from reputational damage, we hypothesize that:

Hypothesis 3: The better the reputation of a PSF, the lower the propensity of its members to be involved in agency problems.

*'Hard' controls in PSFs.* In response to profound economic and institutional changes in the legal profession over the last three decades, many PSFs have adopted more formal organizational practices that have long been established in other forms of enterprise organization, but that were traditionally believed to be inimical to the professions. These more generic organizational practices fall into two broad categories.

First, the introduction of strategic planning and performance management practices may pressure professionals to compromise professional norms and values in order to realize planned economic performance. These practices may trigger a more calculative mode of deliberation in professionals that not only has been found to negatively affect cooperative dispositions (Frank, Gilovic, & Regan, 1993) and increase the prevalence of unethical behaviors (Frank & Schulze, 2000), but may also crowd out the 'softer' professional values that give voice to the vulnerable interests of clients and third party beneficiaries (Frey & Jegen, 2001). Additionally, the introduction of generic performance management practices in PSFs often conflicts fundamentally with more traditional professional practices and attitudes, which may create a state of normative ambiguity within PSFs that is often referred to as 'anomie' (Durkheim & Thompson, 2004; Merton, 1968), and which is empirically associated with various forms of opportunistic behavior (Cullen, Parboteeah, & Hoegl, 2004; Martin, Cullen, Johnson & Parboteeah, 2007). See Hypothesis 4:

Hypothesis 4: The more a PSF engages in strategic planning and performance management practices, the higher the propensity of its members to be involved in agency problems.

A second category of 'hard' controls adopted by PSFs involves the formal governance of professionals, which is complementary to their increasing involvement in strategic and performance management. For example, the highly collegial and decentralized decision-making practices characterizing the P<sup>2</sup> often stand in the way of effective strategy formation. Many PSFs have therefore adopted more centralized decision-making structures, which concentrate decision-making authority in the hands of a more limited set of managing partners or even involve the appointment of specialized (often financially trained) managers. Furthermore, the 'soft' controls of the P<sup>2</sup> form are also poorly suited to monitor strategy implementation and performance, which has led many PSFs to introduce 'hard' controls at different levels in the firm. Some PSFs have adopted knowledge management systems in an attempt to 'alienate' professional knowledge of its human carriers and make PSFs less dependent on highly mobile human capital. Finally, PSFs have increasingly implemented formal ethics management programs in order to contain liability and reputational risks that become increasingly difficult to control though traditional collegial monitoring the larger PSFs become.

The adoption of such formal governance practices is likely to increase the prevalence of agency problems for three reasons, however. First, the 'hard controls' through which they operate constitute the organizational levers through which professionals are pressured to put economic over professional performance, which may alienate professionals from professional values and ideals. Second, while formal governance practices can be effective in monitoring economic performance, they are a poor substitute for collegial monitoring in containing opportunistic agentic behaviors that are less observable and more difficult to detect. Third, formal ethics programs, more specifically, allow real actions and intentions to be decoupled from appearances, especially when such programs are adopted for symbolic purposes in order to contain the firm's external legal liabilities (Treviño et al., 1999). Such programs may also

exacerbate agency problems when they conflict with hard performance controls or professional values, as this contributes to 'anomie' within PSFs. We therefore hypothesize:

Hypothesis 5: The greater the attention paid to governance and ethics management in a PSF, the higher the propensity of its members to be involved in agency problems.

*Professionals' risk propensities.* In PSFs, individual professionals are likely to have different propensities to become involved in agency problems due to the differential risk orientations that result from their experience and job roles. One vulnerable category is the non-partnered associate. PSFs feature highly competitive human resource management practices, centered on 'up or out' promotion principles (Morris & Pinnington, 1998), which stage the process of an associate's admission to partnership as an all-or-nothing tournament. In 'up or out' systems, the fruits of several years of deferred compensation, hard work, and relentless dedication are distributed highly unequally between associates (Becker & Huselid, 1992; Eriksson, 1999). The substantial rewards associated with becoming a partner, the disproportional influence of the threat of being denied partnership on decision making (Kahneman & Tversky, 1979), and the single-shot character of promotion to partner decisions all may lead associates to become more frequently involved in agency problems than individuals working in different roles.

Another vulnerable category is the experienced professional. With experience, professionals may become more risk prone and more frequently involved in agency problems (Elm & Nichols, 1993). More seasoned professionals can become overconfident in their own skills and expertise, and may therefore overestimate the chance of getting away with opportunistic behaviors. More experienced professionals are also less likely to be subjected to collegial correction of beliefs and behaviors, as they tend to work more autonomously. Furthermore, experienced professionals also tend to work on more complicated cases, which increases the chance of them becoming involved in agency problems. We therefore suggest that:

Hypothesis 6: Due to their higher risk propensities, both associate and more experienced professionals are more likely to be involved in agency problems.

## **4.3 Methods**

### **4.3.1 Sample**

To test our hypotheses, we constructed a multilevel dataset consisting of lawyers ('level 1 observations'; Raudenbush & Bryk, 2002) nested in Dutch law firms ('level 2 observations'). For our dependent variable, collected at level 1, we depended on the private and voluntary disclosure of complaints information by Dutch district courts. Seven out of 19 courts disclosed this information to the research team. Jointly, these seven districts are home to 556 law firms. Firm-level data was collected by means of a survey instrument. All firms for which at least one responded reported a score on all firm-level questionnaire items were retained in the final dataset. When scores of several respondents were available for a single firm, we averaged these ratings. This resulted in a level 2 sample of 203 law firms, representing a response rate of 36.5 percent. The 556 firms located in the aforementioned seven districts jointly employed 3894 lawyers, of which 2083 were affiliated with the firms in our sample. Complete archival complaints and control variable records were available for all of them, implying a level 1 population coverage of 53.5 percent for the seven disclosing districts.

### **4.3.2 Research design and data collection**

For law firms, data on organizational variables pertaining to issues like corporate governance and strategy formation are difficult to obtain from archival sources, as they are privately owned and subjected to very limited disclosure obligations. We therefore developed a survey instrument to tap into the variables we aimed to research. To the largest extent possible, we relied on psychometric scales that were used and validated in prior research, as recommended by several experts (Babbie, 2009; Dillman, 2007). In case appropriate scales were not available in the literature, we relied on canonical scale development processes to ensure construct validity (Hinkin 1998, Nunnally 1978; Steenkamp & Van Trijp 1991). These processes involved: (1) inductive and deductive item generation, (2) content validity assessment and item

reduction with the help of an expert panel consisting of 10 academics specialized in strategy and organization and 10 lawyers, (3) internal consistency assessment, (4) confirmatory factor analysis (CFA) for goodness of fit assessment, and (5) convergent/discriminant validity assessment. All multi-item scales were measured with seven point Likert items, where 1 always represented “strongly disagree” and 7 “strongly agree”. In all, our survey instrument consisted of 92 items representing 8 firm-level composite variables.

We opted for an online survey design using Global Park survey administration software ([www.globalpark.com](http://www.globalpark.com)). Our research was endorsed by the Dutch Bar Association ([www.advocatenorde.nl](http://www.advocatenorde.nl)). They provided us with a mailing list of all lawyers admitted to the bar in the Netherlands, containing their email addresses as well as individual-level scores on several variables used as independent and control variables in this study. We sent out two waves of electronic surveys. The first wave resulted in 674 fully completed responses. The second wave was sent out as a reminder two weeks later, and provided us with an additional 623 responses. Jointly, these 1297 lawyers represented 203 law firms. The breakdown of our level 2 sample over the various size strata represented in our sampling frame is provided in Table 1.

**Table 1: Sample descriptives**

Organization size	Sampling frame	In sample	Percentage
2 - 5 lawyers	402	100	24.9%
6 - 20 lawyers	131	80	61.1%
20 - 60 lawyers	20	20	100%
> 60 lawyers	3	3	100%

### 4.3.3 Measures

**Dependent variable: complaints.** We use archival data in the form of a count variable detailing the number of complaints against any specific lawyer working in one of the seven disclosing districts in the year 2008 as our dependent variable. Under Dutch law, complaints filed against lawyers by clients or interested third parties are recorded and investigated by local disciplinary courts. Privacy laws prevented us from obtaining information on later stages of the disciplinary process. In total, 310 complaints were reported in our focal year. The number of complaints filed against individual lawyers ranged from 0 to 7, with a mean of .20 and a standard deviation of .57.

**Socialization: developmental work experience.** To capture the extent to which junior lawyers were socialized into the profession by seniors through close supervision,

we used the 4-item 'developmental work experience' scale developed by Malos and Campion (2000). The scale maps the extent to which interns and junior lawyers are closely supervised in their developmental work experience ( $\alpha = .97$ ). Sample items include: "in our organization, interns are quickly assigned their own case" and "in our organization interns are quickly given client responsibilities" (see Appendix D for a complete overview of all scales and items used in this study). Confirmatory factor analysis showed a satisfactory fit with the data ( $\chi^2 = 24.23$ , d.f. = 2, CFI = .97 IFI = .97, NFI = .97, RMRS = .01). All factor loadings were significant and exceeded .60.

**Socialization: human capital development.** A second dimension of lawyer socialization entails the more formal human capital development strategies adopted by law firms. The scale we used to capture this dimension is based on the 5-item scale developed by Malos and Campion (2000), but we added 15 items to capture additional practices that are more prevalent in the Dutch context ( $\alpha = .88$ ). Sample items included: "as an employee or intern in our company you receive a lot of feedback from partners", "in our company a great deal of attention is placed on the continued professional development of employees", "in our company we regularly hold internal area of expertise meetings", and "in our company there is a great deal of talk concerning possible promotion to partner". Confirmatory factor analysis showed a satisfactory fit with the data ( $\chi^2 = 343.74$ , df = 155, CFI = .95 IFI = .95, NFI = .91, RMRS = .07). All factor loadings were significant and exceeded .40.

**Club value: social capital.** We measured the degree of social capital existing in a given law firm using an existing four-item scale by Subramaniam and Youndt (2005). The scale proved to be adequately reliable ( $\alpha = .88$ ). Sample items include: "our employees are skilled at collaborating with each other to diagnose and solve problems" and "our employees interact and exchange ideas with people from different practice areas of the company." Confirmatory factor analysis showed a satisfactory fit with the data ( $\chi^2 = 5.96$ , df = 2, CFI = .99 IFI = .99, NFI = .99, RMRS = .02). All factor loadings were significant and exceeded .60.

**Club value: commitment.** The degree to which lawyers are committed to the firm they work for was measured using a scale developed by Jaworski and Kohli (1993), consisting of seven items ( $\alpha = .92$ ). Sample items include: "employees feel as though their future is intimately linked to that of this organization" and "it is clear that employees are fond of this firm". Confirmatory factor analysis showed a satisfactory fit with the data ( $\chi^2 = 75.42$ , df = 14, CFI = .96 IFI = .96, NFI = .95, RMRS = .05). All factor loadings exceeded .60.

**PSF reputation.** As reputation is a social evaluation of the overall quality of an organization's capabilities and outputs by outsiders (Bitektine, 2011; Fombrun & Shanley, 1990), we had PSF's reputations assessed by their competitors. In our survey, we asked each respondent to name up to five competitor firms which they believed to have an excellent reputation in their area of expertise. Across all respondents we then summed the number of times a firm was mentioned, and used the straight count as a measure of a firm's reputation. Our reputation variable ranged between 0 and 23, with a mean of 1.01 and a standard deviation of 2.76.

**Strategic planning and performance measurement.** To measure the extent to which law firms engage in strategic planning processes and monitor the performance of their employees, we used a 20-item scale ( $\alpha = .91$ ) based on the strategic planning scale developed by Rogers, Miller, and Judge (1999). Of the 21 original items we retained 19, after discussions with our expert panel revealed that one of the dimensions of this scale ('broad analysis') was not readily applicable in law firms. Also based on our discussions with industry experts, we added one additional item to the 'goals and plans' dimension of this scale ('we have a written business plan'), to capture the broader take on these issues customarily found in law firms. Further sample items include: "planning is important for achieving efficiency", "we develop formal plans for potential products and markets", and "we use tight budget controls". Confirmatory factor analysis indicated a satisfactory fit with the data ( $\chi^2 = 464.24$ ,  $df = 164$ ,  $CFI = .94$ ,  $IFI = .94$ ,  $NFI = .91$ ,  $RMRS = .09$ ). All items had factor loadings above the .40 threshold, and all but two items had factor loadings exceeding .60.

**Organizational governance.** To capture the extent to which PSFs have moved beyond self-supervision towards more managerial forms of monitoring (Morris & Pinnington, 1998), we developed a new twelve-item psychometric scale ( $\alpha = .86$ ). Sample items include: "in my firm employees have regular performance appraisals" and "in my firm there is a great deal of attention for ensuring proper procedures guaranteeing financial integrity." Confirmatory factor analysis showed a satisfactory fit with the data ( $\chi^2 = 115.97$ ,  $df = 53$ ,  $CFI = .97$ ,  $IFI = .97$ ,  $NFI = .94$ ,  $RMRS = .06$ ). All factor loadings were significant and exceeded .40.

**Ethics management instruments.** Based on a thorough reading of the prior literature on ethics management (e.g., Weaver, Treviño, & Cochran, 1999a,b; Treviño et al., 2006) and discussions with our expert panel, we compiled a list of nine ethics management instruments commonly used in law firms: codes of conduct, ethics hotlines, ethics training programs, mission or core value statements, ombudspersons,

newsletters in which attention is regularly paid to ethical issues, regular meetings to discuss integrity dilemmas, ethics trainings and/or courses, and ethics committees. Respondents were asked to indicate which of these ethics management practices were currently in use in their firms. The number of flagged practices per firm was subsequently used as a straight count variable in the analysis. The number of adopted practices ranged from 0 to 5, with a mean of 1.35 and a standard deviation of 1.17.

**Risk propensity: exposure.** Exposure both in terms of client contacts as well as exposure to high target demands was captured by organizational rank. We asked respondents whether they were interns, junior associates, senior associates, or partners at their firm. As this was a questionnaire item, we do not have information on all lawyers in the dataset. We therefore constructed a reference category, to which we assigned all lawyers whose organizational rank was unknown. Of the 2097 lawyers in our sample, 240 were junior associates, 20 senior associates, 40 partners, and 1783 fell into the 'rank unknown' reference category. In similar vein, we asked respondents whether they currently had managerial responsibilities, whether they served on the board of the firm, or whether they served as patron (a patron being a formally appointed mentor to an intern). Of the 2097 lawyers in our sample, 108 were managers, 134 served on their firms' boards, and 188 acted as patrons.

**Risk propensity: experience.** To capture individual professionals' experience as a practicing lawyer, we measured the time elapsed since their admission to the Dutch Bar. The data was provided to us by the Dutch bar association, and was recorded as net experience: time elapsed since first admission to the Bar minus periods of temporary inactivity due to, for example, parental or sick leave. Experience ranged from 0 to 43.4 years, with a mean of 11.3 years and a standard deviation of 9.9 years.

**Control variables.** Our level 2 control variables consisted of organizational age, size, and performance. *Organizational age* was measured through a survey item asking for the number of years elapsed since firm founding. *Organizational size* was operationalized as the number of lawyers currently active in the firm. We used an archival measure, provided to us by the Dutch Bar Association. As law firms do not routinely disclose performance data, we measured *organizational performance* with the help of a newly developed 16-item self-report scale ( $\alpha = .84$ ), with the individual items rooted in both expert interviews and the literature on PSF performance (e.g. Desarbo, Di Benedetto, Song, & Sinha, 2005; Løwendahl, 2005). The scale consisted of the following items: "our firm has been able to attract the best junior lawyers", "our firm has been able to retain many of its clients", "our firm had a very competitive cost

structure”, and “our firm has a high gross margin on its hourly fee”. Confirmatory factor analysis showed a satisfactory fit with the data ( $\chi^2 = 304.62$ ,  $df = 94$ ,  $CFI = .90$  IFI = .90,  $NFI = .86$ ,  $RMRS = .10$ ). All factor loadings were significant and exceeded .40.

Our level 1 control variables included gender and the university from which a lawyer received his or her law degree. *Gender* information was archival, and was provided to us by the Dutch Bar Association. 42.7 percent of the lawyers in our sample were female. The same institute also provided us with information concerning the specific *university* from which a lawyer received his or her law degree. All major Dutch universities were represented in our sample: Erasmus Universiteit Rotterdam (EUR; 154 lawyers), Open Universiteit (OU; 12 lawyers), Radboud Universiteit Nijmegen (RU; 268 lawyers), Rijksuniversiteit Groningen (RUG; 124 lawyers), Universiteit Leiden (RUL; 480 lawyers), Universiteit van Maastricht (UM; 128 lawyers), Universiteit Utrecht (UU; 220 lawyers), Universiteit van Amsterdam (UvA; 95 lawyers), Universiteit van Tilburg (UvT; 85 lawyers), and Vrije Universiteit (VU; 59 lawyers).

#### 4.3.4 Analysis

To test our hypotheses, we used Hierarchical Linear Modeling (HLM), as we were interested in explaining individual lawyers’ propensity to be involved in agency problems using both individual-level and organizational-level predictors. Using HLM allowed us to overcome two shortcomings from which non-hierarchical modeling techniques suffer when used to analyze our type of nested data. First, most non-hierarchical modeling techniques are premised on the notion of simple random sampling with replacement from an infinite population. However, our sampling design is a two-stage sample (Snijders & Bosker, 1999), in which both level 2 and level 1 units are sampled from their respective populations, and in which level 1 units are mutually dependent due to their joint inclusion in level 2 units. Such clustered data are best analyzed with hierarchical (linear) models, which allow both intercepts (i.e., average number of complaints per firm) and slopes (i.e., the predictive strength of independent variables in a given firm) to vary randomly (Raudenbush & Bryk, 2002). Second, treating level 1 observations as independent would produce biased standard errors, due to the distorting effect of unobserved sample size differences due to nesting in level 2 units. Using HLM allows us to simultaneously estimate level 2 and level 1 equations while accounting for sample size differences, thus producing accurate standard errors (Raudenbush & Bryk, 2002).

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In multilevel Poisson regression, it is essential to assign precise meaning to the variables included in the analysis, such that the empirical results can meaningfully be related to the theoretically motivated hypotheses (Raudenbush & Bryk, 2002). Assigning proper values to variables to facilitate further interpretation is especially important at the individual level of analysis, as in hierarchical models the level 1 intercept and slopes become outcome variables at level 2. We chose to grand mean-center all continuous and ordinal variables at both level 1 and level 2, which is also common procedure in the standard ANCOVA model (Miller & Chapman, 2001). After grand mean centering, the intercept can be interpreted as an adjusted mean for the level 2 unit to which a given level 1 subject belongs. To ensure the interpretability of our estimates for dichotomous variables, we left these uncentered.

Standard (maximum likelihood) HLM estimations assume the dependent variable to be continuously distributed, and the residuals at both levels to have normal distributions. Yet our dependent variable is a non-normally distributed count variable, such that the application of regular HLM techniques could lead to erroneous conclusions (Snijders & Bosker, 1999). Given that complaints are a rare event (the majority of Dutch lawyers did not receive a single complaint in 2008), the complaints distribution's variance is driven by its mean. In such instances, multilevel Poisson regression is the most appropriate modeling technique, as the Poisson distribution is an approximation of the binomial distribution for the situation in which the number of 'trials' (i.e., the number of lawyers at risk of receiving a complaint) is large and the 'success' probability (i.e., lawyers actually receiving a complaint) is low (Cameron & Trivedi, 1998). We thus estimated our models using the multilevel Poisson regression routine in the HLM6 data analysis software package (Raudenbush, Bryk, & Congdon, 2004).

## 4.4 Results

### 4.4.1 *Multilevel poisson regression results*

Table 2 shows the descriptive statistics for our two-stage sample data. Table 3 displays the results of our multilevel Poisson regression analysis: Model 1 contains the level 1 control variables only, Model 2 adds the level 1 predictors, Model 3 enters the level 2 control variables, and Model 4 shows the full model including level 2 predictor variables.

Table 2: Descriptive Statistics

	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. Complaints	.20	.57															
2. Human Flow	5.18	.73															
3. Mentomg	5.70	1.32															
4. Social Capital	5.47	1.00															
5. Commitment	5.41	1.06															
6. Reputation	1.01	2.76															
7. Strategy Formation	4.25	.83															
8. Performance	4.48	.69															
9. Governance	5.07	.89															
10. Ethics	1.35	1.17															
11. Size	10.19	15.82															
12. Age	26.27	28.09															
13. Junior	.12	.32															
14. Senior	.01	.10															
15. Partner	.02	.14															
16. Management	.05	.22															
17. Board	.06	.25															

	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
18. Patron	.09	.29	.01	-.09**	-.01	-.02	.02	-.12**	-.12**	-.06**	-.09**	-.13**	-.15**	-.13**	.56**	.30**	.42**	.58**	.59**
19. Experience	11.31	9.85	.16**	-.05*	.04	-.02	.02	-.08**	-.14**	-.07**	-.06**	-.11**	-.01	.22**	-.07**	-.14**	-.00	.02	.02
20. Male	.57	.49	.09**	-.01	.06**	-.01	.00	-.05*	-.05*	-.01	-.03	-.02	-.06*	-.03	.08**	-.04*	-.04	-.02	-.02
21. Age	39.78	10.88	.15**	-.11**	.07**	-.03	-.02	-.17**	-.20**	-.12**	-.11**	-.12**	-.19**	-.11**	.23**	-.08**	-.07**	.01	.04
22. RU	.13	.33	.02	.05*	.02	.00	.01	.03	-.04	.01	.01	-.02	-.02	-.03	-.07**	-.01	.02	-.03	-.03
23. RUG	.06	.24	-.01	.01	-.04*	-.03	-.02	.06**	.03	.02	.00	.01	.07**	.04	-.04	.06**	.01	.02	.03
24. RUL	.23	.42	-.03	.04	-.01	.05*	.06**	-.03	.07**	.07**	.06**	.03	.05*	.01	-.01	-.01	-.01	-.03	-.03
25. EUR	.07	.26	-.05*	-.04	.01	.03	-.07**	-.05*	.01	-.01	-.04	-.03	-.05*	-.04*	-.03	.01	.01	-.01	-.01
26. RUU	.11	.31	-.04	.02	-.02	-.02	-.01	-.02	.02	-.03	.01	.04	.05*	.03	-.05*	-.02	.02	-.00	-.01
27. UVA	.05	.21	-.01	-.01	.02	.00	.00	.02	.03	-.03	-.01	.04	.03	.02	-.04*	-.02	.04	.01	-.00
28. KUB	.02	.15	.00	-.03	-.02	-.06**	-.05*	-.03	-.03	-.02	-.04*	-.07**	-.04	-.06	.03	.02	-.02	-.01	.01
29. VU	.03	.17	-.03	-.03	.02	-.01	-.04	-.03	-.01	-.03	-.02	.00	.00	-.00	.02	.01	-.02	.01	.01
30. UVV	.02	.13	-.01	.01	-.01	.00	-.05*	.07**	.05*	.02	.00	.03	.04	.05*	-.05*	.06**	.01	.02	.01
31. OU	.01	.08	.04	-.01	.03	.00	-.00	-.05*	.02	-.02	.02	-.02	-.05*	.03	.01	-.01	-.01	-.02	-.02
32. RUM	.06	.24	-.01	.02	-.02	.05*	.05	.02	.03	.09**	.06**	-.04	-.04	-.04	-.03	.04	.07**	.04	.02

	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
17. Board		.80**														
18. Patron				.59**												
19. Experience			.02	.01												
20. Male						.31**										
21. Age		.01	.04	.05*	.86**	.33**										
22. RU																
23. RUG		.02	.03	.01	.11**	.03	.11**									
24. RUL																
25. EUR																
26. RUU																
27. UVA		.01														
28. KUB																
29. VU		.01	.01	.04	.08**	.03	.06**	.07**	.04*	.09**	.05*	.06**	.04	.03		
30. UVT		.02	.01	.01	.13**	.03	.15**	.05*	.07**	.04	.05*	.03	.02	.02		
31. OU																
32. RUM		.04	.02	.05*	.19**	.14**	.10**	.07**	.14**	.09**	.06**	.04	.04*	.04*	.01	.01

\* = .05 significance level

\*\* = .01 significance level

*'Soft' control results.* Our results confirm Hypothesis 1. Model 4 in Table 3 shows that a lack of professional socialization in the form of on-the-job training, as captured by higher scores on the developmental work experience variable, results in a greater number of complaints raised against individual lawyers ( $\gamma = .18; p < .05$ ). Likewise, stronger professional socialization in the form of more formal training, as indicated by higher scores on the human capital development variable, has a significant negative effect on the number of complaints ( $\gamma = -.50; p < .01$ ).

Hypothesis 2 has to be rejected on the basis of the results reported in Table 3, Model 4. PSFs with higher 'club' value do not experience lower complaint levels. This is true for both the social capital ( $\gamma = -.12; p > .10$ ) and organizational commitment ( $\gamma = .11; p > .10$ ) measures of 'club' value.

Likewise, the results in Table 3, Model 4 suggest that Hypothesis 3 has to be rejected. PSF reputation has no curtailing effect on the number of complaints ( $\gamma = .05; p > .10$ ).

*'Hard' control results.* Hypothesis 4 was supported. The results in Table 3, Model 4, show that lawyers working for law firms that place greater emphasis on strategic planning and that manage their personnel by subjecting them to economic performance targets are more likely to receive complaints and be involved in agency problems ( $\gamma = .23; p < .05$ ).

On the basis of the evidence contained in Table 3, Model 4, Hypothesis 5 had to be rejected. A greater emphasis on more formal forms of governance by law firms appears not to cause the lawyers they employ to be involved in agency problems and incur complaints more frequently ( $\gamma = .15; p > .10$ ). Similarly, the adoption of ethics management instruments does not affect lawyers' propensity to display opportunistic agentic behaviors and reap complaints as a results ( $\gamma = -.08; p > .10$ ).

**Table 3: Results of multilevel poisson regression**

Variables	Model 1 Level 1 Controls	Model 2 Full Level 1	Model 3 Full level 1 & level 2 controls	Model 4 Full level 1 & level 2
Intercept	-1.61 (.16)**	-2.02 (.17)**	-1.99 (.21)**	-2.04 (.20)**
Developmental work experience				.18 (.07)*
Human capital development				-.50 (.20)**
Social capital				-.12 (.08)
Commitment				.11 (.10)
Reputation				.05 (.03)
Strategic planning intensity				.23 (.10)*
Organizational governance				.15 (.13)
Ethics Instruments				-.08 (.07)
Size			-.01 (.00)**	-.02 (.00)**
Age			-.00 (.00)	-.00 (.00)*
Performance			-.05 (.09)	.05 (.14)
Junior associate		-.43 (.24)†	-.43 (.29)	-.45 (.27)†
Senior associate		.81 (.71)	.83 (.84)	.62 (.77)
Partner		-.34 (.71)	-.30 (.74)	-.48 (.69)
Management		-1.29 (.46)**	-1.32 (.52)*	-1.28 (.51)*
Board		-.08 (.35)	-.02 (.42)	-.11 (.43)
Patron		.53 (.26)*	.46 (.31)	.58 (.30)*
Experience		.06 (.01)**	.07 (.01)**	.07 (.01)**
Male	.18 (.09)*	.17 (.08)*	.18 (.11)†	.18 (.11)†
Age	.03 (.00)**	.00 (.01)	-.00 (.01)	-.00 (.01)
RU	.13 (.18)	.69 (.20)**	.70 (.26)**	.71 (.25)**
RUG	.30 (.21)	.91 (.21)**	.92 (.29)**	.93 (.29)**
RUL	.12 (.14)	.73 (.17)**	.71 (.22)**	.72 (.22)**
EUR	-.32 (.19)†	.29 (.19)	.23 (.24)	.24 (.25)
UU	-.06 (.16)	.55 (.18)**	.54 (.24)*	.57 (.25)*
UvA	.11 (.17)	.78 (.19)**	.75 (.25)**	.75 (.25)**
VU	-.45 (.25)†	.17 (.27)	.15 (.36)	.13 (.39)
UvT	.26 (.34)	.97 (.33)**	.98 (.49)*	.96 (.46)*
OU	.68 (.50)	1.70 (.51)**	1.65 (.54)**	1.62 (.50)**
UM	.04 (.23)	.71 (.23)**	.69 (.28)*	.69 (.28)*
Level-1 N	2083	2083	2083	2083
Level-2 N	203	203	203	203
Tau	.68	.73	.58	.53
Reliability intercept	.48	.49	.46	.43

† &lt; .10 significance level

\* &lt; .05 significance level

\*\* &lt; .01 significance level

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**Risk propensity results.** Hypothesis 6 was broadly supported. The evidence reported in Table 3, Model 4 shows that junior associate lawyers were significantly less likely to attract complaints ( $\gamma = -.45$ ;  $p < .10$ ) than senior associates closer to the admission to partnership decision or partners subjected to much lower levels of peer control. Furthermore, lawyers acting in a management role, which increases the peer scrutiny they are under and reduces their client contacts, experience lower levels of complaints raised against them ( $\gamma = 1.28$ ;  $p < .05$ ). Lawyers acting in a patron role, in contrast, attracted more complaints ( $\gamma = .58$ ;  $p < .001$ ). They apparently suffer from having to perform multiple tasks simultaneously, such as the supervision of interns and junior associates, on the one hand, and the handling of a full load of client contacts, on the other. Finally, and as hypothesized, risk propensity increased with experience ( $\gamma = .07$ ;  $p < .01$ ). In other words, the longer someone's tenure as a lawyer, the greater the likelihood of that person receiving complaints.

#### 4.4.2 Control variable results

**Level 2 control variables.** Organizational size is a commonly recognized contingency factor, which has been documented to influence a wide range of organizational processes (Donaldson, 2001). Our analyses also reveal a size effect, as this variable negatively affects the number of complaints a given lawyer stands to incur ( $\gamma = -.02$ ;  $p < .01$ ). We also detected a contingency effect for organizational age, as older law firms were less likely to see their employees involved in agency problems than younger ones ( $\gamma = -.00$ ;  $p < .05$ ). Whereas it might have been expected that law firms experiencing financial distress would more likely be associated with agency problems, our results showed no such effect ( $\gamma = .05$ ;  $p > .10$ ).

**Level 1 control variables.** Gender had a significant effect on the propensity of an individual lawyer to attract complaints (Daicoff, 1997). Male lawyers received more complaints as compared to their female counterparts ( $\gamma = .18$ ;  $p < .10$ ). Similarly, the university from which lawyers graduate appears to exert an influence on their propensity to be involved in agency problems in later career stages. Apparently, universities are not just organizations transferring (legal) scientific knowledge, but also institutions in which individuals are pre-socialized into the norm sets of their later profession, with greater or lesser efficacy (Spiegel, 1979).

## 4.5 Discussion

### 4.5.1 *The corporate governance of non-publicly-listed firms*

Our study contributes to the emerging literature on the corporate governance of non-publicly listed firms (Daily & Dollinger, 1992; Gómez-Mejía et al., 2007; McCahery & Vermeulen, 2008; Schulze et al., 2001). While even casual observation shows that there exists a variety of organizational forms in business (Hansmann, 1996), corporate governance research to date has focused almost exclusively on publicly-listed firms for which data are abundantly available due to the strict disclosure obligations to which firms of this type are subjected. However, this selective disclosure has likely resulted in significant sample selection biases (Heckman, 1979), resulting in a disproportionate focus on the agency relationships characterizing publicly-listed firms (Fama & Jensen, 1983), to the detriment of those typifying other forms of enterprise organization (Schulze et al., 2001). Due to this systematic bias in corporate governance research, we currently lack sufficient understanding of the governance challenges and practices of other organizational forms, which typically have little to do with those emerging from conditions of separated ownership and control, which have long been regarded as a defining condition for the field of corporate governance (Berle & Means, 1991).

After conceptualizing the external agency relations characterizing PSFs as an organizational form, we have theorized and assessed empirically how various types of organizational controls affect the prevalence of agency problems in these relationships. Specifically, we segregated the governance practices of PSFs into ‘soft’ and ‘hard’ controls, and found evidence that both types of controls influence the manifestation of agency problems in PSFs. We found that certain ‘soft’ controls—notably socialization in the form of both on-the-job mentoring and off-the-job training—have a significant negative effect on the likelihood that lawyers employed by a given PSFs are confronted with complaints. In contrast, we found that certain ‘hard’ controls—in particular strategic planning and performance measurement practices—in fact have a significant positive effect on the prevalence of complaints against individual lawyers.

These findings suggest that the type of long-established informal practices that feature predominantly in PSFs of the P<sup>2</sup>-type (Greenwood et al., 1990) are better attuned to the specific governance challenges of PSFs than the more formal practices characterizing MPB-like PSFs (Cooper et al., 1996). Presumably, this is because these informal practices are better suited to deal with hard to observe and difficult to monitor professional behaviors than more formal organizational practices (Greenwood

& Empson, 2003). While the latter seem better attuned to monitoring economic performance, and have often been specifically adopted for that purpose, they also appear to 'crowd out' traditional professional values from PSFs (Frey & Jegen, 2001). In general, our findings suggest that effective corporate governance practices are likely to be highly specific to an organizational form, and emphasize the need for corporate governance researchers to move beyond the study public firms and research the governance challenges and practices of other organizational forms, even if the data for such studies is difficult to collect.

#### **4.5.2 Professional service firms as a distinct organizational form**

Through this study we contribute in three ways to the rapidly growing literatures on the PSF as a distinct organizational form (Von Nordenflycht, 2010; Zardkoohi, Bierman, Panina, & Chakrabarty, 2011) and on organizational forms-based theories of organizational design and effectiveness more broadly (Greenwood & Miller, 2010). First, our finding that higher involvement in strategic planning and performance measurement leads to a significant increase in the prevalence of opportunistic agentic behaviors in PSFs provides scientific underpinnings to the popular view that such practices are difficult to reconcile with professionalism and traditional PSF practices. The adoption of more business-oriented practices may help remedy certain organizational inefficiencies that PSFs have long been able to afford due to the highly regulated and institutionalized markets in which they operate (Von Nordenflycht, 2010). Yet such practices are not simply benign instruments, and their application appears to jeopardize vulnerable client and third party interests. In conjunction with our findings on the (pre-)socialization role of university education, mentoring, and training, these results suggest that legal professional associations ought to devote more time and effort to teaching (aspiring) lawyers about the perils and proper use of organizational practices like strategic planning and performance measurement.

Second, our results shed interesting light on the transition many PSFs are currently undertaking, away from the traditional P<sup>2</sup> archetype into the direction of the MPB. It has already been documented that the adoption of more formal organizational control practices need not come at the expense of more informal practices, and that both kinds often durably co-exist as separate layers within single PSFs (Cooper et al., 1996). Our findings indicate that there may be a functional story to tell about this 'sedimentation' of organizational practices within PSFs, as the socialization practices that PSFs traditionally feature play a vital role in containing professional agency

problems. As we found that certain more formal control practices can in fact increase the prevalence of opportunistic agentic behaviors in PSFs, our study suggests that there are limits to how far PSFs can go in adopting more business-oriented management practices in their quest to rationalize and modernize their business models (Greenwood & Empson, 2003). While more research is needed on the relative effectiveness of specific organizational practices in curbing agency problems in PSFs, managing partners in professional organizations are in the mean time advised to hold on to their organizational form-specific and time-tested human resource management practices.

Third, our findings challenge the view that reputation mechanisms in markets for professional services function as an important external governance mechanism. More specifically, the view that PSFs vouch their reputational capital to assure the quality and integrity of the professional services they deliver (Coffee, 2006) is inconsistent with the evidence presented in Table 3, Model 4. While earlier research suggests that reputation is an important driver of PSF performance (Greenwood et al., 2005), our findings suggest that the value of this jointly developed and maintained asset alone is an insufficient safeguard for protecting PSFs collectively against the opportunistic agentic acts of individual professionals. Future research is therefore needed to explore the concrete mechanisms through which collectively held and maintained assets like corporate reputation influence individual behaviors. Such research is necessary not only to develop a more definitive understanding of whether and how reputation mechanisms in professional service markets can function as a remedy for PSF-specific agency problems, but also to help us understand better how PSFs might use incentives and sanctions to develop and protect their 'intangible assets at risk'.

#### ***4.5.3 Individual-level risk propensities***

Finally, our results draw greater attention to the role that individual-level risk propensities play in explaining the likelihood that individual lawyers will be involved in agency problems that lead to complaint filings by clients and interested third parties. For the traditional agency theory model, which is premised on the condition of separated ownership and control in publicly listed firms, researchers have long established that individual-level factors shape managers' propensity to engage in risky agentic behaviors (Hitt & Tyler, 1991; Sanders & Hambrick, 2007; Wiseman & Gomez-Mejia, 1998). Specifically, scholars have pointed to the influence of factors like age

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(Hambrick & Mason, 1984), educational background (Westphal & Zajac, 1995), experience (Hitt & Tyler, 1991) and managerial level (Ireland, Hitt, Bettis, & dePorras, 1987) on managerial decision making. To date, however, no research is available that demonstrates the influence that such individual-level factors can play in the emergence of agency problems in alternate organizational forms that feature different agency relationships.

Our study shows that individual level risk factors also play a role in the PSF context, where they can put additional strain on the unique types of agency relationships that characterize this organizational form. For example, we found that the type of job roles professionals can take on in PSF contexts influence the likelihood that they become involved in agency problems. Furthermore, the results show that more experienced professionals are more likely to be involved in agency problems. Finally, although not explicitly hypothesized, we found that lawyers' educational backgrounds influence their risk propensities. While we have only just begun to understand the finer-grained mechanisms through which professionals come to accept excessive risk and reduce the self-policing impact of professional norms on their behavior, our findings do point out new avenues for PSF research. In particular, they demonstrate the applicability of demographic (Hambrick & Mason, 1984) and decision-making (Hitt & Tyler, 1991) theories of organizational action in the PSF context. Additional studies are needed to assess whether other individual-level characteristics, which feature prominently as explanatory variables in these behavioral organizational theories, similarly influence the behavior of professionals in deeply institutionalized contexts.



# Chapter 5. Organizational forms and professional service firm outcomes: A set-theoretic study<sup>4</sup>

## Abstract

Organizational forms consist of specific configurations of interconnected organizational practices. A recent stream of research has traced the development of professional service firms (PSFs) from the professional partnership (P<sup>2</sup>) configuration into an emerging new configuration called the managed professional business (MPB). Using survey data on a sample of 450 Dutch law firms, we use set-theoretic methods and existing organizational theories to develop propositions about the economic and social performance of relatively pure P<sup>2</sup> and MPB configurations as compared to hybrid ones. We address the implications the existence of multiple objective functions of these PSF organizational configurations.

## 5.1 Introduction

Organizational sociologists and management scholars have long been interested in the status and position of professionals in organizational collectives and society at large (Schön, 1983; Sorensen & Sorensen, 1974). Yet until relatively recently, these scholars have primarily dedicated their research attention to a better understanding of the professions (Abbott, 1988; Goode, 1957; Parsons, 1939): autonomous vocations into which professionals are selected on the basis of specialized educational training. In contrast, research on professional service firms (PSFs) – commercial businesses “whose primary assets are a highly educated (professional) workforce and whose outputs are intangible services encoded with complex knowledge” (Greenwood, Li, Prakash, & Deephouse, 2005: 661) – did not come off the ground until relatively recently.

Based on empirical research on Canadian accounting firms, Greenwood, Hinings and Brown (1990) were able to move beyond Mintzberg’s (1979) classic characterization of the ‘professional bureaucracy’ by developing the first full-fledged

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<sup>4</sup> This chapter is co-authored with Prof.Dr. J. (Hans) van Oosterhout and Prof.Dr. Pursey P.M.A.R. Heugens. A previous version of this paper was presented at the EGOS consortium in Gothenburg, 2011. This paper is currently under review at the Academy of Management Journal.

conceptualization of PSFs, which they coined the ‘Professional Partnership’ or ‘P<sup>2</sup> configuration’. The core observation of Greenwood and his associates is that the P<sup>2</sup> configuration is an organizational form in its own right, to be distinguished from other forms of enterprise organization by features like its limited size, weakly developed strategic capabilities, and consensus-oriented decision-making (Greenwood et al., 1990:748-752). Subsequent research on Canadian law firms by Cooper, Hinings, Greenwood, and Brown (1996) revealed the existence of another PSF configuration, which they labeled the ‘Managed Professional Business’ (MPB). Whereas the MPB configuration is very much a PSF, it is distinct from the P<sup>2</sup> in terms of its larger size, better developed strategy function, and centralized decision-making procedures.

Although these landmark contributions set the stage for a productive stream of empirical research on PSFs (Greenwood et al., 2005; Greenwood, Suddaby, & Hinings, 2002; Hitt, Bierman, Shimizu, & Kochhar, 2001; Suddaby & Greenwood, 2005), they also raised a number of fundamental questions in regard to PSF configurations. First, as most of the foundational work on PSF configurations is qualitative and interpretative (e.g., Robertson, Scarbrough, & Swan, 2003; Suddaby & Greenwood, 2005) or conceptual (e.g., Greenwood & Empson, 2003; Malhotra & Morris, 2009) in kind, we presently lack a more systematic empirical validation of the P<sup>2</sup> and MPB configurations. The first research question we address is therefore: *can the P<sup>2</sup> and MPB configurations be discerned in populations of PSFs, or are these configurations merely archetypes of which extant PSFs are predominantly hybrids?* Second, against the backdrop of contingency-theoretical explanations of the substantive and symbolic performance of organizational forms (Donaldson, 2001; Drazin & Van de Ven, 1985), the PSF literature raises the question whether the P<sup>2</sup> and MPB configurations are well-fitted and efficient organizational forms, or whether they owe their existence primarily to the competition-reducing institutional peculiarities of the professional environment in which they operate (Von Nordenflycht, 2010). Our second research question is thus: *do the P<sup>2</sup> and MPB configurations outperform hybrid configurations substantively in terms of financial performance and symbolically in terms of reputation?* Third, all PSFs serve at least two objectives. One is the public objective of serving vulnerable client and third-party interests, for example by buttressing the legal system (law firms) or by ensuring the materiality and transparency of information in financial markets (auditing firms). Another is the private objective of generating profits for the owners of the firm. Prior contributors have argued that PSF’s public objectives have greater currency in the P<sup>2</sup> configuration, while private objectives are deemed more important in the MPB

configuration (Cooper et al., 1996; Greenwood & Suddaby, 2006). These observations inspire our third research question: *are MPB configurations more likely to violate vulnerable client and third party interests than P<sup>2</sup> configurations?*

We explore these three research questions in the context of law firms, which are widely acknowledged to be paradigmatic for PSFs (Von Nordenflycht, 2010). Furthermore, prior qualitative research has hinted at the presence of both P<sup>2</sup> and MPB configurations in populations of law firms (Cooper et al., 1996; Empson, 2007). Our data derive from a survey amongst Dutch law firms ( $n = 450$ ), allowing us to map their configurations and determine in each individual case whether a firm is a P<sup>2</sup>, MPB, or hybrid. To obtain answers to the aforementioned questions we use fuzzy-set qualitative comparative analysis (fs/QCA: Fiss, 2011), a novel empirical methodology derived from political science. Fs/QCA is a technique that it deliberately designed to unravel causal complexity by applying set-theoretic methods to cross-case evidence (Rihoux & Ragin, 2009). Due to its reliance on computerized Boolean logic procedures, fs/QCA is well-equipped to handle a greater volume of cases than the handful that researchers can maximally deal with using traditional, non-automated comparative procedures (Ragin, 1987).

Our contribution to the PSF literature is threefold. First, we empirically validate existing configurational conceptualizations of PSFs, by looking whether these apply consistently to our sample of law firms. While we find evidence for the existence of the MPB configuration and a somewhat modernized version of the P<sup>2</sup> which we label the P<sup>2.1</sup>, (a classic P<sup>2</sup> in all respects except for its greater emphasis on formal governance and/or strategy formation), we also find that the extant variety of organizational configurations in our sample is much larger than any of the currently available conceptualizations of PSFs would allow, and that the PSF landscape is littered with a large variety of hybrids. Second, we find that the ‘pure type’ MPB and P<sup>2</sup> configurations tend to outperform hybrid configurations in both substantive and symbolic terms. This evidence shows that the MPB and P<sup>2</sup> configurations are not simply ‘relics of the past’ (Greenwood & Empson, 2003), but fit and well-adapted organizational configurations that can cope well with the pressures emanating from their task and institutional environments. Third, we show PSFs in general have difficulties with serving more than one objective function simultaneously (cf. Jensen, 2001). For smaller P<sup>2</sup> configurations, which are primarily geared towards serving public objectives (Cooper et al., 1996; Greenwood & Suddaby, 2006), this tension has no direct consequence for the type of vulnerable client and third-party interests that

the professions have traditionally sought to protect. For larger MPB configurations, however, which are principally geared towards serving private interests, these tensions result in higher than average incidences of organizational misconduct (Greve, Palmer, & Pozner, 2010). In a concluding discussion section, we discuss the managerial and public policy implications of these findings.

## **5.2 Professional Service Firms**

In order to address our research questions with regard to organizational design implications, Greenwood & Miller (2010) suggest that the focus should be on a specific type of organization. Hence, in our study we focus on what has recently been conceptualized as a distinctive organizational form: the professional service firms (Von Nordenflycht, 2010). PSFs deliver knowledge-intensive and intangible services (Løwendahl, 2005) that are highly customized through intensive client consultations (Hansen, Nohria, & Tierney, 1999), making the knowledge they exploit difficult to codify and commodify. Because of the resulting inalienability of professional knowledge from its human carriers (Dow, 2003), PSFs are human capital intensive (Hitt et al., 2001), while they have little need for external financial capital (Von Nordenflycht, 2010). Finally, because the quality of outputs and the quantity of inputs is difficult to evaluate for clients and other external parties (Alvesson, 2001), PSFs typically operate in highly institutionalized and professionalized environments and are uniquely dependent on their reputation in selling and delivering their services (Greenwood et al., 2002).

Because of these unique existential conditions, PSFs typically feature rather specific combinations of organizational practices, as they are often owned by a subset of their employees (Greenwood & Empson, 2003), develop and maintain their human and reputational resource base through a somewhat unusual combination of credentials-based hiring practices (Hitt et al., 2001) and tournament-type, merit-based promotion procedures (Malos & Campion, 1995), and feature highly decentralized and collegial decision and control structures that are quite unique for enterprise organizations.

Although recent work on PSFs has tried to systematically connect these existential conditions, organizational challenges, and the organizational practices adopted to meet them into an inclusive conceptualization of the PSF as an organizational form (Von Nordenflycht, 2010), two obstacles currently stand in the

way of further developing our understanding of PSFs in organizational theory. First, recent environmental developments have led to significant and widespread changes in the configuration of organizational practices that were thought to characterize the PSF. More specifically, the combination of practices that make up the P<sup>2</sup> archetype seems to increasingly give way to a new and emergent configuration called the MPB. Second, the current debate on the conceptualization of the PSF as an organizational form lacks appropriate empirical evidence that could decide the ongoing discussion on which organizational practices are present in the current population of PSF. In order to address these obstacles, we will first set the stage by positioning the MPB and P<sup>2</sup> configurations. Subsequently address the importance of environmental fit, followed by configuration change. The proposition section will follow with an in depth focus on the implications of specific configurations on respectively performance, reputation and misbehavior.

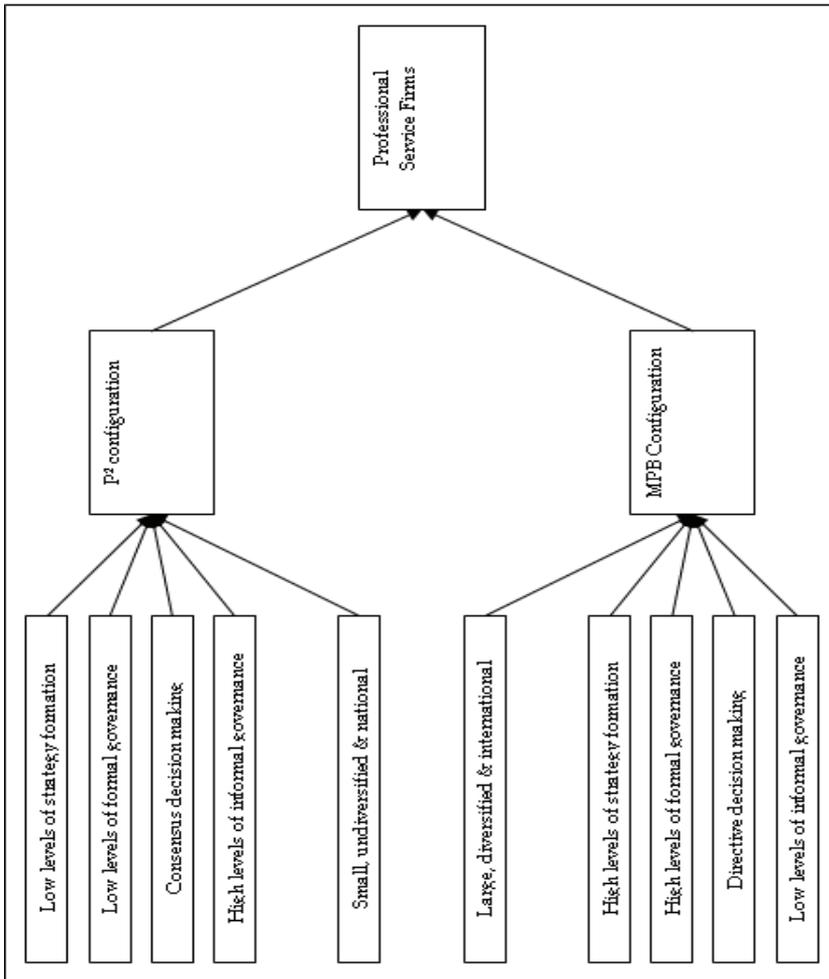
### **5.2.1 *The professional partnership versus the managed professional business***

In the literature on PSFs two main organizational configurations can be discerned. Greenwood et al. (1990) documented the Professional Partnership. They suggest that professional firms rely on a different set of controls as compared to regular organizations, due to their specific organizational challenges. As professionals apply an esoteric body of knowledge – which is difficult to code into knowledge systems – to complex problems they enjoy high levels of discretion and autonomy in the delivery of their services (Greenwood et al., 1990). Additionally, senior members, who typically own and manage the firms, continue to contribute to the delivery of the service. They are often responsible for their particular practice areas and hence place priority hereon in favor of the entire organization. In practice this means that the strategy of the firm can be described as the aggregate of the partners' individual interest (Pinnington & Morris, 2003). In terms of organizational systems and practices, the P<sup>2</sup>-archetype relies on primarily informal and collegial control mechanisms at the expense of more formal and hierarchical systems (Greenwood et al., 1990).

Another documented configuration of organizational practices within PSFs can be described as being more consciously managed and is dubbed the Managed Professional Business (Cooper et al., 1996). The underlying values of the PSF have shifted from the application of expertise in the interest of public service to a focus on efficiency and value added provision of the services rendered by the firm (Pinnington & Morris, 2003). Partly due to changes in legislation, economic and social trends

(Løwendahl, 2005) as well as financial and factor market pressures (Cooper et al., 1996), this fundamental shift inherently involves a move away from the traditional forms of control. As opposed to the decentralized decision making and the peer supervision form of governance in the P<sup>2</sup>, the MPB features a consorted effort of formal means of controls coupled with formal strategizing and planning to avoid strategic drift (Lorsch & Tierney, 2002). Figure 1 depicts these two PSF configurations documented within the law industry.

Figure 1: P<sup>2</sup> and MPB Configurations



### **5.2.2 *Organizational configurations and environmental fit***

To maximize their effectiveness, all organizations – PSFs included – strive towards fit with their organizational environment (Lawrence & Lorsch, 1967; Drazin & Van de Ven, 1985; Donaldson, 1987). Coping with these environmental requirements is necessary in order for organizations to survive and prosper (Hage & Aiken, 1970). When out of sync with these demands organizations adapt their structure to reduce misfit (Donaldson, 1995). For PSFs one of the key environmental determinants is client demands. In the traditional P<sup>2</sup>-PSFs, partners enjoy high levels of discretion in both day-to-day activities and their manner of supervision of their subordinates (Greenwood et al., 1990). On the organization level, more strategic matters are usually decided upon through collegial practices such as partner meetings, where decision-making is often based on consensus. These P<sup>2</sup> features allow for operational autonomy and collegial decision making style and make these types of firms uniquely suitable for servicing an undiversified, national and homogenous client base. However, when a firm diversifies into multiple law areas it is often headed by new and more heterogeneous partners. As a consequence the organization becomes too large, complex, and unwieldy when the firm continues to rely on collegial decision making and informal governance practices. This situation is further aggravated when the organization expands internationally. These contingencies result in increased internal agency costs due to inter-partner monitoring and collective decision making (Greenwood & Empson, 2003). Consequently, large and complex firms often use formal controls to supervise daily operations and more directive forms of decision making such as a managing partner or a daily board (Cooper et al., 1996). Therefore given the nature of the work, small, national organizations are best organized in a P<sup>2</sup> manner with informal controls and collegial decision making. In contrast, large transnational PSFs function best as MPBs by introducing directive decision making and more formal methods of governance.

### **5.2.3 *Changing configurations and getting stuck-in-the-middle***

Changes within and movement between archetypes are difficult and complex for three interrelated reasons (Greenwood & Hinings, 1988). First, structural inertia (Hannan & Freeman, 1984) suggests that organizations simply do not change as they do not perceive and recognize the need for change as they are caught in the current design and underlying values (Miller & Friesen, 1984; Pettigrew, 1985). Second, if the need for change is perceived, it is often subject to a cost-benefit analysis that will postpone

change until it becomes unavoidable. Thirdly, professionals currently in politically powerful positions will try to sustain and advance their vested claim on scarce resources (Miller & Chen, 1994; Mintzberg, 1983). These resources are often intimately tied to the structures and processes that currently prevail in the organization, which makes change unlikely.

Even though change can be hazardous (Amburgey, Kelly & Barnett, 1993; Sing, House & Tucker, 1986; Haveman, 1992), when it does occur the most documented change in PSFs is through a process called sedimentation. Sedimentation (Cooper et al., 1996) refers to the layering of a new set of practices atop an old configuration. This results in a mixture of values and practices in the new organizational design. However, the systems and practices in configurations require substantive coherence and act in a complementary way. As configurations of organizational practices and structures give coherence to the underlying values related to the institutional context (Greenwood & Hinings, 1996), they are the strategic and structural manifestations of the dominant institutional paradigm in the field. Therefore these configurations reinforce the value systems underlying the P<sup>2</sup> (a professional logic; Greenwood et al., 1990) and the MPB (a commercial logic; Cooper et al., 1996). When changing parts of the organizational configuration its complementary nature is compromised. Thus we expect that sedimented organizational forms are inconsistent and unstable in their structures, systems and values. This would forgo the complementary nature of archetype-systems and result in poorer performance as compared to 'pure' organizational forms.

#### ***5.2.4 The performance implications of organizational forms***

Given the environmental contingencies faced by the PSF, it is up to top management to devise an organizational strategy as bundles of resources within a firm can be used to support multiple and differing activities (Løwendahl, 2005; Penrose, 1959). In order to assure that the organizational competitive advantage will come to the fore; the most important consideration for a PSF is to define its product/market strategy (Ansoff, 1967; Løwendahl, 2005). Three strategic choices need to be considered: the type of clients, the geographical reach, and the type of services that are going to be delivered (Lorsch & Tierney, 2002; Løwendahl, 2005). First, the organization has to decide whether it want to service their clients as an one-stop-shop firm or whether it wishes to cater to specific client demands through specialty services (e.g. 'deal' or 'transaction' firms; Hitt et al., 2001). Second, the firm needs to decide on level of quality they wish

to deliver. Generic services with low profit margins require a different set of organizational practices as compared to specialty services with high profit margins. For example, these procedure services require greater leverage as it involves recognizable problems with reproducible solutions executable by juniors (Maister, 2003). Third, a PSF also needs to decide how to deal with internal client demands (Hitt et al., 2001), i.e. does it wish to remain a local, national player, or an international player. These three performance considerations are strongly related. One-stop-shop firms are likely to offer generic services in a global setting whereas specialized firms with high profit margins retain a strong home market. The PSFs organize themselves either in the MPB (the global & generic one-stop-shop) or the P<sup>2</sup> (the local & specialized deal firms) as their different organizational configurations of processes and systems are unique suited to efficiently address these performance pressures. Organizations that are stuck-in-the-middle will not be able to as efficiently as the pure form, address these performance pressures and hence we propose that:

Proposition 1: Pure P<sup>2</sup> or MPB organized law firms outperform sedimented firms.

### ***5.2.5 Category spanning and reputation***

PSFs, like any other type of organization, are routinely subjected to social evaluations by audiences like clients, prospective employees, regulators, and competitors (Bitektine, 2011). Through an assessment of their substantive and symbolic features, such audiences assign organizations their status, legitimacy, and reputation. For PSFs, reputation is arguably the most important type of social evaluation, as it has been documented that PSFs with better reputations can charge their clients premium prices for their products, save on advertising costs, and enjoy a better position in the market for scarce professional talent (Greenwood, Oliver, Sahlin & Suddaby, 2008).

As a PSF's reputation represents a reflection on, and an evaluation of its features, the organizational form of the PSF directly matters for its reputation. The emergent literature on category spanning (Hsu, 2006; Hsu, Hannan, & Koçak, 2009) suggests that PSFs that closely resemble one of the two archetypical categories in a professional field—P<sup>2</sup> or MPB—are likely to be assigned better reputations than hybrids spanning both categories. This is the case for at least three reasons. First, the ability of organizations to appeal to audiences decreases significantly when they

display features of both the P<sup>2</sup> and the MPB. Audiences may find it difficult to make sense of the product offerings by hybrid organizations, and may favor the products offered by category specialists (Hsu, 2006). Second, hybrids are at a positioning disadvantage, because they compete with two discrete sets of category specialists for customers of legal services (Khessina & Carroll, 2008; McKendrick, Jaffee, Carroll & Khessina, 2003). Third, audiences tend to have less confidence in the quality of the products offered by hybrids, as their capabilities cannot be assessed as easily by raters by legal services whose primary evaluation experiences are in vetting the skill sets of category specialists (Ruef & Patterson, 2009). In short, we propose that hybrid PSFs incur social penalties as compared to PSFs that specialize in a single archetypical category.

Proposition 2: Pure P<sup>2</sup> or MPB organized law firms have a better reputation as compared to sedimented firms.

### **5.2.6 Professional misconduct: P<sup>2</sup> vs. MPB**

A final outcome of PSF-design is professional misconduct. As “it is logically impossible to maximize in more than one dimension, purposeful behavior requires a single valued objection function” (Jensen, 2002:1). PSFs have two objective functions. First, as they are gatekeepers (e.g. law firms as guardians of the law and accountants as ensuring materiality and transparency of information in financial markets) PSFs have a public responsibility. Failure to address this need for integrity will lead to negative externalities (Liu, & Turnovsky, 2005) in delivery of services by PSFs. However at the same time they have a profit orientation as partner demand a return on their investment. Professional configurations differ in the relative importance they assign to these two objective functions. To assure their effectiveness in their gatekeeper function (Coffee, 2006), professional organizations in the P<sup>2</sup>-configuration, rely on informal controls and professional norms. The MPB-configuration on the other hand, has strategic planning and performance management practices that pressure professionals to compromise professional norms and values in order to realize planned economic performance. This may trigger a more calculative mode of deliberation in professionals has been found to negatively affect cooperative dispositions (Frank, Gilovic, & Regan, 1993) and increase the prevalence of unethical behaviors (Frank & Schulze, 2000). Additionally, it may also crowd out the ‘softer’

professional values that give voice to the vulnerable interests of clients and third party beneficiaries (Frey & Jegen, 2001). These generic practices in PSFs often conflict fundamentally with traditional professional practices and attitudes. We hence conjecture that:

Proposition 3: P<sup>2</sup> organized law firms have lower level of professional misconduct as compared to MPB or sedimented firms.

## 5.3 Data and methods

### 5.3.1 *General overview*

Any attempt at theoretical development requires the interplay between theory and method (Van Maanen, Sørensen & Mitchell, 2007). Theories without any methodological foundation are likely to receive little empirical support. Methods that stand removed from theory can be technically sophisticated but uninformative to extant theory. Research on organizational configurations offers a unique arena to address this interplay between theories and methods. Organizational configurations take a holistic and systemic approach to studying organizations, rather than focusing on individual elements that are related to an organizational outcome. By studying these interrelated patterns configuration research is able to describe, explain and predict (Short, Payne & Ketchen Jr., 2008). Description is done through studying organizational patterns along key dimensions that are prevalent across organizations. Subsequently these patterns can be explained through the use of extant theories such as contingency theory. Finally, based on these explanations and descriptions, organizational configuration research is able to predict which sets of firms are likely to be successful given a set of contingencies. The most appropriate methodology to conduct configuration research is set theoretic-methods: “set-theoretic methods contribute to theory building by providing a rigorous way to combine verbal statements with logical relationships...allowing for the expression of complex causal relations in ways that generate new insights for organizational theory” (Fiss, 2007: 1181). Through fs/QCA, we will apply set-theory to our sample of Dutch law firms.

### **5.3.2 Sample & research design**

Archetypes as suggested by Short et al. (2008) are context specific organizational configurations based on the presence or absence of organizational features that include strategic, structural and procedural elements. However data on organizational features in the Dutch law industry is not readily available due to limited disclosure obligations. Hence, for the purpose of this study, we constructed a survey instrument that aims to tap into the organizational features that, identified by previous literature (e.g. Greenwood et al., 1990; Pinnington & Morris, 2003), are reminiscent of the P<sup>2</sup> and the MPB archetypes. We developed our survey in line with recommendations made by Dillman (2007). For our measurement instrument, we first used psychometric scales validated in prior studies. If such scales were unavailable, we developed new scales based on development procedures suggested by Hinkin (1998) and Steenkamp and Van Trijp (1991). First, through inductive and deductive reasoning possible items for scales were generated. Subsequently, in the second step, these items were judged both in terms of their content validity and their relevance, by an expert panel comprised of 10 academics specialized in strategy and organization processes and 10 lawyers. As final three steps, the scales were tested for their internal consistency, their measurement properties through CFA and their convergent and discriminant analysis. All our scales were measured on a 7-point Likert scale, where 1 represented 'strongly disagree' and 7 'strongly agree'.

The survey was administered online to all Dutch lawyers in 2008 using Global Park survey administration ([www.globalpark.com](http://www.globalpark.com)). We received a mailing list that included 6323 lawyers working for 1678 independent law firms with 2 or more lawyers from the Dutch Bar Association. The first wave resulted in 480 completed responses. Following a reminder after 4 weeks another 443 responses were collected, making a total of 923 completed surveys representing a response rate of 14.6%. These lawyers represented 450 different law firms, covering 26.8% of all firms. Of the group of firms staffed with 2 - 5 lawyers, we have 14.8% in the sample (175 firms); of the group with 6 - 10 lawyers we have 43.0% (122 firms); of the group of firms with 11-60 lawyers we have 70.5% (129 firms); and of the final group with more than 60 lawyers we have responses from all firms, i.e. covering 100% (24 firms) of the sample frame. This sample shows significant variation in terms of size, structure, strategy and governance.

### 5.3.3 Outcome measures

For our analysis we use three different types of dependent variables. First we use firm *performance*. Normally research on PSF-performance uses profits per partner as proxy of firm performance. In the Dutch context however, limited disclosure obligations make it impossible to use this measure as indicative of firm performance. Additionally the expert panel indicated that profits per partner did not fully capture what lawyers would consider good firm performance. Hence we constructed a performance measure based on inductive item generation through interviews with the expert panel and the deductive generation through the use of literature of PSF performance. This process resulted in four different facets that lawyers suggest constitute good firm performance: profits, organizational efficiency, attraction of quality staff, and customer retention. The profits items included statements such as “my firm successfully achieved a high profits-per-partner ratio” and “my firm realized a large growth in profits”. Through items such as “my firm successfully developed or maintained a very efficiency organization structure” and “achieved a low overhead percentage” we measured organizational efficiency. Attraction of quality personnel was measured by asking whether the firm was successful in attracting the best interns, junior lawyers and senior lawyers. Finally, based on DeSarbo, Di Benedetto, Song and Sinha (2005) we measured customer retention by asking whether the firm was successful in retaining its largest clients, and able to attract new clients. In all these four facts comprised 16-items that shows very good reliability (Cronbach’s  $\alpha = .84$ ) and explained 62.0% of the variance. Subsequent confirmatory factor analysis (CFA) shows a satisfactory fit with the data ( $\chi^2 = 860.46$ ,  $df = 98$ , CFI = .85, NFI = .83, RMRS = .12) All factor loadings are significant.

*Reputation*, our second dependent variable is measured using the four-item scale developed by Combs & Ketchen Jr. (1999). As the quality of the inputs as well as the quality of the services lawyers render is difficult for clients to judge, reputation is often used as proxy and therefore constitutes a key resource for PSFs. The scale shows very good reliability (Cronbach’s  $\alpha = .88$ ) explaining 75.3% variance and confirmatory factor analysis (CFA) shows excellent fit with the data ( $\chi^2 = 14.38$ ,  $df = 2$ , CFI = .99, NFI = .99, RMRS = .02) All factor loading are significant.

The *misconduct* scale is self-developed and aims to measure the extent of misbehavior within the firm. The items (e.g. “how often do employees break formal rules set by the Dutch Bar Association?”) tap into clear examples of misconduct. The 6 item scale proves to be very reliable (Cronbach’s  $\alpha = .83$ ) covering 54.9% of the

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variance. CFA shows satisfactory measurement properties ( $\chi^2 = 202.31$ ,  $df = 9$ ,  $CFI = .87$ ,  $NFI = .87$ ,  $RMRS = .09$ ) All factor loadings are significant.

#### 5.3.4 *Independent measures*

Our independent measures are aimed to tap into the difference in organizational practices between the P<sup>2</sup> and MPB archetype. *Organizational diversification* measures the ratio of different law practice areas the firm is engaged in where 1 represents a firm that is completely diversified covering all 18 identified law practice areas. Often P<sup>2</sup> archetype firms are relatively small and only have the expertise to service a narrow range of different law areas. Hence we expect for low levels organizational diversification to be associated with the P<sup>2</sup> form, whereas the MPB firms are typically more diversified. The median score of diversification was .50 with a standard deviation of .21.

The *strategy planning* scale we use contains 20 items and is adapted from Rogers, Miller and Judge (1999). It focuses on the extent of the existence of 'goals, plans and scanning' for potential markets and clients, 'accounting control', 'integration and coordination' and 'flexibility'. The original scale has 21 items; however on the advice of expert panel we dropped the final two items that captured the 'broad analysis' dimension of the scale. Also we added one item ("we have a written business plan") in the "goals, plans and scanning" dimension. The items combines into a reliable scale (Cronbach's  $\alpha = .92$ ) explaining 64.7% of the variance. CFA shows satisfactory measurement properties ( $\chi^2 = 727.01$ ,  $df = 164$ ,  $CFI = .96$ ,  $NFI = .95$ ,  $RMRS = .06$ ) All factor loadings are significant. For this scale, given the literature, we expect that the P<sup>2</sup> archetype firms exhibit low levels of strategic planning, whereas the large and complex nature associated with the MPB demand extensive planning.

We measure the presence of *formal governance* using a self-created 8-items scale that aims to tap into the absence or presence of formal governance in the firm. It contains items as "in my firm all employees undergo formal periodic performance appraisals" and "a lot of time is invested in the development of procedures that ensure financial integrity." These 8 items form a reliable scale (Cronbach's  $\alpha = .78$ ) and explains 53.8% of the variance. CFA shows excellent measurement properties ( $\chi^2 = 37.45$ ,  $df = 99$ ,  $CFI = .99$ ,  $NFI = .97$ ,  $RMRS = .03$ ) All factor loadings are significant. Similar to the argument for strategic planning, we expect formal governance to be limited for the P<sup>2</sup> firms whereas it is extensive for the MPB firms.

In contrast, the presence of *informal governance* systems should be more prevalent with the P<sup>2</sup> firms as a means to ensure efficiency and combat misbehavior. For the MPB firms this is largely replaced by formal governance systems. Sample items include “there is significant informal information exchange in relation to the goals set by the organization” and “it is completely normal for coworkers to point out potential mistakes or inappropriate behavior to each other”. The four items of the self-constructed scale prove reliable (Cronbach’s  $\alpha = .79$ ) and explain 59.5% of the variance. CFA shows excellent measurement properties ( $\chi^2 = 2.23$ ,  $df = 2$ , CFI = .1, NFI = .1, RMRS = .01) All factor loadings are significant.

A final point of divergence between the P<sup>2</sup> and the MPB archetype rests with its *decision making* procedures. The P<sup>2</sup> decision making structure reflects the collegial nature of this configuration. Decision making is done by reaching consensus. However this form of decision making is inefficient for MPBs. Due to its large size and often complex structure, MPB firms rely on forms of directive decision making to speed up the decision making process. Therefore we constructed a three point scale that captures the manner of decision making. If the organization uses a ‘board of directors’ we took this to signify the most directive form of decision making. When decisions were still made in partner meetings this is less directive in nature. Subsequently, the manner in which decisions are made-either through voting or consensus-is used to differentiate between this form of decision making. The consensus form is the least directive, the more unanimous, in nature, whereas voting during partnership meetings lies between the unanimous and board of director form.

For our operationalization of organizational structure, we include two measures. The first is *internationalization*. This measure included three points of reference: not active internationally, active in one other country, active in two or more countries.

Our second measure for organizational structure is *organizational size*. We classify firms with fewer than 10 lawyers as small, those with 15 as medium sized and firms with more than 20 lawyers as large.

To summarize, given the literature on configurations, we believe that the MPB firms are likely to be *large, international and diversified*, whereas the P<sup>2</sup> is small, national and undiversified. Consequently given these contingencies, we believe P<sup>2</sup> firms should score low on *strategic planning, formal governance, high on informal governance* and exhibit a *collegial decision making structure*. In turn we believe that MPB

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firms should score high on *strategic planning*, *formal governance*, low on *informal governance*, and exhibit a *directive decision making structure*.

### 5.3.5 Construct validity

*Convergent and discriminant validity.* Besides judging a survey instrument on the reliability and measurement properties of its scales, it is also necessary to address issues of convergent and discriminant validity. A construct is said to have convergent validity when the multiple indicators used to measure the construct are positively and significantly correlated (Carime & Zeller, 1979). Using structural equations modeling (SEM) this can be discerned by looking at the factor loading of the items underlying the latent variable (Steenkamp & Van Trijp, 1991). As we reported above, the survey scales we use all have significant and positive standardized factor loadings thus indicating the convergent validity of our survey instrument. A survey instrument is said to possess discriminant validity when the theoretical constructs under investigation are not highly significantly correlated with each other. When this is the case, the latent variables indeed measure different constructs (Carmine & Zeller, 1979). This can also be assessed using SEM through comparing a unconstrained confirmatory factor analysis (CFA) model (in which all correlations are freely estimated) with models in which pairs of latent variables are set to unity, i.e. fully correlate with each other. This is done by setting the covariance between the constructs to 1. We estimated these models for each pair of latent variables. When all models show worse fit as compared to the freely estimated CFA model, a survey instrument is said to be discriminantly valid. This proves to be the case as all model show significantly lower fit.

*Common method variance.* Except for our variable *organization size*, all data was obtained from our survey instrument. This exposes our analyses to the presence of common method bias. In order to test the extent of this problem we use two procedures. First as suggested by Podsakoff, MacKenzie, Lee and Podsakoff (2003) we estimated common method variance through a three model procedure. As an initial step a single method factor model is estimated. This means that the entire measurement model is loaded on a single latent variable. This model yielded a model fit of  $\chi^2 = 18658.48$ ,  $p < .0000$   $df = 1595$ ,  $RMSEA = .154$ . When we compare this model to the actual measurement model, its properties are considerable worse:  $\chi^2 = 4437.58$ ,  $p < .0000$   $df = 1517$ ,  $RMSEA = .065$ ;  $\Delta \chi^2 = 14247.90$ ,  $\Delta df = 78$ ,  $p < .0000$ . The next step entails estimating a trait and method model, wherein the items are loaded not only on

their respective latent variables but also on the single method factor. When that model shows better measurement properties as compared to the measurement model, it indicates the presence of common method variance (Williams, Cote, & Buckley, 1989). This proved to be case:  $\chi^2 = 3717.74$ ,  $p < .0000$   $df = 1446$ ,  $RMSEA = .059$ ;  $\Delta \chi^2 = 719.84$ ,  $\Delta df = 71$ ,  $p < .0000$ . The amount of common method variance can subsequently be determined on the basis of the sum of squared loadings associated with the method factor. Where the common cut-off point is at 25 percent as suggested by Williams et al. (1989), our common method variance only adds up to 6.7%. Another common test for the presence of single method bias is Harman's single-factor test. If indeed a problem, an unrotated principal component factor solution should show that a single factor explains a significant portion of the variance. In our case, the largest factor only covers 17% percent of the variance and the first 4 factors contribute to only 23.8% of the variance explained. This indicates that are results are not driven by one general factor, thus suggesting that common method variance does not seriously bias our results.

### **5.3.6 Calibration**

An important step in the process of conducting fs/QCA analysis involves the calibration of the variables. This requires specifying anchor values using the measurement scores of the variables such that they can be calibrated to fit into membership sets. The anchors values are specified based on theoretical foundations and descriptive statistics. Three of these anchors need to be specified. The first assigns cases into the category for the full membership. For example a researcher can specify a value that, when crossed, warrants inclusion into the membership set of high-performing firms. This value additionally means that variance over that particular value is considered irrelevant. Whether a firm is just over this value or to a large extent is treated as similar, both are assigned the value of 1. Similarly a threshold value is specified for low-performing membership set. All cases below this value are assigned the value zero. Finally, the researcher needs to specify a value that is termed the crossover point. If a value is higher than the crossover threshold but below the full membership anchor this indicates that a case is more in than out. When this value is lower than the crossover point but above the fully-out anchor, the observation is more out-than in. For each of our scales, which we averaged, we used the median score as crossover point. For the full non-membership and full membership anchors respectively, we subtracted and added 1 standard deviation from this value. *Size, internationalization and decision making* where calibrated using the points of the

categories indicated at the variable description. Using the “direct method” of calibration described by Ragin (2008), the anchors can be used to transform the variables into measures between 0 and 1, suitable for fs/QCA. “The basic intuition underlying this calibration is that it rescales an interval variable using the crossover point as an anchor from which deviation scores are calculated, with the values of full membership and full non-membership as the upper and lower bounds” (Fiss, 2011: 35). The transformation was done using the *compute* command in version 2.5 of fs/QCA. Additionally Ragin (2009) suggests the avoidance of the precise value of .5 as this score is difficult to analyze. Therefore following Fiss (2011) we randomly added and subtracted .001 from the observations of .5.

### 5.3.7 *Analysis*

To test our hypotheses, we employ fs/QCA. This method is grounded in set theory and is particularly suited for testing causal processes that underlie typologies (Fiss, 2011). In a nutshell, fs/QCA explores how membership of cases in causal conditions is linked to membership in the specified outcomes (Schneider, Schulze-Bentrop & Paunescu, 2010). This also opens up the possibility for analyzing conjectural causation, meaning that it is the combinations of conditions rather than a single condition that leads to certain outcome. This suggests the presence of complementarities between causal conditions. Additionally the results of the analysis can indicate multiple paths that lead to a similar outcome, thereby introducing the idea of equifinality (Fiss, 2007). In specific the ability of fs/QCA to discern between core and peripheral conditions, allows for drawing conclusions on 1<sup>st</sup> and 2<sup>nd</sup> order equifinality. This method is also able to address issues of asymmetric causality. The reverse of the combinations of conditions that lead to high scores of the outcome variable do not necessarily lead to low scores on the same outcome variable. It may be that other causal conditions result in for instance poor performance. In our analysis, we will report both the causal configurations that lead to high scores on the outcome as well as the causal configurations that will lead to low scores.

Standard statistical methods are unable to unveil similar results. Although regression analyses can be augmented and suggest complementarities through interaction effects, they still assume a single path leading to a certain outcome (Grandori & Furnari, 2008), i.e. the method is unable to address the concept of equifinality. Additionally although three way interactions are currently a possibility for regression methods its interpretation is inherently difficult (Drazin & Van der Ven,

1985). It will become impossible to interpret when, as in our case, 6 variables are introduced and causally connected. This would lead to six way interactions. Also, cluster and factor analysis are unable to differentiate between core and peripheral conditions in the combinations that lead to a certain outcome. In all fs/QCA is better suited to investigate the complementary nature of configurations.

To empirically accomplish our fs/QCA analysis we follow the three step approach as suggested by Fiss (2011). The first step is to construct a truth matrix and “each row of this table is associated with a specific combination of attributes, and the full table thus lists all possible combinations” (p. 25). The empirical cases are subsequently sorted in these possible combinations, where some rows may have large numbers of observations, some a few and some none at all.

Second, minimal consistency levels and number of cases are indicated. Consistency refers to extent that cases correspond to the set-theoretic relationships in all possible solutions. This consistency is thus the proportion of cases that exhibit a certain configuration divided by the number of cases that exhibit the same configuration but do not exhibit the outcome. Additionally the level of consistency is adjusted by given small penalties for minor inconsistencies and large penalties for major inconsistencies. We set the lowest consistency score threshold for solutions at  $>.80$ , which is in line with previous work (Fiss, 2011). However, we were more stringent in the necessary number of minimal acceptable cases. Important considerations in the number-of-cases threshold are the total number of cases, the number of causal conditions, the substantive knowledge of the researchers regarding the cases, the degree of calibration precisions, the extent of measurement and assignment error and the interest of the researcher in either fine- or coarse-grained patterns (Ragin, 2009). Given the large number of cases in our dataset, the number of admitted solutions would significantly increase when the boundary would be set to 3 as done in previous research. This allows us to err on the side of caution as membership in a category may be caused by measurement or coding error. Hence low-frequency causal combinations are treated similar to those combinations that lack strong empirical instance altogether (Ragin, 2009). We set the number-of-cases threshold to a minimum of 6 observations. For the dependent variables high-performance 116, for high-reputation 26 and for high-misconduct 49 cases exceed both thresholds. For the negated outcomes (i.e. the low-performance, low-reputation and low-misconduct outcomes) we have respectively, 106, 137 and 56 cases.

Finally, Boolean algebra will be used to logically reduce the number of truth table rows to simplified combinations. As a limited number of variables can result in a large number of truth tables rows, the result is that there are no or a limited number of observations in each of these rows. Counterfactual analysis allows overcoming this lack of empirical variation. We distinguish between two types of outcomes. We present the parsimonious solution that includes both the “easy” and “difficult” counterfactuals. Easy counterfactuals are situations in which a redundant causal condition is added to a combination of conditions that already lead to the desired outcome. Difficult counterfactual relates to situations where a condition is removed from a set of combinations that lead to the outcome given that this condition is redundant. Also, we present the intermediate outcome that deals only with easy counterfactuals. On the basis of these two outcomes core and peripheral conditions are identified. Core conditions are those not eliminated from the parsimonious solution, while those eliminated can be seen as peripheral, interchangeable conditions.

## 5.4 Results

Table 1 presents the descriptive statistics and correlations for all measures. The table shows the expected positive correlations between size, strategic planning, diversification, formal governance, directive decision making and internationalization and the expected negative correlation between size and informal governance. Likewise diversification is positively correlated with strategic planning and formal governance and internationalization.

Table 1: Descriptive Statistics

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. Organizational Diversification	.46	.38									
2. Strategic Planning	.47	.39	.29**								
3. Formal Governance	.51	.36	.15**	.46**							
4. Informal Governance	.49	.36	-.08	.07	.38**						
5. Decision Making	.14	.30	.24**	.17**	.08	.17**					
6. Internationalization	.22	.39	.25**	.34**	.21**	-.04	.24**				
7. Organizational Size	.26	.40	.40**	.32**	.21**	-.18**	.43**	.29**			
8. Performance	.52	.36	.03	.31**	.42**	.19**	.10*	.19**	.18**		
9. Reputation	.49	.36	-.03	.12	.32**	.17**	.02	.10*	.07	.42**	
10. Misconduct	.47	.36	.21**	.04	-.05	-.19**	.19**	.08	.30**	-.11*	-.22**

\* = .05 significance level  
 \*\* = .01 significance level

### 5.4.1 High & low performance configurations

Table 2 shows the results for the fuzzy-set analyses of high and low performance. The notation used, follows that introduced by Ragin and Fiss (2008). Full circles represent the presence of a condition, the crossed-out circles the absence of a condition. Blank spaces represent 'don't care' situations in which the causal condition may either be present or absent. Large circles are core features that are present in both the intermediate and the parsimonious solution. Peripheral features-the small circles-are conditions present only in the intermediate solution.

**Table 2: High & low performance configurations**

	High performance				Low performance		
	Generalist	MPB	Small national	Star	Misfit 1	Misfit 2	Unmanaged firm
	1a	1b	2	3	1	2	3
<b>Structure</b>							
High Diversification	●	●		⊗	●	●	⊗
Large Size	⊗	●	⊗	⊗	⊗		⊗
International	⊗		⊗	⊗	⊗	⊗	⊗
<b>Practices</b>							
Strategy formation	●	●	●			⊗	⊗
Formal Governance	●	●	⊗	●	⊗	⊗	⊗
Directive Decision making	⊗		⊗	⊗	⊗	⊗	
Informal Governance		⊗	●	⊗		⊗	⊗
Consistency	.79	.85	.77	.80	.80	.84	.81
Raw coverage	.14	.14	.12	.16	.24	.20	.27
Unique coverage	.05	.08	.04	.07	.07	.04	.15
Overall solution coverage	.46				.43		
Overall solution consistency	.78				.78		

The solution table of the fuzzy-set analysis for high performance shows that there are four different conjectural causal configurations possible with acceptable consistency scores<sup>5</sup>. These outcomes point to the presence of first-order, or so-called across-type equifinality. In other words there are different causal combinations that

<sup>5</sup> The configuration tables for performance, reputation and misconduct show only those configuration that have unique coverage scores of .03 and higher. Those configurations that have lower coverage score are shown in the appendix.

lead to a high performance outcome. Additionally, a number of neutral permutations exist in solution 1 that suggests second-order or within-type equifinality, i.e. the presence of core and peripheral conditions. The first two configurations that lead to high-performance, solution 1a and 1b, show the same core conditions, the main difference is between them is firm size. The original template for the  $P^2$  suggests a lack of strategy formation and formal governance, coupled with the presence of informal governance and unanimous decision making. We dubbed solution 1a the generalist. The outcomes suggest that the original collegial mechanisms have partly been replaced by more formal practices to adapt to its contingency of high diversification. The generalist has collegial decision making, and the presence or absence of informal governance is a don't care situation. However, strategy formation and formal governance are core conditions when coupled with high levels of diversification. Solution 1b is largely in line with the configuration suggested by the MPB. It has strategy formation, formal governance and high levels of diversification as core conditions, with the absence informal governance as a peripheral condition.

Solutions 2 and 3 are small, national, undiversified firms. Here formal processes are combined with informal processes. In configuration 2 strategy formation is complementary with the informal governance. In configuration 3, formal governance is a necessity if there is an absence of informal governance.

Proposition 1 suggests that sedimented firms should perform worse as compared to pure configurations as they suffer from system misfit. Additionally, contingency factors should determine the practices necessary to ensure proper functioning. The three configurations listed below seem to only partly confirm this hypothesis. Both solutions 1 and 2 lend credence to the contingency argument. Both configurations have high levels of diversification but lack any sort of system to regulate and organize this contingency. Solution 3 is basically an unmanaged firm, therefore unsurprisingly leading to poor internal coordination and low levels of performance. For high performance however, the hybrid organizations (solutions 1a, 3 & 4) are high performing firms together with the MPB. The original  $P^2$  form is not among the high-performance configurations.

#### **5.4.2 High & low reputation configurations**

Solution table 3 presented below shows the configurations of the fuzzy-set analyses for high and low reputation. Interestingly, the number of configurations that lead to high levels of reputation show fewer numbers of outcomes as compared to the analysis for

high performance configurations. Additionally the outcomes are also different in terms of causal conditions. Solution 1, which we dubbed the P<sup>2.1</sup>, indicates a firm that has low levels of diversification, no internationalization and small in size, still should have strategic formation and formal governance, but definitely not mix this with the traditional P<sup>2</sup> practice of informal governance. In contrast, international organizations should have informal governance coupled with formal practices. The absence of mixed elements is also evident in the MPB configuration which neatly overlaps with the theoretical predictions. Firms large, diversified and international in nature, require strategic formation, formal governance and especially directive decision making combined with a lack of informal governance. Overall this suggests that audiences indeed evaluate firms showing coherence in their practices more favorably as compared to mixed ones. However audiences do demand that firms show the quality of their formal systems even if firms might not require them given their size and limited diversification.

**Table 3: High & low reputation configurations**

	High reputation			Low reputation	
	P <sup>2.1</sup>	International Star	MPB	Misfit configuration	Unmanaged firm
	1	2	3	1	2
<b>Structure</b>					
High Diversification	⊗	⊗	●	●	
Large Size	⊗	⊗	●		⊗
International	⊗	●	●	⊗	⊗
<b>Practices</b>					
Strategy formation	●	●	●	⊗	
Formal Governance	●	●	●	⊗	⊗
Directive Decision making	⊗	⊗	●	⊗	⊗
Informal Governance	⊗	●	⊗	⊗	⊗
Consistency	.80	.82	.80	.81	.80
Raw coverage	.12	.05	.04	.12	.26
Unique coverage	.11	.04	.04	.03	.09
Overall solution coverage	.20			.48	
Overall solution consistency	.80			.75	

The results for the low reputation analysis show overlap with those of the low performance category. Of the two configurations leading to low performance one is identical to configurations leading to low performance. Configuration 1 (similar to configuration 2 for low performance) shows that audiences judge firms that do not responded to contingency factors properly, poorly. Configuration 2 is an unmanaged firm that lacks formal and informal governance and is judged as poorly led as it has unanimous decision making.

In all proposition two is to some degree accepted. The MPB is among the high reputation configurations and the international star is well adapted to its contingencies. On the other hand, the P<sup>2</sup> form is not among the high reputation configurations yet its revised form the P<sup>2.1</sup> is. Unsurprisingly, In terms of low reputation, poorly managed and ill-adapted configurations are punished by their audiences.

#### **5.4.3 High & low misconduct configurations**

The solution table for high and low misconduct (table 4) shows a slightly different picture as compared to the two tables presented above. A core characteristic shared by the two outcomes for high levels of misconduct is organizational size coupled with the peripheral condition of high levels of diversity. These firms are apparently overly large and complex that, even when managed formally, misbehavior cannot be rooted out.

Significant in these findings are also that solution 1a is seen also in another outcome. 1a is similar to the MPB configuration that leads to high performance. Hence what is good for performance does not ensure the proper functioning of the organization in terms of upholding professional ethics. This confirms proposition three that a firm cannot maximize on more than one objective function. The second solution that results in misbehavior by lawyers rests again in a contingency situation where being large and diversified without any form of practices offers little in the way of control.

An important conclusion that can be drawn from the configurations in the low misconduct category is that, again size matters. Small firms are the only type of firms that show low levels of misconduct. Additionally, of these solutions only solution 4 is found in previous analysis. In was also present in the high reputation analysis. Configuration 1 and 2 show one important element that is not observed in any other configuration until now. It combines the presence of one of the formal mechanisms governance or strategizing with informal governance.

**Table 4: High & low misconduct configurations**

	High misconduct		Low misconduct			
	MPB	Misfit 1	Small formalizing P <sup>2</sup>	Small formalizing P <sup>2</sup>	Small Generalist	International Star
	1a	1b	1	2	3	4
<b>Structure</b>						
High Diversification	●	●	⊗	⊗	●	⊗
Large Size	●	●	⊗	⊗	⊗	⊗
International		⊗	⊗	⊗	⊗	●
<b>Practices</b>						
Strategy formation	●	⊗	⊗	●	●	●
Formal Governance	●	⊗	●	⊗	●	●
Directive Decision making		⊗	⊗	⊗	⊗	⊗
Informal Governance	⊗	⊗	●	●	⊗	●
Consistency	.88	.87	.81	.82	.80	.86
Raw coverage	.16	.07	.19	.11	.08	.05
Unique coverage	.09	.03	.12	.04	.04	.03
Overall solution coverage	.21		.31			
Overall solution consistency	.84		.80			

Small, undiversified, non-international firms seem to benefit from a healthy dose of formal processes; however the P<sup>2</sup> elements of informal governance and unanimous decision making are also necessary. When diversification comes into play, as shown in configuration 3, the informal governance gives way to both formal elements. These result support proposition three that the P<sup>2</sup> is best equipped to handle matters of professional misconduct, with the caveat that it does require an investment in at least some formal processes.

## 5.5 Discussion

The objective of this paper is to add to the discussion on organizational configurations by integrating different theoretical perspectives and by focusing on a single distinctive organizational form: the PSFs (Von Nordenflycht, 2010). Based on an analysis of these themes in the context of Dutch law firms, the contributions of our study are threefold.

First, contributors to the PSF literature have previously documented two organizational configurations, the P<sup>2</sup> and the MPB (Greenwood et al., 1990; Cooper et al., 1996). However their description has been based on interpretative case studies, and with the notable exception of Pinnington and Morris (2003), the extent of their applicability in the entire domain of a professional industry such as law and accounting has not been researched. Additionally, the original descriptions of these two configurations are approximately two decades old. Under the influence of recent economic upheavals (Løwendahl, 2005), they may in reality have been subject to change. Our sample, the Dutch law industry, provides an opportunity to validate these prior conceptualizations of the PSF, and assess their relative prevalence in a competitive organizational field. In our analyses, a number of different observations come to the fore. First, we find evidence that the MPB is indeed a common organizational configuration, and that it has persisted to this day in much the same form as was originally described by Cooper and his associates (1996). Second, however, our results also show that the P<sup>2</sup>-archetype, while still discernable, no longer exists in exactly the same form as first described by Greenwood and his colleagues (1990). Specifically, we observe that, consistent with the broader societal trend towards formalization, efficiency, and commercialization (Suddaby & Greenwood, 2005), law firms are also subject to these institutional forces. Originally the P<sup>2</sup>-archetype relied exclusively on informal and collegial manners of supervision and control. Yet we find that especially the reliance on the informal governance practices has been wholly replaced by formal governance and strategy formation processes. However, consensus decision making remains the most adequate form of inter-partner interaction. To highlight this change that has occurred in the P<sup>2</sup> configuration, we dubbed this form the P<sup>2.1</sup>. However, due to the cross-sectional nature of our data, we cannot claim this is part of a broader configurational evolution in the form of sedimentation of the MPB configuration on the P<sup>2</sup> configuration. In sum, as long as we account for some minor differences in the P<sup>2</sup> configuration that can readily be interpreted as structural adaptations to newly emerged contingences in the institutional landscape, MPB and P<sup>2.1</sup> configurations still dominate the population of Dutch law firms.

Second, we have assessed the causal links between the various types of configurations present in the Dutch law industry and their substantive and symbolic performance. What is noteworthy about these analyses is that we detected that only P<sup>2.1</sup> and MPB configurations are present in the Dutch law industry, but also a number of different hybrid configurations. Whereas such hybrid configurations have been

described in the literature as being unstable and inconsistent in their values, systems, and structures (Gray, 1999), our analyses show that they do not necessarily yield poor performance. While we cannot assess whether these hybrids are stable or unstable, their performance and reputation implications are often positive. On the other hand, the MPB configuration in its purest form appears to be the most powerful configuration for generating high substantive and symbolic performance. These results seem to support a generic structural contingency theory-based take on PSF performance (Greenwood & Miller, 2010), indicating that the success of PSF configurations is dependent on the contingencies these firms face. Internationalization, for example, requires PSFs to use informal governance for coordination across borders. Similarly, high levels of diversification or increased size require formal governance and strategy formation in order to provide the integration and coordination necessary to safeguard high substantive and symbolic performance in complex and opaque organizational environments. Inversely, not responding to these contingencies leads to substantive and symbolic performance, and high levels of misconduct. In sum, while the P<sup>21</sup> and the MPB are stably amongst the highest-performing configurations, hybrids can also realize acceptable performance, as long as they emerge out of adaptations to crucial contingency factors.

Our third contribution entails an improved understanding of what produces the darker side of organizational configurations. Specifically, our answer to the question as to what causes PSFs to engage in misconduct (Greve et al., 2010) and jeopardize vulnerable client and third party interests lies in the tradeoffs that PSFs must necessarily make when combining public and private objective functions. In general, PSF research treats these two objectives as being separate, while the findings we have reported suggest the necessity of conjoint analysis. One part of research on PSFs relates to the performance implications of PSF management practices, and thus highlights the maximization of the private objective function (e.g., Greenwood et al, 2005; Hitt et al., 2005). This first branch of the PSF literature stresses that PSFs are very affluent enterprises that are superior vehicles for creating wealth for their owners (Aharoni, 1993). Another part of the research on PSFs research focuses on the societal impact PSFs have, and stress the maximization of the public objective function. In this second branch of the literature, PSFs are primarily seen as stimulators and guardians of the economic order. In their role as stimulators, PSFs help shape the industries of their clients in positive ways. Specifically, they are often heralded as knowledge engines (Lorsch & Tierney, 2002), which through their innovations (Alvesson, 1995)

and solutions to complex organizational problems stimulate the value creation process within their clients' firms (Hansen et al., 1999; Løwendahl, Revang, and Fosstenlökken, 2001). In their role as guardians, PSFs are primarily portrayed as gatekeepers (Coffee, 2006), vouching for their clients' legitimacy by staking their reputation on the validity of their complex business transactions.

What our empirical results show, however, is that it is absolutely critical to assess the private and public objective functions of PSFs simultaneously when vetting the effectiveness and desirability of any PSF configuration in particular. For example, the MPB configuration offers an organizational design that does well in terms of the private objective function by ensuring high substantive and symbolic performance, but it does so at the cost of poor outcomes on the public objective function: the MPB scores very high in terms of the level of organizational misconduct it produces. The absence of strong informal governance, through which professionals can collegially correct one another's misdeeds and which is one of the hallmarks of the original P<sup>2</sup>-configuration, is the key ingredient that is missing in these firms. As our analyses suggest, informal governance can be used as a complement to or as a substitute for formal governance when organizational size, complexity, and scope are minimal. However when PSFs grow, diversify, or internationalize, they require more formal governance. Promisingly, however, our results show that there are a number of small firm configurations that are seemingly able to balance both the public and private objective functions, but only to the extent that these involve symbolic performance and avoidance of misconduct. In short, senior managers of PSFs and public policy makers ought to be aware of the inherent tradeoffs between the private and public objective functions of PSFs. As our analyses show, any attempt to further stimulate the substantive and symbolic performance of PSFs beyond a satisfactory minimum is likely to generate a weaker score on the public objective function and result in greater misconduct.



# Appendix

## Appendix A. Firms strategies in chapter 2

<b>Firm: A</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Defiance	R1: Yes, we are trying to increase the number of advisory products.
	Training	Manipulate	R1: We have created a bachelor in cooperation with a university to train our people to be able to advise clients.
<b>(Advisory) Services</b>	Formal business development	Defiance	R2: We have hired a business manager, and with him a strategy for new product development mainly related to automation.
	Range of services, specialist concept	Defiance	R2: We want to provide business through a full service concept, but also want to hold on to the bottom of the market.
<b>Mentality professionals</b>	General mentality	Compromise	R1: You need to offer good salary packages but also education. You really need to offer them options.
<b>Automation of services</b>	Portals/ Online Service	Manipulate	R1: We are way ahead in terms of web based access. We give presentations on it, to show that.
	XBRL	Compromise	R3: We do too little. However, it is a key point for us to increase efficiency in the audit.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R1: A non-professional need to be very good to be accepted by a professional, I doubt we would accept a non-professional at a similar level.
	Decision making/voting	Compromise	R1: I would be in favor of more directive decision making, but you need to know when you are directive or when you need to convince.
<b>Performance pay system</b>	Division profits	Acquiesce	R2: Another sore spot is the reward system. Everyone gets the same based on a point system, but we do not have a differentiated performance pay system.
	Evaluation	Defiance	R2: Our performance system has

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	functionality		criteria such as how good are you with your clients, what is your profitability and how satisfied are your people.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R3: It has been debated whether to merge locations, however a lot of people were against it.
	Critical mass	Defiance	R2: You need a large club to get scale advantages from you IT investments, as well as being able to specialize.
	Separation audit & advisory	Acquiesce	R3: Our firm still has a mixed practice, so we did not separate audit and advice.
	Service lines	Compromise	R1: It is a matrix structure organized geographically and through service lines.
	Staff services	Defiance	R1: We have staff services with their own directors, who all report to one partner.
<b>Internationalization</b>	Clients/ Services	Defiance	R1: Being in an international network allows you to service your clients in a uniform manner.

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<b>Firm: B</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R1: It's not smart to compete on price, you need to excel in terms of advise and your relation with the client.
	Training	Manipulation	R3: We are trying to use new techniques such as Wiki and e-learning.
<b>(Advisory) Services</b>	Formal business development	Defiance	R2: It is very important! You need to be innovative and come up with new products, new ideas and solutions. We have a R&D department for that.
	Range of services, specialist concept	Compromise	R3: We want to be a generalist first, then a specialist when we are able.
<b>Client acquisition</b>	Cold Acquisition	Acquiesce	R3: Cold calling is not working.
<b>Mentality professionals</b>	Work/life balance	Compromise	R3: If you come work for us, you can still work and live in your local community.
<b>Automation of services</b>	Portals/ Online Service	Defiance	R3: We have an online portal on which clients can log on.
	XBRL	Defiance	R3: IT in consolation work is really important. It resulted in a new business model.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R2: I think to be a good manager you need to understand who the client is, how he reacts, and what the problems are. To do this you need to have technical expertise.
	Decision making/voting	Compromise	R3: We are mainly organized centrally but with local differences.
<b>Performance pay system</b>	Division profits	Defiance	R1: We have profit sharing throughout the firm, even the secretary.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R1: No you need to show your face in the market, and clients should not be scared of the size of your firm.
	Critical mass	Defiance	R3: We have an acquisition program.
	Separation audit & advisory	Defiance	R4: We have separated audit and advice since 2007.

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	Service lines	Defiance	R3: We are organized along service and staff lines.
	Staff services	Defiance	R3: We need to start growing and put the right people in place for ICT and HRM.
<b>Internationalization</b>	Clients/ Services	Compromise	R3: We focus on the Dutch market but we have the ambition to grow international. At the moment we use local partners.

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<b>Firm: C</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R3: Our profits for accounting are dropping and we have to make that up through accountancy, the question is if we have the right people.
	Training	Compromise	R2: We have had intense training courses to develop commercial skills.
<b>(Advisory) Services</b>	Range of services, specialist concept	Defiance	R2: We have a full service firm, but we're not really good at cross-selling.
<b>Client acquisition</b>	Cold Acquisition	Acquiesce	R1: Cold calling wasn't very successful, networking works better.
<b>Mentality professionals</b>	Work/life balance	Compromise	R1: We have three generations in the firm that we cater to but we are still reasonably traditional.
	General mentality	Acquiesce	R1: It is really difficult for us to let go of the old way of working.
<b>Automation of services</b>	Portals/ Online Service	Defiance	R1: Clients can log on through portals.
	XBRL	Compromise	R2: You can still make reasonable profits through annual accounts. However we need to do that efficiently, and invest in XBRL.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Compromise	R2: The managing director is still an RA.
	Decision making/voting	Acquiesce	R2: There is centralized strategizing, however you have to adapt to local prerogative.
<b>Performance pay system</b>	Division profits	Compromise	R1: There is a differentiated pay system.
	Evaluation functionality	Compromise	R1: We have a performance pay system in which commercial goals are included.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R1: We still want to remain local, however we make sure it remains efficient in terms of scale advantages.
	Critical mass	Compromise	R1: We still want to remain local, however we make sure it remains efficient in terms of scale advantages.
	Separation audit & advisory	Compromise	R1: We need clear separation of responsibility because of rules but also because our accountants want

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	Staff services	Compromise	to do one or the other. R2: There are staff services at the head-office.
<b>Internationalization</b>	Network	Compromise	R3: We do not plan to expand internationally but we have alliances.

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<b>Firm: D</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R4: Changing your core business is full of risks, and it is quite frightening, as it is a threat for 25% of the partners.
	Training	Compromise	R1: At the international partner meeting we set the whole thing in motion, tools and training.
<b>(Advisory) Services</b>	Formal business development	Defiance	R2: I think business development is now the number 1 priority for us.
	Range of services, specialist concept	Compromise	R1: We are very selective in what we offer. We only offer things we are good at and things our clients really need.
<b>Client acquisition</b>	Cold Acquisition	Defiance	R1: We plan it more nowadays, whom to target and we follow up on how it went.
<b>Mentality professionals</b>	Part time employment	Acquiesce	R3: If you see the amount of time I put into the firm. I cannot endure if someone believes a less then 40 hours working week is enough.
	General mentality	Compromise	R1: We are starting to become less traditional.
<b>Automation of services</b>	XBRL	Acquiesce	R3: Unfortunately, things need to hurt first, before we start acting. Same thing with XBRL. We discussed it, but decided not to invest in it yet.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R3: I'm not sure if it would be accepted. Professionals are highly educated, and you need someone with clients and market knowledge to lead.
	Decision making/voting	Compromise	R1: We think it is necessary to be more directive, however, we still do not really hold people responsible.
<b>Performance pay system</b>	Division profits	Manipulate	R1: We have a point system, if you perform well you get more points and have a larger claim on the profits.
	Evaluation functionality	Manipulate	R4: The performance criteria have changed, and are now much more geared towards leads and business development.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R4: It is really a constellation of diverse practices and partners.

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	Critical mass	Compromise	R2: We do want a minimal complement at each location, to minimize risk purposes.
	Separation audit & advisory	Defiance	R4: We have separated control and advice, and we have a compliance offer, and check if we can take on a client
	Service lines	Defiance	R2: We have structured our firm along corporate, SME, and tax service lines.
	Staff services	Defiance	R3: There is a manager to run the staff services.
<b>Internationalization</b>	Network	Manipulate	R1: We are part of an international firm but not everyone is happy with that. For example, they don't appreciate mandatory structures.
	Clients/ Services	Manipulate	R3: Our international network is really beneficial for us.

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<b>Firm: E</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R1: There was a lot of resistance, but over time it has reduced. People are getting more enthusiastic, and more entrepreneurial.
	Training	Compromise	R3: Very intense! It was a cultural shock. It required a lot of money and training to get it going. We are still working on it.
<b>(Advisory) Services</b>	Formal business development	Compromise	R3: The annual report will remain important, the other services are just additional.
	Range of services, specialist concept	Compromise	R2: We are going from a generalist role to more of a full service firm with expert knowledge.
<b>Mentality professionals</b>	Work/life balance	Compromise	R3: There are developments there, to which we need to get accustomed to. They want to work part-time, we try to adjust to these demands.
<b>Automation of services</b>	Part time employment	Compromise	R3: It is difficult but we do offer part-time employment.
	Portals/ Online Service	Compromise	R3: We try to stay ahead and tell clients that we have these online services.
	XBRL	Compromise	R1: We have been on the side line for a long time but are now working on implementing XBRL.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Manipulate	R1: We have a non-professional running offices, as we know professionals are not great managers.
	Decision making/voting	Compromise	R2: We have a full-time board which centrally governs the firm, however, each office is run by a managing partner.
<b>Performance pay system</b>	Division profits	Acquiesce	R1: The partnership is not really enthusiastic about a differentiated partner reward system.
	Evaluation functionality	Defiance	R1: We introduced the concept of competence management. Our strategic goals are coupled to the specific competences of our people.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R2: We want to keep a network of offices to ensure that clients find

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	Critical mass	Defiance	us everywhere both geographically as well as in terms of types of services. R3: We need larger units to serve larger clients and to be able to specialize.
	Separation audit & advisory	Defiance	R1: Audit is separated from accountancy and advisory in order to assure quality.
<b>Internationalization</b>	Network	Acquiesce	Not part of an international network.
	Clients/ Services	Acquiesce	R3: When demand is large enough, we might want to join an international network

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<b>Firm: F</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Manipulate	R1: We have one person who coordinates all the communication between the customer and the company. We call this person the relation manager. That is our vision.
<b>(Advisory) Services</b>	Range of services, specialist concept	Defiance	R2: We have a full-service firm, but this does certainly not mean we neglect specialism. We do both.
<b>Client acquisition</b>	Cold Acquisition	Compromise	R1: Cold calling is possible but in our network we get promoted through word of mouth.
<b>Mentality professionals</b>	Work/life balance	Defiance	R2: We have flexible working areas.
<b>Automation of services</b>	Portals/ Online Service	Manipulate	R3: Our contracts allow you to 'buy' things that are of importance to you. R2: We are one of the groups that are ahead in terms of ICT. We have a portal that is free of charge, and we have electronic client files.
	XBRL	Defiance	R2: XBRL is fully up and running here.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R1: We think you need managers with both legs in the practice. Only then will your people follow you.
	Decision making/voting	Defiance	R2: Our two-headed board makes the policies on which a small group of people can vote.
<b>Performance pay system</b>	Division profits	Defiance	R3: You can buy shares on different levels of the organizations. We try to stimulate entrepreneurship this way.
	Evaluation functionality	Compromise	R3: We have competency based evaluations and coaching meetings, this does not however determine pay.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R2: In the past, our firm sought country wide coverage, but no anymore. We want to have a strong local presence. We did consolidate some locations, as they just weren't efficient.

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	Critical mass	Compromise	R3: We need to grow. If we don't we need to think about of joining another party.
			R2: We try to grow autonomously, but we don't necessarily preclude merging.
	Separation audit & advisory	Defiance	R3: Yes we separated audit from consolidation and advice in order to assure quality.
	Staff services	Defiance	R3: Yes we have staff services at our head-office.
<b>Internationalization</b>	Network	Compromise	R2: We have a network for international clients. We don't have the ambition to go international ourselves.
	Clients/ Services	Compromise	R2: International advice is a growing market at the moment.

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<b>Firm: G</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R1: Our raison d'être is secured by law. Sure things are easier now, with XBRL, but we still provide the auditors assurance, and that means something.
	Training	Compromise	R2: How do you engage in acquisition? What skills are necessary? That means training, and we are in the middle of that process.
<b>(Advisory) Services</b>	Range of services, specialist concept	Compromise	R1: We are looking to expand our services for instance business risk services and consultancy.
<b>Client acquisition</b>	Cold Acquisition	Defiance	R4: Nowadays, cold acquisition is part of the market.
<b>Mentality professionals</b>	Work/life balance	Compromise	R1: We promote flexibility. You can work with clients using laptops, all records are electronic, and you can work from home.
	Part time employment	Compromise	R1: People are just different, not better or worse. They want to work, earn money, develop themselves, but also have a social network, go out, go on holiday. This should all be possible
	General mentality	Compromise	R1: We try to relate to the attitude, but you cannot combine that with a career in accountancy.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R3: A non-professional as manager would not work with us. You need to really understand the business.
	Decision making/voting	Compromise	R3: It has changed. It is a bit more directive, but not too much.
<b>Performance pay system</b>	Division profits	Acquiesce	R2: No, the system we use is equal profit sharing, so we assume everyone contributes equally.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R1: No we clearly stick to the old principle of local offices. It gives visibility.
	Critical mass	Compromise	R3: You need a certain level of critical mass to be able to service your client well.
	Service lines	Defiance	R2L: We have an autonomous growth strategy of X% per year. R1: The strategy is made along the

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	Staff services	Defiance	lines, so audit, assurances, fiscal, and specialist services. R2: We now have staff services for P&O, automation, finance and marketing. This used to be the work of the partners, but we wanted them to serve their clients.
<b>Internationalization</b>	Network	Defiance	R1: That way, you can rely on a large amount of knowledge and experience, as well as economies of scale for automation purposes.
	Clients/ Services	Defiance	R1: This is really and advantage. It makes it much easier to approach larger companies.

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<b>Firm: H</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Defiance	R2: We want to make the base product as efficient as possible, to be able to spend more time advising.
	Training	Compromise	R2: We are giving summer courses to our consolidation department to change their mindset.
<b>(Advisory) Services</b>	Formal business development	Defiance	R1: There is a special department that focuses on developing new products.
	Range of services, specialist concept	Compromise	R1: We mainly deliver advice on financial processes. For other processes, we refer our clients to specific partners.
<b>Client acquisition</b>	Cold Acquisition	Acquiesce	R2: We stopped cold acquisition. Networking is much better as you need to have a trust relationship with the clients.
<b>Mentality professionals</b>	Work/life balance	Compromise	R3: I think we are exaggerating. There is too much emphasis on the I, not on the firm.
	Part time employment	Compromise	R2: There is a possibility for part-time employment.
	General mentality	Compromise	R1: We have provided our people with more freedom compared to some years ago, when everything was monitored.
<b>Automation of services</b>	Portals/ Online Service	Defiance	R3: Our portal is ready. The software just needs to be finalized.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Compromise	R2: We have someone, who used to be an accountant running the firm operationally. But that was not a criterion.
	Decision making/voting	Acquiesce	R1: The daily board prepares strategic plans and the partners vote on them.
<b>Performance pay system</b>	Division profits	Acquiesce	R1: We have stopped the discussion on a performance pay system. You need to work within boundaries; and if you fall below those you're out.
	Evaluation functionality	Compromise	R2: There are assessment criteria for partners, but secretaries who bring in new clients are also rewarded extra.
<b>Organizational</b>	(Merging) Number	Acquiesce	R3: We work with local heroes

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<b>structure</b>	of locations		that need to be in the local network, so local presence is necessary.
	Critical mass	Compromise	R1: We have moved people around to ensure the development of specialism. We want to grow both autonomously as well as through acquisition.
	Separation audit & advisory	Defiance	R1 Because of the regulations we have decided to make the audit practice a separate specialism, so our people had to choose.
	Service lines	Compromise	R1: We are working along matrix lines, which is quite difficult.
	Staff services	Defiance	R3: There are staff services.
<b>Internationalization</b>	Network	Compromise	R1: Our clients are starting to go international, so we have joined an international network to service them.

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<b>Firm: I</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R2: We try to change our people into full-fledged advisors in order to respond to the shift from compliance to advice.
	Training	Manipulate	R1: We have a master class in order to train our people to display entrepreneurial behavior.
<b>(Advisory) Services</b>	Formal business development	Manipulate	R1: In order to develop new products, we have started cooperating with a university, and they have developed some really nice products.  R2: We have an internal committee for product development, automation and people.
	Range of services, specialist concept	Compromise	R3: You need develop specialist knowledge in certain areas.
<b>Client acquisition</b>	Cold Acquisition	Defiance	R2: For the MKB you need to be multidisciplinary. R3: What we try to do is organize events with other parties like banks and discuss a particular subject.
<b>Mentality professionals</b>	Work/life balance	Defiance	R2: Work/life balance is really important and we try to facilitate this.
<b>Automation of services</b>	Part time employment	Compromise	R3: Yes it is possible, but not for management positions.
	Portals/ Online Service	Compromise	R2: We have portals just to send files to our clients such that they can verify them.
	XBRL	Compromise	R3: Currently, we are trying to work with XBRL to follow the trend.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R3: Well, I think it would only be possible if you separate the operational from the professional affairs.
	Decision making/voting	Compromise	R1: This getting more directive, but it would be exaggerating to say its directive.
<b>Performance pay system</b>	Division profits	Acquiesce	R3: No, there is equal profit sharing.
	Evaluation	Compromise	R3: These criteria are very

Appendix

<b>Organizational structure</b>	functionality		diverse: professional skills, acquisition, and teamwork.
	(Merging) Number of locations	Acquiesce	R1: Local presence is of real importance.
	Critical mass	Compromise	R2: We have been looking for other parties to expand in order to be able to ensure the quality of our specialized services, and to ensure the return on the quality system.
	Separation audit & advisory	Defiance	R3: Yes these are separate entities.
	Service lines	Defiance	R3: We are structured along the various service lines.
<b>Internationalization</b>	Staff services	Defiance	R2: We've grown in size, so we professionalized our HR. We have attracted someone to do this.
	Network	Compromise	R3: We have an international network for support purposes. We don't have the ambition to go international.

<b>Firm: J</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Defiance	R1: We have always invested in perfection in the annual statement. We should reduce this to deliver an 8, to be able to shift the attention to advisory...perhaps we can move our annual reports construction to Eastern Europe to reduce costs.
	Training	Acquiesce	R1: Training wasn't very successful. We actually stopped training sessions, because the group didn't want to go back.
<b>(Advisory) Services</b>	Formal business development	Defiance	R1: We have a product manager who develops new products.
	Range of services, specialist concept	Defiance	R1: We do not want all competences, but we have a network of firms that we refer our clients to.
<b>Client acquisition</b>	Cold Acquisition	Acquiesce	R1: We don't believe in client hunting.
<b>Mentality professionals</b>	Work/life balance	Compromise	R1: We adhere to the developments of the labor market in terms of work-life balance.
<b>Automation of services</b>	Portals/ Online Service	Defiance	R1: We have made huge investments in digital filings, as well as portals.
	XBRL	Defiance	R1: We have also invested in XBRL, I think it offers opportunities.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Manipulate	R1: Appointing a non-professional as manager really meant negotiating, and convincing, but now I have a mandate now to change things.
	Decision making/voting	Defiance	R1: It is quite directive. We have a 3-year strategic plan, which is being implemented.
<b>Performance pay system</b>	Division profits	Acquiesce	R1: We have an equal profit sharing system.
	Evaluation functionality	Compromise	R1: We decide on performance goals that have to do with productivity and the quality of your work.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R1: We want to be close to our clients with small offices. Large offices just move slowly.
	Critical mass	Manipulate	R1: Adding offices is done

Appendix

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	Staff services	Defiance	through acquisitions, mainly for additional services. R1: Recently, a non-accountant has been put in charge of staff services.
<b>Internationalization</b>	Network Clients/ Services	Acquiesce Acquiesce	No international network. Clients do not demand this.

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<b>Firm: K</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Acquiesce	R1: We have a great consolidation practice, but in time it will diminish, so we will need to ensure that the quality of our advisory services increases.
<b>(Advisory) Services</b>	Training	Acquiesce	R1: We offer external training and reforming into advisors.
	Formal business development	Compromise	R1: Product development is really important, but I feel we do too little and too ad hoc.
	Range of services, specialist concept	Compromise	R3: Well at some point in time we need to decide if we want to go full service. We have some specialization but we are not using it optimally.
<b>Client acquisition</b>	Cold Acquisition	Compromise	R1: Some offices do use cold calling, and others don't.
<b>Mentality professionals</b>	Work/life balance	Defiance	R1: Work-life balance has high priority for us.
	Part time employment	Compromise	R2: Part-time is definitely an option but not for management.
<b>Automation of services</b>	XBRL	Acquiesce	R2: Well, you see, it needs to be necessity before we start doing it.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Compromise	R1: We have someone for the operational part of the firm. He is a non-professional.
	Decision making/voting	Acquiesce	R1: There is a daily board that prepares the plans that are discussed in partner meetings.
<b>Performance pay system</b>	Division profits	Acquiesce	R2: No, we haven't thought of a differentiated profit system yet.
	Evaluation functionality	Acquiesce	R1: We have a really nice organization. We do not really judge people on their productivity or contribution, only if they do something extra.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R1: Local coverage is important with a minimum complement of 20 people.
	Critical mass	Compromise	R3: At this point, I think that our firm is too small to be able to invest in ICT and specializations.
	Separation audit & advisory	Acquiesce	R3: At some point this will probably be necessary, but not now.
<b>Internationalization</b>	Network	Acquiesce	They do not have an international network.

**Appendix B. Internal resistance in chapter 2**

<b>Firm: A</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor Mentality professionals</b>	Core business  General mentality	Defiance  Compromise	R1: Yes, we are trying to increase the number of advisory products. R2: In a traditional organization as this one, you come across a lot of criticism.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R1: A non-professional need to be very good to be accepted by a profession. I doubt we would accept a non-professional at a similar level.  R4: Well that is something I have been saying that for 15 years! The director of Avis also doesn't polish his own cars!
	Decision making/voting	Acquiesce	R1: I would be in favor of more directive decision making, but you need to know when you are directive, or when you need to convince.
<b>Organizational structure</b>	Service lines	Compromise	R1: Changing the structure to service lines of course led to discussion. It used to be arranged regional.
<b>Firm: B</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Automation of services</b>	XBRL	Defiance	R3: It is definitely a challenge. Some people see it as a threat, but, personally, I see it as a challenge.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R2: To be a good manager, I think you need to understand who the client is, how he reacts, and what the problems are. You need to have technical expertise to be able to do this.

<b>Firm: C</b>			
		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R2: Turning people to account managers is not easy. In fact, a lot of people are saying that they don't feel at home here because of this change.
<b>Mentality professionals</b>	Work/life balance	Compromise	R2: Well you do see that some managers find it difficult that they don't see their people from 9 to 5. It requires some getting used to.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Decision making/voting	Acquiesce	R2: There is centralized strategizing, however, you have local prerogative to adapt.
<b>Firm: D</b>			
		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R1: Accountants and tax advisors are risk averse. They don't like change.  R3: I think it just stays the same for 95%. We do audits, and try to sell some advisory services.
<b>(Advisory) Services</b>	Formal business development	Defiance	R3: I have let people go that didn't want to engage in business development or innovation.
<b>Client acquisition</b>	Cold Acquisition	Defiance	R2: We conducted an internal marketing campaign to get people enthusiastic about engaging in client acquisition.
<b>Automation of services</b>	XBRL	Acquiesce	R3: Unfortunately, things need to hurt first, before we start acting. Same thing with XBRL, we discussed it but decided not to invest in it yet.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R3: I'm not sure if it would be accepted. Professionals are highly educated, and you need someone with clients and knowledge of the market to lead.
<b>Organizational structure</b>	(Merging) Number of locations	Acquiesce	R2: Well, I think that's only human. Each partner tries to defend his little island.
<b>Internationalization</b>	Network	Manipulate	R1: We are part of an international firm, but not everyone is happy with that. For example, they don't appreciate mandatory structures.

Appendix

<b>Firm: E</b>			
<b>ROLE OF THE ACCOUNTANT</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>Accountant to Advisor</b>	Core business	Compromise	R1: There was a lot of resistance, but over time it has reduced. People are getting more enthusiastic and more entrepreneurial.
	Training	Compromise	R3: Very intense! It was a cultural chock, we requires a lot of money and training to get it going. We are still working on it.
<b>Mentality professionals</b>	Work/life balance	Compromise	R3: There are developments there, to which we need to get accustomed to. They want to work part time, we try to adjust to these demands.
<b>ORGANIZATION</b>			
<b>Performance pay system</b>	Division profits	Acquiesce	R1: The partnership is not really enthusiastic about a differentiated partner reward system.
<b>Firm: F</b>			
<b>ROLE OF THE ACCOUNTANT</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>Accountant to Advisor</b>	Core business	Manipulate	R3: The normal accountant does not have the communicative and commercial skills to fully comprehend what clients want. You need real relation managers for that.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R1: We think you need managers with both legs in the practice. Only then will your people follow you.

<b>Firm: G</b>			
<b>ROLE OF THE ACCOUNTANT</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>Accountant to Advisor</b>	Training	Compromise	R4: There are a lot of people here that are skeptical of all the changes, whether they are really necessary.
<b>Client acquisition</b>	Cold calling	Defiance	R2: Not everyone is suited for cold acquisition. You need to be a smooth talker.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R3: A non-professional as manager would not work with us. You need to really understand the business.
	Decision making/voting	Compromise	R4: Well, you cannot always say what you like, there is a clear difference between the older and younger partners.
<b>Performance pay system</b>	Division profits	Acquiesce	R1: The partnership is not really enthusiastic about a differentiated partner reward system.
<b>Internationalization</b>	Network	Defiance	R1: Well, joining an international firm meant no longer being the owner of your own office. How that would play out frightened people.
<b>Firm: H</b>			
<b>ROLE OF THE ACCOUNTANT</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>Accountant to Advisor</b>	Core business	Defiance	R3: There is a general resistance to change. These people have been doing the same thing for ten years, so they don't want to change. So, if you want to change you need to do it by force, on every level of the organization.
<b>Client acquisition Mentality professionals</b>	Cold Acquisition	Acquiesce	R3: Cold-calling is horrible.
	Work/life balance	Compromise	R3: I think we are exaggerating. There is too much emphasis on the I, not on the firm.
<b>ORGANIZATION</b>			
<b>Performance pay system</b>	Division of profits	Acquiesce	R1: We have stopped the discussion on a pay performance system.

<b>Firm: I</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Compromise	R2: Well, what you see is that a number of colleagues cannot make the transition, and they will probably leave or have little growth opportunities.
	Training	Manipulate	R1: You need to change the mindset of people towards being an advisor. They really fear the unknown.
<b>Client acquisition Mentality professionals</b>	Cold Acquisition	Defiance	R3: I'm not enchanted by this trend of cold calling.
	Work/life balance	Defiance	R3: Work-life balance is sometimes hard when you try to look for replacements. There are few that have the drive to fully pursue their career.
<b>ORGANIZATION</b>			
<b>Organizational governance</b>	Background management/board members	Acquiesce	R1: Putting a non-professional in charge? I don't see that happening anytime soon.
	Decision making/voting	Compromise	R3: People have their own little islands and you cannot change their way of thinking overnight.
<b>Firm: J</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor</b>	Core business	Defiance	R1: Does every employee embrace our transformation? No. Does every partner? Yes, in principle.
	Training	Acquiesce	R1: Training wasn't very successful. We actually stopped training sessions, because the group didn't want to go back.
<b>Firm: K</b>		<b>STRATEGY</b>	<b>QUOTE</b>
<b>ROLE OF THE ACCOUNTANT</b>			
<b>Accountant to Advisor (Advisory) Services</b>	Core business	Acquiesce	R2: We are not very innovative. In fact, we are somewhat in the middle.
	Formal business development	Compromise	R1: Well people are slow to change, when the money keeps rolling in.
<b>Client acquisition</b>	Cold Acquisition	Compromise	R1: It's neither in people's education nor in their nature.
<b>Automation of services</b>	XBRL	Acquiesce	R2: Well, you see, it needs to be necessary before we start doing it.

## **Appendix C. Survey instrument used in chapter 3**

### **Human capital**

1. Our lawyers are highly skilled.
2. Our lawyers are widely considered the best in their practice area.
3. Our lawyers are creative and bright.
4. Our lawyers are experts in their particular area and function.
5. Our lawyers develop new ideas and knowledge.

### **Reputation**

Comparing this company to all other law firms

1. How well respected is this company?
2. How good of a value is this company perceived to provide for its price?
3. How strong is this company's reputation for consistent quality and service?
4. How strong is this company's brand name recognition in its service area?

### **Organizational governance**

1. In my firm all employees undergo formal periodic performance appraisals.
2. In my firm everyone is aware of the formal internal rules and regulations.
3. In my firm you can expect to receive an appropriate reward when you have significantly contributed to the attainment of financial or operational goals.
4. In order to assure that realistic personal and organizational goals are set, we regularly compare our goals with those of similar firms.
5. In my firm new employees receive adequate instructions concerning our goals, methods, and regulations.
6. In my firm a lot of time is invested in the development of procedures that ensure financial integrity.
7. In my firm the quality of the services we deliver is regularly compared with our self-set quality standards.

### **Strategic planning intensity**

1. We use tight budget goals.
2. Trends in performance are closely monitored.
3. We keep close watch on costs incurred in various practice areas.
4. We keep close watch on costs incurred by each lawyer.
5. We intensely monitor profits made by practice area.
6. In hindsight we check if the incurred costs match the budgeted costs for that service.
7. Planning is important for achieving efficiency.
8. Planning helps integrate practice areas through information exchange.
9. Information sharing is critical in delivering our services.
10. Planning helps us achieve coordination of goals and projects within our firm.
11. Planning helps us achieve coordination and organizational unity within our firm.
12. Planning's crucial role is facilitating information sharing.
13. We often adjust our goals to meet changes in the market.
14. In our planning we must deal with strategic issue turnover.
15. We really plan all the time rather than at regular intervals.
16. Specific, short-range goals are known to all partners in the firm.
17. We develop formal plans for potential services and markets.
18. We have a written business plan
19. We systematically search for new services, customers and investments.
20. Our planning deals with a broad range of strategic issues.

### **Organizational performance**

Over the last three years, my firm...

1. ...has used a very competitive hourly fee.
2. ...has had a competitive cost structure.
3. ...has had a low overhead percentage.
4. ...has been able to retain its largest clients.
5. ...has been able to retain most of its clients.
6. ...has been able to attract new clients.
7. ...has had a very efficient firm organization.
8. ...has had great success in achieving long-term organizational goals.

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## Appendix D. Survey instrument used in chapter 4

### Developmental work experience

In my firm, junior lawyers are quickly allowed...

1. to handle their own cases.
2. to have direct client contact.
3. to have a role in client matters.
4. to appear before a judge.

### Human capital development

In my firm...

1. the cases are very interesting. (original item)
2. the cases are very gratifying.
3. you are paid well.
4. the relations between lawyers are very good.
5. the relations between partners and staff/interns are very good. (original item)
6. the training and coaching are very poor. (reverse coded)
7. there is a great deal of financial transparency.
8. we often discuss the criteria involving potential promotion to partner. (original item)
9. realistic billable hour targets are set.
10. your capabilities as a lawyer are greatly stimulated.
11. as staff member or intern you receive ample feedback from partners. (original item)
12. we often hold jurisprudence meetings.
13. a great deal of attention is paid to the constant professional development of employees. (original item)
14. employees have, next to the legal patron, also access to personal coaches and mentors.
15. the teaching of courses at universities or other institutions is stimulated.
16. we regularly engage in peer consultations.
17. you are able to take courses for personal development regularly.
18. people find partaking in legal courses important.
19. people find taking management and skills courses important.

20. you can easily drop by a colleague's office for advice.

### **Social capital**

1. Our lawyers are skilled at collaborating with each other to diagnose and solve problems.
2. Our lawyers share information and learn from each other.
3. Our lawyers interact and exchange ideas with people from different areas of the company.
4. Our lawyers apply knowledge from one area of the company to problems and opportunities that arise in another.

### **Commitment**

1. Our lawyers feel as though their future is intimately linked to that of this organization.
2. Our lawyers would be happy to make personal sacrifices if it were important for the organizations' well being.
3. The bonds between this organization and its lawyers are weak. (reverse coded)
4. In general, lawyers are proud to work for this organization.
5. Our lawyers often go above and beyond the call of duty to ensure this organizations' wellbeing.
6. Our lawyers have little or no commitment to this organization. (reverse coded)
7. It is clear that our lawyers are fond of this organization.

### **Strategic planning intensity**

1. We use tight budget goals.
2. Trends in performance are closely monitored.
3. We keep close watch on costs incurred in various practice areas.
4. We keep close watch on costs incurred by each lawyer.
5. We intensely monitor profits made by practice areas.
6. In hindsight we check if the incurred costs match the budgeted costs for that service.
7. Planning is important for achieving efficiency.
8. Planning helps integrate practice areas through information exchange.

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9. Information sharing is critical in delivering our services.
  10. Planning helps us achieve coordination of goals and projects within our firm.
  11. Planning helps us achieve coordination and organizational unity within our firm.
  12. Planning's critical role is facilitating information sharing.
  13. We often adjust our goals to meet changes in the market.
  14. In our planning we must deal with strategic issue turnover.
  15. We really plan all the time rather than at regular intervals.
  16. Specific, short-range goals are known to all partners in the firm.
  17. We develop formal plans for potential services and markets.
  18. We have a written business plan. (new item)
  19. We systematically search for new services, customers and investments.
  20. Our planning deals with a broad range of strategic issues.

**Organizational governance**

1. In my firm employees have regular performance appraisals.
2. In my firm there is a great deal of informal information exchange in relation to the goals of the firm.
3. In my firm everyone is aware of the formal internal rules that indicate what is acceptable and unacceptable behavior.
4. In my firm it is considered normal to point out to coworkers that their behavior is inappropriate.
5. In my firm when you contribute significantly to achieving financial or operational goals, you receive a satisfactory reward.
6. In order to assure realistic personal and organizational goals we often benchmark our firm to comparable firms.
7. In my firm, new employees are adequately informed of its goals, ways of working and rules.
8. In my firm there is a great deal of attention for ensuring proper procedures guaranteeing financial integrity.
9. In my firm lawyers are quite aware of each other's cases, integrity and work ethos.
10. In my firm partners invest a great deal of time in supervising non-partners.
11. In my firm it is considered normal to call on coworkers to think along on work-related personal and functional issues.

12. In my firm the quality of our services that we deliver is regularly tested against our target quality.

**Performance**

Over the last three years, my firm...

9. ...has achieved high gross profits per partner.
10. ...has used a very competitive hourly fee.
11. ...has earned a high gross margin on its provided services.
12. ...has had a competitive cost structure.
13. ...has had a low overhead percentage.
14. ...has been able to attract the best interns.
15. ...has been able to attract the best junior lawyers.
16. ...has been able to attract the best senior lawyers.
17. ...has been able to maintain its good reputation on the labor market.
18. ...has been able to retain its largest clients.
19. ...has been able to retain most of its clients.
20. ...has been able to attract new clients.
21. ...has achieved a large growth in profits.
22. ...has achieved a large growth in staff.
23. ...has had a very efficient firm organization.
24. ...has had great success in achieving long-term organizational goals.

## **Appendix E Survey instrument used in chapter 5**

### **Strategic planning intensity**

1. We use tight budget goals.
2. Trends in performance are closely monitored.
3. We keep close watch on costs incurred in various practice areas.
4. We keep close watch on costs incurred by each lawyer.
5. We intensely monitor profits made by practice areas.
6. In hindsight we check if the incurred costs match the budgeted costs for that service.
7. Planning is important for achieving efficiency.
8. Planning helps integrate practice areas through information exchange.
9. Information sharing is critical in delivering our services.
10. Planning helps us achieve coordination of goals and projects within our firm.
11. Planning helps us achieve coordination and organizational unity within our firm.
12. Planning's critical role is facilitating information sharing.
13. We often adjust our goals to meet changes in the market.
14. In our planning we must deal with strategic issue turnover.
15. We really plan all the time rather than at regular intervals.
16. Specific, short-range goals are known to all partners in the firm.
17. We develop formal plans for potential services and markets.
18. We have a written business plan. (new item)
19. We systematically search for new services, customers and investments.
20. Our planning deals with a broad range of strategic issues.

### **Formal governance**

1. In my firm employees have regular performance appraisals.
2. In my firm everyone is aware of the formal internal rules that indicate what is acceptable and unacceptable behavior.
3. In my firm when you contribute significantly to achieving financial or operational goals, you receive a satisfactory reward.
4. In order to assure realistic personal and organizational goals we often benchmark our firm to comparable firms.

5. In my firm, new employees are adequately informed of its goals, ways of working and rules.
6. In my firm there is a great deal of attention for ensuring proper procedures guaranteeing financial integrity.
7. In my firm partners invest a great deal of time in supervising non-partners.
8. In my firm the quality of our services that we deliver is regularly tested against our target quality.

**Informal governance**

1. In my firm there is a great deal of informal information exchange in relation to the goals of the firm.
2. In my firm it is considered normal to point out to coworkers that their behavior is inappropriate.
3. In my firm lawyers are quite aware of each other's cases, integrity and work ethos.
4. In my firm it is considered normal to call on coworkers to think along on work-related personal and functional issues.

**Performance**

Over the last three years, my firm...

1. ...has achieved high gross profits per partner.
2. ...has used a very competitive hourly fee.
3. ...has earned a high gross margin on its provided services.
4. ...has had a competitive cost structure.
5. ...has had a low overhead percentage.
6. ...has been able to attract the best interns.
7. ...has been able to attract the best junior lawyers.
8. ...has been able to attract the best senior lawyers.
9. ...has been able to maintain its good reputation on the labor market.
10. ...has been able to retain its largest clients.
11. ...has been able to retain most of its clients.
12. ...has been able to attract new clients.
13. ...has achieved a large growth in profits.
14. ...has achieved a large growth in staff.
15. ...has had a very efficient firm organization.

16. has had great success in achieving long-term organizational goals.

### **Reputation**

Comparing this company to all other law firms

1. How well respected is this company?
2. How good of a value is this company perceived to provide for its price?
3. How strong is this company's reputation for consistent quality and service?
4. How strong is this company's brand name recognition in its service area?

### **Misconduct**

How often do the following practices occur in your firm?

1. Charging the client more hours than the actual hours used.
2. Charging senior fees while junior conduct the work.
3. Employees break the formal rules of the organization.
4. Employees break the informal rules of the organization.
5. Employees break the behavior norms set for by the Dutch Bar Association.
6. Employees break the informal rules that exist in the legal profession.

**Appendix F. Additional performance, reputation and misconduct configurations found in chapter 5**

	High performance	
	International Generalist	International firm
	1a	1b
<b>Structure</b>		
High Diversification	●	
Large Size	●	⊗
International	●	●
<b>Practices</b>		
Strategy formation	●●	●●
Formal Governance	●	●
Directive Decision making	⊗	⊗
Informal Governance		●
Consistency	.84	.89
Raw coverage	.06	.08
Unique coverage	.00	.02
Overall solution coverage	.46	
Overall solution consistency	.78	

	Low reputation			
	International Managed Generalist	Unmanaged firm 1	Unmanaged firm 2	Misfit 2
	1	2	3	4
<b>Structure</b>				
High Diversification	●	⊗	⊗	●
Large Size		⊗	⊗	⊗
International	●	⊗	⊗	⊗
<b>Practices</b>				
Strategy formation	●	⊗	⊗	
Formal Governance	●	⊗		⊗
Directive Decision making	⊗		⊗	⊗
Informal Governance	●	⊗	⊗	
Consistency	.90	.82	.85	.83
Raw coverage	.09	.15	.10	.23
Unique coverage	.00	.01	.02	.01
Overall solution coverage	.48			
Overall solution consistency	.75			

	High Misconduct	
	Merged, directionless firm 1	International Generalist 2
<b>Structure</b>		
High Diversification	●	●
Large Size	●●	●●
International	⊗	●
<b>Practices</b>		
Strategy formation	●	●
Formal Governance	●	●
Directive Decision making	⊗	⊗
Informal Governance	⊗	
Consistency	.83	.79
Raw coverage	.23	.07
Unique coverage	.01	.02
Overall solution coverage	.21	
Overall solution consistency	.84	



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## Executive summary

Over the last decade there has been a substantial increasing interest in Professional Service Firms (PSFs), whereas research until the 1990s was mostly focused on the status and position of professionals in organizational collectives and society. This lack of attention is surprising given that PSFs form an integral part of the contemporary knowledge-based economy. PSFs are among the most affluent business enterprises, can be considered knowledge engines and have a public professional objective by serving vulnerable client and third party interests.

In this dissertation I focus on two canonical industries of PSFs: the law and accounting industries. Although PSF research lacks a precise definition it has been identified as a distinctive organizational form facing specific challenges, which derive from the nature of the services it delivers, its distinctive resource dependencies, and the highly institutionalized environment in which it operates. In order to deal with these challenges, PSFs organize themselves along the lines of two organizational configurations. The P<sup>2</sup>-configuration comprises an organizational form in its own right, to be distinguished from other forms of enterprise organization by features like its limited size, weakly developed strategic capabilities, and consensus-oriented decision-making. Although the P<sup>2</sup> has historically been the dominant form of enterprise organization in classic professions such as law and accounting, changes in economic and social trends, government policies, and client preferences have led to the spread of a commercial ethos in the professions, which challenges traditional P<sup>2</sup>-organizational practices. Many PSFs are now adopting face-changing strategies and practices, and are moving in the direction of a new organizational template coined the 'Managed Professional Business'. In comparison to the P<sup>2</sup>-configuration, MPB-organized firms complement their existing P<sup>2</sup> practices with "more formal strategic planning, controls over quality of work and productivity of staff, greater emphasis on coordinated marketing activities and more elaborate and centralized financial systems" (Morris & Pinnington, 1998: 76) in order to avoid strategic drift.

This shift from the professional logic to the commercial logic is the point of departure for this dissertation and forms the basis of my overarching question: what are the effects of the changing logic from professionalism to commercialism on PSFs? This question is addressed through a number of sub-questions. First, how do PSFs perceive the current institutional change and what are their organizational responses

to the resulting clash of the professional with the commercial logic? Although mid-tier firms are similarly confronted with conflicting demands of the trustee and commercial logic, the structures and procedures resulting from this clash are different as compared to those documented with the big 4. The mid-tier firms pick and choose between components of strategic and structural organizational responses. These differences are due to the continued influence of the professional logic, which makes both partner and non-partnered accountants unwilling to compromise their professional norms. Resistance to change within these firms thus results in differing organizational responses. The diffusion process of the commercial logic in the field segment populated by mid-tier firms therefore looks more like a process of institutional bricolage. While significant environmental jolts are hypothesized in prior literature to result in revolutionary transformations of organizations rather than their evolutionary development this is not what we observe in my group of mid-tier firms. My findings call into question whether the entire accounting profession has changed from the trustee to the commercial logic. Apparently the generalizability of findings from prior literature within the classical industries is limited.

Second, although prior literature has documented the introduction of novel-to-context strategic and governance practices alongside the traditional drivers of PSF performance, their actual implications are as of yet unknown. Therefore my related research question is: what are the performance effects of the novel organizational practices as compared to the original drivers of PSF performance? My findings suggest that size and diversification indeed positively influence governance and strategizing. In turn governance, strategy formation, human capital and reputation, all have a positive impact on PSF performance. Through my findings I contribute to the literature on PSFs in three ways. My study is the first to empirically assess the effects of novel-to-context organizational practices, and I find evidence that the positive effects of formal governance and strategic planning outweigh their negative performance implications. Second, prior work aimed at identifying the drivers of PSF performance has largely tested their effects in isolation, as most existing studies scrutinize only a single or maximally two performance drivers. Third, several scholars have recently made a case for a special theory of the PSF. My results suggest that contingency elements should be built into the design of the nascent theory of the PSF.

Third, the professional or so-called "social trustee definition of professionalism subordinates self-interest and commercial gain in favor of ideals of service and public welfare" (Greenwood, 2007: 191). When these ideals of service and

public welfare are subordinated in favor of commercial gain and self-interest this could be quite detrimental for professional behavior. As novel practices in the MPB-configuration are developed to that aim, the question becomes: what are the effects of both novel organizational and traditional PSF practices on professional misconduct? After conceptualizing agency problems in PSFs my findings suggest that the type of long-established informal practices that feature predominantly in PSFs of the P<sup>2</sup>-type are better attuned to the specific governance challenges of PSFs than the more formal practices characterizing MPB-like PSFs. Presumably, this is because these informal practices are better suited to deal with hard to observe and difficult to monitor professional behaviors than more formal organizational practices. While the latter seem better attuned to monitoring economic performance, and have often been specifically adopted for that purpose, they also appear to 'crowd out' traditional professional values from PSFs.

In the final chapter I combine the novel-to-context and traditional practices by analyzing configurations of PSFs. Using set-theoretic methods, I analyze what the effects of specific combinations of practices within PSFs are on substantive and symbolic performance as well as on professional misconduct. An interesting question with regard to this chapter is: are there configurations of organizational practices that allow for optimizing all three objective functions of PSFs? My empirical results show that it is absolutely critical to assess the private and public objective functions of PSFs simultaneously when examining the effectiveness and desirability of any PSF configuration in particular. For example, the MPB configuration offers an organizational design that does well in terms of the private objective function by ensuring high substantive and symbolic performance, but it does so at the cost of poor outcomes on the public objective function: the MPB scores very high in terms of the level of organizational misconduct it produces. The absence of strong informal governance through which professionals can collegially correct one another's misdeeds, and which is one of the hallmarks of the original P<sup>2</sup>-configuration, is the key ingredient that is missing in these firms.



## Summary (Dutch)

Gedurende het laatste decennium is de interesse in Professional Service Firms (PSFs) sterk toegenomen. Onderzoek tot omstreeks 1990 was grotendeels gericht op de status en positie van professionals in hun professie en in relatie tot de maatschappij. Dit gebrek aan academische aandacht is opmerkelijk gezien het integrale belang van deze groep ondernemingen in de hedendaagse kennisintensieve economie. PSFs behoren tot de meest welvarende ondernemingen, kunnen worden gezien als kennisontwikkelaars en hebben een publieke functie als vertegenwoordigers van hun cliënten en derde partijen.

In dit proefschrift richt ik me op twee klassieke PSF industrieën: advocatuur en accountancy. Hoewel er geen precieze definitie bestaat van de PSF, is deze recentelijk geïdentificeerd als unieke organisatievorm met zijn eigen uitdagingen welke voortkomen uit het type service dat PSFs leveren, hun afhankelijkheid van professionals en de zeer geïnstitutionaliseerde omgeving waarin ze opereren. Om het hoofd te kunnen bieden aan deze uitdagingen organiseren PSFs zich langs de blauwdruk van twee organisatieconfiguraties. De P<sup>2</sup>-configuratie is een organisatievorm sui generis vanwege zijn beperkte omvang, zwak ontwikkelde strategische capaciteiten en op consensus gerichte besluitvorming. Hoewel de P<sup>2</sup> van oudsher de dominante organisatievorm is bij klassieke professies zoals de advocatuur en accountancy, hebben economische en sociale ontwikkelingen, overheidsbeleid en klantvoorkeuren geleid tot de ontwikkeling en verspreiding van een meer commercieel ethos in de vrije beroepen. Veel PSFs voeren nu vergaande strategische en procesgerichte veranderingen door, en ontwikkelen zich door in de richting van een nieuw organisatiesjabloon dat de 'Managed Professional Business' wordt genoemd. In vergelijking met de P<sup>2</sup>-configuratie, vullen MPB-georganiseerde bedrijven hun bestaande P<sup>2</sup> praktijken aan "met meer formele strategische planning, meer controle op de kwaliteit van het werk en de productiviteit van het personeel, meer nadruk op gecoördineerde marketing activiteiten en meer uitgebreide en gecentraliseerde financiële systemen" (Morris & Pinnington, 1998: 76) om onsamenhangende strategisch keuzes te voorkomen.

Deze verschuiving van de professionele logica naar de commerciële logica is het uitgangspunt van dit proefschrift en vormt de basis van mijn leidende vraag: Wat zijn de effecten van de veranderende logica van professionaliteit naar commercialiteit

voor PSFs? Om deze vraag te kunnen beantwoorden zijn een aantal deelvragen geformuleerd. Ten eerste: Hoe percipiëren PSFs de veranderingen in hun institutionele omgeving en wat zijn de resulterende organisatieveranderingen? Hoewel de middelgrote bedrijven eveneens geconfronteerd worden met de tegenstrijdige eisen van de trustee logica en de commerciële logica zijn hun reacties hierop in termen van structuur en praktijken anders dan de veranderingen gedocumenteerd bij de 'grote 4'. De middelgrote organisaties kiezen uit een palet van strategisch en structurele reacties. De verschillen tussen de reacties zijn het gevolg van de aanhoudende invloed van de professionele logica, die ervoor zorgt dat zowel partners en niet-partners, weigeren hun professionele waarden te compromitteren. Weerstand tegen verandering binnen deze bedrijven resulteert dus in verschillende organisatorische reacties. Het diffusieproces van organisatiepraktijken vanuit de commerciële logica in middelgrote accountantsbedrijven lijkt dientengevolge sterk op institutionele bricolage, een proces waarin organisaties hun reacties samenstellen uit elementen van meerdere logica's. Hoewel volgens de literatuur, grote schokken in de omgeving van bedrijven zouden moeten leiden tot revolutionaire transformaties van organisaties, is dit niet wat ik waarneem binnen deze groep organisaties. Mijn bevindingen laten zien dat de verandering van de trustee naar de commerciële logica niet aanwezig is voor de gehele accountancy industrie. Klaarblijkelijk ontbreekt het aan generaliseerbaarheid van eerdere bevindingen binnen deze klassieke industrie.

Ten tweede, hoewel literatuur de introductie van strategievormings- en governancepraktijken documenteert, in aanvulling op de traditionele praktijken, is de invloed van deze praktijken op de economische prestatie van PSFs vooralsnog onduidelijk. Mijn gerelateerde onderzoeksvraag is: Wat zijn de effecten van de nieuwe organisatiepraktijken in vergelijking met de traditionele praktijken op PSF prestaties? Mijn bevindingen laten zien dat omvang en meer diversificatie in positieve relatie staan tot formele governance en strategievorming en dat dit, net als de kwaliteit van de professionals en reputatie van het kantoor, leidt tot verbeterde prestaties van PSFs. Met deze bevindingen draag ik als volgt bij aan de literatuur. Als eerste laat ik de positieve effecten van de nieuwe organisatiepraktijken in PSF zien. Ten tweede geven mijn uitkomsten inzicht in de grootte van de effecten van de nieuwe en traditionele praktijken, waarbij reputatie de grootste bijdrage levert aan PSF prestaties. Als laatste laten mijn uitkomsten zien dat, gezien de invloed van ondernemingsomvang en diversificatie, contingentie theoretische argumenten onmiskenbaar onderdeel zijn van de zich ontwikkelende theorie over PSFs.

Ten derde, de professionele of zogenaamde “sociale trustee definitie van professionalisme maakt eigenbelang en commerciële belangen ondergeschikt aan de idealen van dienstverlening en publiek welzijn” (Greenwood, 2007: 191). Wanneer deze idealen van dienstverlening en publiek welzijn ondergeschikt raken aan de commerciële doelen en eigenbelang kan dit zeer schadelijk zijn voor professioneel gedrag. Omdat aan nieuwe praktijken in the MPB-configuratie commerciële doelen ten grondslag liggen, wordt de vraag: Wat zijn de effecten van de nieuwe en traditionele praktijken op professioneel wangedrag? Nadat ik eerst de agency problemen van PSFs heb geconceptualiseerd, laten mijn uitkomsten zien dat de traditionele informele praktijken, veelal aanwezig in het klassieke P<sup>2</sup>-type, de governance uitdagingen die verband houden met dienstverlening en publieke belangen beter aankunnen dan de meer formele praktijken die de MPB karakteriseren. Vermoedelijk komt dit omdat deze informele praktijken geschikter zijn om professioneel gedrag te controleren dan de meer formele praktijken, welke vooral bedoeld zijn om economische prestaties te waarborgen.

In het laatste hoofdstuk combineer ik de nieuwe en traditionele organisatiepraktijken in een analyse van organisatieconfiguraties van PSFs. Met behulp van methoden gebaseerd op de verzamelingenleer, analyseer ik het effect van specifieke combinaties van de organisatiepraktijken op financiële en symbolische prestaties, alsook op professioneel wangedrag. Een interessante vraag die in dit hoofdstuk wordt gesteld is: Zijn er configuraties van organisatiepraktijken die ervoor zorgen dat alle drie de doelen kunnen worden geoptimaliseerd binnen PSFs? Mijn empirische resultaten laten zien dat het absoluut essentieel is om gelijktijdig de private en publieke doelfuncties van PSFs te analyseren bij het doorlichten van de effectiviteit en wenselijkheid van een bepaald PSF configuratie. De MPB-configuratie bijvoorbeeld, zorgt voor goede financiële en symbolische prestaties, maar zorgt gelijktijdig voor slechtere uitkomsten ten aanzien van de publieke doelstelling, aangezien professioneel wangedrag meer voorkomt in MPBs. De afwezigheid van een sterke informele governance, praktijken waarin professionals elkaar op collegiale wijze kunnen corrigeren, is een belangrijk ingrediënt dat ontbreekt bij deze ondernemingen. Deze traditionele praktijk is een van de kenmerken van de originele P<sup>2</sup>-configuratie, dat zijn waarde in het waarborgen van goede uitkomsten ten aanzien van de publieke doelstelling van PSFs heeft bewezen.



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## PROFITS OR PROFESSIONALISM? ON DESIGNING PROFESSIONAL SERVICE FIRMS

Research on professional service firms (PSFs) did not come off the ground until recently. This lack of attention is surprising, given their integral role in contemporary knowledge-based economies. In this dissertation, I focus on two professional industries: law and accounting. Historically, these industries were infused with a dominant professional logic, with its corresponding Professional Partnership configuration as dominant form of enterprise organization. However, changes in economic and social trends, government policies, and client preferences have led to the spread of a commercial ethos in the professions, with the corresponding configuration of the Managed Professional Business. This shift from the professional to the commercial logic is the point of departure for this dissertation. But what are the effects of this changing logic from professionalism to commercialism on PSFs? This dissertation shows, first, that the shift from professionalism to commercialism is not complete for all PSFs, as many professionals in mid-sized firms resist this new logic. Second, although in conflict with the logic of professionalism and the corresponding organizational practices, novel-to-context practices of strategy formation and formal governance do contribute to the performance of PSFs. Yet they do so at a cost, third, as they increase misconduct of lawyers which in Professional Partnerships were effectively remedied by collegial controls. Fourth, PSFs face a choice about the corporate objective function they pursue, as my final study suggests that combining professional and commercial logics in a single configuration is seemingly impossible.

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