

## IS PUBLIC OWNERSHIP BAD FOR PROFESSIONAL SERVICE FIRMS? AD AGENCY OWNERSHIP, PERFORMANCE, AND CREATIVITY

ANDREW VON NORDENFLYCHT  
Simon Fraser University

**Does public ownership create negative consequences for professional service firms by reducing employee incentives? This question was addressed with a panel of advertising agencies. Public ownership was associated with inferior performance for small agencies but not for large agencies, and there was no association between ownership and agency creativity, indicating that public ownership did not preclude agencies from competing with strategies requiring highly skilled professionals. The results challenge existing theories about the ownership of professional service firms.**

Scholars are increasingly looking to professional service firms for insights into how the growing importance of human capital in the economy will affect the organization of firms (Blair & Kochan, 2000; Rajan & Zingales, 2000; Teece, 2003) and as potential organizational models for knowledge-intensive firms more generally (Ghoshal & Bartlett, 1999; Greenwood, Li, Prakash, & Deephouse, 2005; Lowendahl, 2000; Teece, 2003). One of the key common assumptions about professional service firms is that they have traditionally been owned exclusively by the professionals inside the firms, with no outside shareholders. Scholars have often inferred that this ownership structure is particularly efficient for professional service firms, primarily because it provides high levels of incentives (in the form of either financial rewards or other preferences, such as prestige or collegiality) to the highly mobile, hard-to-monitor professionals who are the primary source of value in such firms (Dow & Putterman, 2000; Fama & Jensen, 1983; Greenwood & Empson, 2003; Greenwood et al., 2005; Jensen & Meckling, 1979; Roberts & Van den Steen, 2000).

And yet public corporations have emerged in several professional service industries (Greenwood & Empson, 2003), highlighted by high-profile initial public offerings over the last decade, such as the IPOs of the investment bank Goldman Sachs; the consultancies Accenture, KPMG, and LECC; the executive search firms Korn/Ferry and Heidrick & Struggles; and the hedge fund Fortress Investment Group. How should organization theorists interpret these publicly traded professional service firms that have abandoned an ownership model assumed to be optimal?

On the one hand, the aforementioned literature implies that allocating ownership exclusively to

professionals inside a firm (hereafter, “exclusive insider ownership”) contributes greatly to the ability to retain and motivate professionals, which is a critical task in the professional service firm environment (Lorsch & Tierney, 2002). Thus, going public, and thereby introducing outside owners, may be a mistake for such firms. Although the existing owners may get rich in cashing out, the firm will underperform relative to its privately held rivals. This argument seems consistent with conventional wisdom in these industries. For example, the reprivatizations of the once-public consultancies Booz Allen & Hamilton, Arthur D. Little, and LECC led one manager interviewed in 2003 to say, “I think by and large in the consulting industry you’d have to say that public ownership is a failure.” Similar cautionary anecdotes can be found in other professional services settings (e.g., Groyberg, Matthews, Nanda, & Salter, 1999; Millman, 1988: 65; Moskowitz, 1989).

On the other hand, if publicly traded professional service firms are not disadvantaged, then flaws may exist in scholarly theories about the efficiency of the traditional professional service firm ownership model. Addressing this issue is certainly relevant to managers of these firms, as well as to professional associations in law and public accounting, which are increasingly debating whether to repeal long-standing prohibitions against outside ownership (Makin, 2004). However, the issue is also very relevant to organizational theory, since if public professional service firms challenge conventional understanding of such companies, they thereby challenge broader theories of the firm built upon that understanding.

Knowledge of professional service firms is, however, long on anecdotes and short on rigorous empirical evidence. This is particularly true regarding