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Chapter outline

This study asks: how does governance change over time as a professional service firm (PSF) increases in size and complexity? Governance has long been a central theme in the literature on PSFs. Previous studies have presented dichotomized models of organizational archetypes and legal forms: professional partnership *versus* managed professional business, adhocracy *versus* professional bureaucracy, partnership *versus* corporation, private *versus* public corporation. The current study argues that this approach ignores the variety of governance forms within the PSF sector– in reality a PSF will adopt multiple forms of governance over time as it increases in scale and complexity. Adapting Greiner's classic model of the stages of organizational growth, this study presents a multi-stage model of governance in PSFs. The study highlights the crises and reversals that may occur during this process of evolution by presenting two cases: a small, young corporation and a long-established, large global partnership. The chapter concludes by analyzing the key conceptual differences between Greiner's generic model and this study's PSF-specific model and argues that these differences are associated with the distinctive nature of power dependencies within a PSF.

Introduction

As Reihlen and Werr (forthcoming) explain, the entrepreneurial inclinations of professionals potentially represent a significant challenge to the firms that employ them. Whilst professionals typically lack the risk-seeking propensities of entrepreneurs, they share certain important qualities: namely, their resistance to managerial control, their expectation of building their own business, and their ambitions for ownership (Abernethy & Stoelwinder, 1995; Covaleski, Dirsmith, Heian, & Samuel, 1998; Daicoff, 2004; Raelin, 1991; Shane & Eckhardt, 2003; Shane & Venkataraman, 2000). Professional service firms (PSFs) must therefore find ways of controlling and coordinating the entrepreneurialism of individual professionals to ensure that they serve the interests of the firm. The partnership form of governance represents a potential means of achieving this.

In partnerships, professionals themselves are owners of the firm and share unlimited personal liability for the actions of the firm. They are traditionally characterized by collegial clan control and informal methods of mutual monitoring and adjustment (Adler, Kwon, & Heckscher, 2008; Covaleski *et al.*, 1998). However, as professional service firms increase in size and complexity over time, professionals tend to delegate authority to an elected management group who start to introduce more explicit management systems and structures to control their activities (Cooper, Hinings, Greenwood, & Brown, 1996). The innate entrepreneurial qualities of the individual professionals risk becoming subordinated to ‘corporate’-style systems and structures which serve to strengthen managerial hierarchies and centralize control (Empson, 2007).

Numerous studies of PSF governance distinguish between professional service firms which perpetuate informal collegial clan control with those which adopt more explicitly 'corporate' governance systems and structures. The distinction is typically posed in stark terms: partnership *versus* corporation (Empson & Chapman, 2006; Empson, 2007), private *versus* public corporation (Von Nordenflycht, 2007), adhocracy *versus* professional bureaucracy (Mintzberg, 1983) or professional partnership *versus* managed professional business (Cooper *et al.*, 1996; Greenwood, Hinings, & Brown, 1990). The PSF governance literature, therefore, emphasizes dichotomized perspectives on governance which tend to ignore the complex variety of forms of governance prevalent within the professional service firm sector.

Historical and sociological studies of professional sectors, such as accounting (Hinings, Greenwood, & Cooper, 1999), architecture (Blau, 1987), investment banking (Augur, 2008), law (Galanter & Palay, 1993; Nelson, 1988), and management consulting (McKenna, 2010), present more detailed perspectives on the development of systems and structures of governance in specific professional service firms. However, while these studies may offer valuable narratives located in specific institutional and historical contexts, they are unable to present a more generalizable framework.

The current study asks, **how does governance change over time as a professional service firm increases in size and complexity?** More specifically, how can ownership and power be transferred from the firm's entrepreneurial founders to a more diffuse group of professionals? When ownership and authority are diffused amongst a large group of professionals, how does power become concentrated amongst a smaller group

of senior managers? **Ultimately, how does the balance of power shift around a professional service firm?**

The current study develops a multi-stage model of evolutionary and revolutionary change in PSF governance - adapting Greiner's classic but generic model of the stages of organizational growth (1972, 1998) to the distinctive context of professional service firms. It shows how, as a professional service firm increases in size and complexity over time, unresolved governance problems may precipitate organizational crises and that these crises may in turn lead to dramatic shifts in the balance of power within the firm. The current study goes further, to illustrate the complex and messy reality of the process of evolution in the governance of a professional service firm by presenting two cases: a small, young corporation and a long-established, large global partnership. These cases emphasize the crises and reversals that can occur during aborted attempts at governance change. The chapter concludes by analyzing the key conceptual differences between Greiner's generic model and the PSF-specific model and argues that these differences are associated with the distinctive nature of power dependencies within a professional service firm.

Alternative perspectives on governance

The concept of governance encompasses three core themes: *power*, *benefit*, and *accountability* (Mellon, 1995). In other words: who determines and controls the activities of the firm? For what purpose and for whose benefit does the firm act? and who is held accountable for the consequences of these actions? These three themes run

throughout the literature on PSF governance, though they are generally not addressed explicitly. Instead, PSF governance research has tended to focus on two main topics: the implications of the choice of legal form and distinctions between organizational archetypes.

Legal form

Partnership has generally been viewed as particularly well suited to organizing professionals and has long been the prevailing form of governance within the professional services sector (Fama & Jensen, 1983; Greenwood & Empson, 2003; Hinings, Brown, & Greenwood, 1991; Leibowitz & Tollison, 1980; Rajan & Zingales, 2000; Wilhelm & Downing, 2001). The unlimited liability partnership provides a legal context in which it is possible to reconcile the competing claims of three sets of stakeholders: *professionals* seeking to self actualize, *owners* seeking to maximize shareholder value, and *clients* seeking high quality service and value for money (Empson & Chapman, 2006; Empson, 2007). The competing demands of client satisfaction, professional self-actualization, and income maximization are aligned in partnerships by ensuring that the professionals are both co-producers and owners with unlimited personal liability for the actions of their colleagues. They, therefore, have a vested financial interest in ensuring high quality standards and imposing stringent performance expectations on themselves and their peers.

As many professional service firms have increased dramatically in scale and complexity in the past few decades, the traditional processes of collective decision-making and

informal methods of mutual monitoring among partners has proven impractical. When large professional partnerships adopt more seemingly 'corporate' methods of hierarchical and bureaucratic control, this raises questions about the value of retaining partnership as a legal form. Many partnerships have chosen to incorporate (Empson, 2007; Greenwood & Empson, 2003). In addition to the challenges of increasing size and complexity which affect the governance of all firms, Greenwood and Empson's (2003) study highlights five PSF-specific factors which have caused many professional service firms to incorporate: increasing heterogeneity, capital-intensity, commoditization, litigation, and the declining appeal of partnership. In certain sectors, where these factors prevail, there has been a wholesale flight from partnership.

A limited number of studies have begun to explore the implications of changing forms of PSF governance for issues such as strength of financial performance, quality of client service, and core principles of governance. Greenwood, Deephouse, and Li's (2007) study of consulting firms found that both private corporations and partnerships outperformed public corporations in terms of growth in revenue and staff numbers. In terms of quality of client service, VonNordenflycht's (2007) study of publicly-quoted and privately-held advertising agencies found no difference in measures of creativity. In terms of the core principles of governance, Empson and Chapman (2006) found that corporations can 'mimic' the partnership form of governance through deliberate management of their systems and structures.

These recent studies recognize the variety of ownership structures that exist within the professional service firm sector and have begun to explore the consequences of

contemporary developments in PSF governance. However, they are essentially static in their orientation. In other words, they study alternative legal forms but say nothing about how or why professional service firms move between legal forms.

Organizational archetypes

Studies of archetypes in the professional service firm sector have sought to identify alternative 'idealized' forms - and the systems, structures, and interpretive schemes through which they are manifested. Mintzberg's study (1983) does not refer to the concept of archetypes explicitly but, in identifying the Adhocracy and the Professional Bureaucracy, recognizes the distinction between those professional service firms that comprise relatively loose associations of autonomous professionals and those which adopt more conventionally hierarchical and explicitly managed 'corporate' systems and structures..

Greenwood *et al.* (1990) and Cooper *et al.* (1996) have developed the professional service firm archetype more explicitly with their concepts of the Professional Partnership, or 'P^{2}', and the Managerial Professional Business, or 'MPB' which focuses on two alternative interpretive schemes of governance and the different systems and structures through which they are expressed. Both of these studies are extensively cited by scholars of professional service firms (with a collective ISI Web of Knowledge citation count of more than 150 published articles). However, these concepts are very rarely operationalized and applied systematically to the analysis of empirical data.

Notable exceptions include studies by Reihlen, Albers, and Kewitz (2009), Richter, Dickmann, and Graubner (2008), and Pinnington and Morris (2002, 2003).

The majority of studies of professional service firm archetypes deploy the concepts of P^2 and MPB as an intellectual short-hand for distinguishing between the professionalized partnership and the more commercialized 'corporate' style of firm. This approach promulgates a somewhat simplistic distinction between two dichotomous types of professional service firms: i.e. the relatively small and informal firm *versus* the relatively large and bureaucratic firm. Other studies (Harlacher & Reihlen, 2010; Malhotra, Morris, & Hinings, 2006) examine a wider variety of archetypes in the professional service firm sector but even these studies do not explain systematically how a professional service firm moves between archetypes.

This limitation of professional service firm archetype studies is perhaps surprising as the core studies on which they are based (Greenwood & Hinings, 1988; Miller & Friesen, 1980) explicitly address the issue of transitions between archetypes. Miller and Friesen acknowledge the forces of inertia which surround organizational archetypes and argue that extreme changes or even crises in organizational conditions are required to bring about archetype change. Greenwood and Hinings (1988) go further to elaborate the concept of 'tracks' as a means of understanding the process by which organizations move between archetypes.

Greenwood and Hinings emphasize that 'non-linear tracks' or reversals are more common than the literature on change suggests and that 'aborted excursions' are

particularly likely when established power relationships are mobilized to protect the status quo. The concept of organizational tracks also emphasizes that organizations develop over time as they grow and that theories of organizational change need to recognize the significance of an organization's history for its process of development. Greenwood and Hinings argue that, in this way, the concept of tracks is consistent with lifecycle models of organizational development. This is further reflected in the work by Miller and Friesen who, having explored the concept of archetype change in their 1980 article, address the concept of organizational lifecyles more explicitly in their 1984 article.

Stages of organizational growth

Lifecycle models provide some useful insights into the question of how firms develop from their initial entrepreneurial start-up stage to become large and mature organizations. These studies identify a number of key stages in a firm's development and emphasize the periodic 'crises' which precipitate a move to the subsequent stage (see Hanks, Watson, Jansen, & Chandler, 1993, and McMahon, 1998, for a detailed summary). The specific stages identified vary according to the focus and scope of the study (e.g. industry sector, aspect of management practice etc.) but tend to place emphasis on the earliest 'entrepreneurial' stages of development.

While lifecycle models have been criticized on a number of counts[1], they nevertheless represent a useful analytical lens for developing a more nuanced understanding of governance in professional service firms. Greiner's model of the stages of organizational growth (1972, 1998) is the most widely cited of these models (with a current ISI Web of Knowledge citation count of almost 350 published articles)

Greiner's model is based on five key assertions (which are consistent with Greenwood and Hinings', 1988, concept of tracks):

- An organization will pass through several stages as it grows and matures.
- Organizational solutions which are appropriate at a certain stage in an organization's growth will cease to be appropriate as it grows and matures.
- Management may be slow to recognize the need for change until the underlying problems become acute.
- These problems may precipitate dramatic upheavals or 'crises'.
- At any stage, failure to deal with these issues may lead to the reversal or even death of the organization (the ultimate 'failure to mature').

Greiner asserts, therefore, that an organization passes through a specified series of stages of growth via alternating periods of evolution and revolution or, to use less dramatic language, an organization will experience periods of gradual development

[1] A recent review of the lifecycle literature identifies 33 distinct models, which share many fundamental premises but present variations on established typologies (Phelps, Adams, & Bessant, 2007). Two factors help explain the lack of convergence on a common model: the lack of specificity about the concept 'lifestage' (Aldrich, 1999; Hanks *et al.*, 1993) and the lack of empirical foundations to many of the studies (Drazin & Kazanjian, 1993; Levie & Hay, 1998; Miller & Friesen, 1982). Lifecycle models can also be criticized for blurring the distinction between description and prescription (Andersen, 2008). Whereas Greiner and Malernee (2005, p. 275) argue quite modestly that lifecycle models 'provide a roadmap (of) what lies ahead', Phelps *et al.*, 2007 suggest that all firms *should*, and indeed *must*, pass through the specific stages if they are to grow and mature.

punctuated by periods of dramatic change. Greiner, therefore, presents a ‘punctuated equilibrium’ model of organizational change (Gersick, 1991), consistent with the concept of tracks developed by Greenwood and Hinings (1988).

Greiner’s model was developed without reference to professional service firms. He acknowledged this limitation in the 1998 revision to his 1972 article by alluding to his ongoing research into law, consulting and investment firms and subsequently presented a model of the stages of growth in consulting firms which differed substantially from his original study (Greiner & Mallernee, 2005). Unfortunately, the stages identified by Greiner and Mallernee are primarily associated with the entrepreneurial start-up stage of growth and say little explicitly about governance. The study does, however, recognize the variety of different organizational structures, management styles, decision processes, systems and rewards which may be adopted as a consulting firm develops. Greiner and Mallernee, therefore, implicitly challenge the dichotomized perspectives on governance that prevail within the professional service firm literature.

Methods

In the current study, a multi-stage model of PSF governance was derived from in-depth case studies of multiple professional service firms: four management consulting firms, four law firms, three accounting firms, and two actuarial firms. These case studies formed part of three research projects funded by the Economic and Social Research Council of Great Britain, which the author conducted over a 15 year period. The firms studied ranged in size from 30 to 190 000 staff and £4 million to £15 billion fee income.

The youngest firm had been in existence for 10 years at the time when the research was conducted and the oldest 117 years.

As part of these studies, over 500 hours of interviews were conducted, alongside archival analysis and detailed observation of meetings. Since the studies were processural in nature and concerned with change, substantial amounts of historical and contextual data were gathered in the course of the interviews as interviewees offered narratives of organizational development going back over many decades. Published organizational histories of some of the firms were also studied. In the newer and younger firms, detailed data was available about the early stage of growth. In the larger and more mature firms, data about the later stages of growth was more plentiful.

In analyzing the historical accounts that organizational members presented, consistent narratives emerged. When applied to the basic structure of Greiner's framework, these narratives support Greiner's core assertion that organizations pass through a series of identifiable stages as they grow and mature. Given the similarity of the historical narratives presented in the 13 case studies, it has been possible to develop a multi-stage model of governance which is specific to the context of professional service firms. In the following section a conceptual overview of the model is presented. Given the limitations of space it is not possible to present detailed data for all the firms studied but in subsequent sections two detailed cases are presented which illustrate the complex and messy reality of 'aborted excursions' in governance change in professional service firms.

Greiner acknowledges the empirical limitations of his model in his revision to the 1972 article but argues that it represents 'a simple outline of the broad challenges facing management concerned with change' (1998: 65). The model presented in this current study shares some of the empirical limitations of Greiner's study but, by presenting 'a simple outline', the model provides a useful analytical device for exploring the question: **how does governance change over time as a professional service firm increases in size and complexity?**

A multi-stage model of governance in professional service firms

The model is presented in Figure I and described below. Illustrative quotes from five of the 13 case studies are presented in Table 1. The PSF-specific model focuses on the two key contingencies of age and size (as does Greiner's generic model). It identifies the various phases of governance that a professional service firm may pass through as it grows and matures and highlights the potential 'crises' or transition points. However, as Greenwood and Hinings (1988: 308) emphasize, 'change may be fitful and replete with oscillations and delays rather than an ordered and consistent revolution.' The conceptual model is, therefore, supplemented by two case studies: a small, young corporation ('BoutiqueCo') and a long-established, large global partnership ('MegaPartners'). The model below is therefore a conceptual framework which describes the broad pattern of development of PSF governance observed over the course of the research studies, while the detailed case studies illustrate two 'aborted excursions' (to use Greenwood and Hinings', 1988, terminology).

INSERT FIGURE 1

INSERT TABLE 1

Founder-focussed

In the early, **Founder-focussed** years, governance in a professional service firm is relatively simple. In the absence of external shareholders, *power*, *benefit* and *accountability* reside exclusively and unambiguously with the entrepreneurial founders. As is typical in a start-up operation (Mintzberg, 1983), management systems and structures are limited and informal. If the firm succeeds and grows, the founders will recruit more senior professional fee-earning staff to sell and manage the projects - the precise proportion of senior to junior staff hired will depend upon the model of leverage the founders are operating (Maister, 1982).

In time, these senior professionals will expect an increasing involvement in the firm's decision-making processes and share of the profits, reflecting their own entrepreneurial tendencies and desire for autonomy and ownership. However, the founders have made a considerable financial and personal investment in the firm and may be reluctant to surrender management authority or ownership – particularly if the senior professionals lack sufficient funds to pay an attractive price. The first governance 'crisis' arises if unenfranchised senior professionals start to resent their **Exclusion**.

The problems surrounding this crisis of governance are illustrated in detail later in this chapter through the case study of a **Founder-focussed** firm**, '**BoutiqueCo'. It demonstrates the consequence of the entrepreneurial founders' failure to deal effectively with their senior professionals' sense of **Exclusion** from the governance of the firm, in spite of their professed commitment to a **Collegial** style of governance.

Collegial

In order to move to the **Collegial** phase of development, founders must be willing to sell or transfer some of their equity to their senior professionals and to involve them in the decision-making processes within the firm. As long as the founders remain in the firm, they will retain informal influence, but gradually the power of the collective partner/director group will become more fully established. Decision-making will remain consensus-based amongst the expanded group of owners, typically focussed on a weekly meeting of all partners/directors. The management systems and structures may remain ill-defined and the fee-earning staff employed to administer these systems kept to a minimum.

If the firm continues to grow, the number of internal owners will increase and, along with this, the number of people who need to be consulted in order to establish a consensus. In time, the partners/directors may become concerned about the slow pace of decision-making and inadequacy of the management systems and structures as they become frustrated by their growing sense of **Disorganization**. They may respond by establishing **Committees**.

Committee

The **Committee** phase arises because partners/directors recognize that they can no longer be involved in all aspects of management but are not yet ready to relinquish management authority to a full-time manager. Their solution is to create a series of committees, on which they take turns to serve, to undertake hiring, promotion, budgeting, marketing, strategy and other core management tasks.

While these committees may initially resolve the problem of disorganization, new problems will arise if the firm continues to grow. Committees proliferate and increasing numbers of partners/directors gradually become involved in management. **Frustration** builds among professionals, as hoped-for efficiency gains fail to materialize and management activities consume increasing amounts of time to limited effect.

Up until this stage, the core themes of governance - *power*, *benefit*, and *accountability* - have remained essentially bound together, albeit embedded within an increasingly large partner/director group. The **Delegated** phase is the point at which this interweaving of *power*, *benefit*, and *accountability* are unpicked for the first time. A professional service firm can only progress to the **Delegated** phase if partners/directors are willing to relinquish management authority to one or more of their peers.

Delegated

In the **Delegated** phase, the partners/directors of the firm delegate a limited degree of power to one of two individuals (variously called a Senior Partner, Managing Partner, Chairman, Managing Director or CEO) on the understanding that they accept that benefit must still lie with the partner/director group. Power remains contingent, however, and inextricably bound up with accountability - partners/directors can rescind the delegation of authority at any stage, either through formal governance procedures or through a more informal collective 'loss of confidence' in the individual. In other words, this authority is *delegated from the partners/directors to specific individuals at a point in time* and is not evidence that they have accepted the principle of the separation of power, benefit, and accountability in more general terms.

In time the senior executives may become frustrated with the limitations on their power and may argue that the increased scale and complexity of the firm necessitates increased formalization of the management systems and structures and to enable them to take concerted action. If they attempt to exercise this authority without first convincing the majority of their partners/directors to cede further authority to them, the result may be a crisis of **Disconnection**.

The problems surrounding this crisis of governance are illustrated in detail in the case study of 'MegaPartners', presented later in this chapter. This demonstrates the consequence of the **Disconnection** crisis as senior management attempt to impose

Corporate' systems and structures on partners who are still strongly committed to a more traditional partnership-style approach to governance.

'Corporate', Federated, (or Dispersed)

If a substantial subgroup of partners/directors are unwilling to accept a move to a **Corporate** or **Federated** structure, then the firm may become **Dispersed**. Dissatisfied entrepreneurial individuals leave to set up their own firms and thus revert to the **Founder-focussed** phase of governance.

However, the firm can move on to the '**Corporate**' phase (regardless of whether it is actually a corporate or remains a partnership in legal form) if the partners/directors accept further delegation of authority to the management group. This leads to the establishment of more centralized systems and structures of governance. Alternatively, the partners/directors may prefer to adopt a **Federated** approach to governance (such as currently prevails within the Big 4 accounting firms global networks). A federated style recognizes that the firm has become too large and complex to manage as a single unified entity in its current form of governance but avoids moving into the '**Corporate**' phase by operating as a group of smaller relatively loosely connected units. Each of these units, therefore, can potentially revert to the **Collegial** phase. In time, however, as the Big 4 accounting firms are now doing, the partners/directors may recognize the limitations of the federal form and explore means of moving towards a more centrally controlled '**Corporate**' style of governance.

Crises and reversals

As with Greiner's model, the multi-stage governance model appears to suggest that each stage follows on sequentially from an appropriate and inevitable crisis. In reality the process of 'evolution and revolution' is more complex. Crises will arise from a failure to resolve underlying tensions in governance but will not lead inevitably to the next stage in the process.

In the following sections, case studies of two professional service firms are presented which highlight particularly problematic stages in the evolution of professional service firms: the awkward transition from **Founder-focussed** to **Collegial** and the associated crisis of **Exclusion,** and the problems that arise in attempting to move from **Delegated** to '**Corporate'** and the **Disconnection** crisis that ensues.

From Founder-focussed to Collegial: the Exclusion crisis, explores how the founders and employees of a small, young corporation (BoutiqueCo[2]) struggled unsuccessfully for several years to find a governance structure which reconciled the founders' desire to step back from the day-to-day management of the business (and to realize the value of their investment) with their employees' desire for a stake in the ownership and management of the firm. Whilst the founders appeared to be genuinely committed to resolving the professed issue of **Exclusion** and to replace the **Founder-focussed** style with a more **Collegial** style of governance, their actions repeatedly undermined their

[2] Names of the firms, individuals and certain titles have been changed to preserve anonymity. To further preserve the anonymity of the firms, the sectors in which they operate have been disguised. Their form of governance, however, which is the focus of the study, has been described in detail.

protestations. They were unwilling to hand over sufficient levels of responsibility or ownership to satisfy their employees and took decisions without consultation. This ultimately provoked a severe organizational crisis. Eventually the founders and employees concluded that an acquisition was the only way to resolve their intractable problem of governance.

From Delegated to 'Corporate': the Disconnection crisis, explores another aborted change in governance. In this case the senior management of a long-established large global partnership (MegaPartners) were thwarted by the partners in their attempts to introduce more **'Corporate'** governance systems and structures. Although the partners had **Delegated** authority to the management group, the senior management group became increasingly **Disconnected** from the partnership and a revolt by the partners led to the election of an 'anti-management' Managing Partner. The rhetoric of partner inclusion and the reversal of certain decisions helped to re-establish trust in management. Presented with a different business context and a different management rhetoric, the partners ultimately accepted that a more '**Corporate'** style of governance was an acceptable consequence of their desire for growth.

From Founder-focussed to Collegial: the Exclusion crisis

BoutiqueCo was established by three entrepreneurial individuals who had grown frustrated working within a global and relatively commoditized professional service firm. They left the firm in order to establish their own innovative practice. Their business concept proved successful and within three years the initial founders

(Margaret, Stephen, and David) had recruited a total of 27 staff on the back of rapid growth in client demand.

From the beginning, the founders acknowledged that they would want to realize their investment at some point. Recognizing this, they established the firm as a corporation rather than the partnership, because it would be easier to dispose of equity at a later stage. They also believed strongly in encouraging staff to have a sense of 'ownership' in the business, both literally in terms of shares, and figuratively in terms of a sense of involvement in decision-making. So, within five years of establishing BoutiqueCo, the founders had sold 10% of their shares to 10 of their staff (each founder retained a 30% stake). To facilitate a wider sense of involvement for all staff, both professional and support, regular office meetings were held at which all employees discussed key management issues and agreed decisions together with the founders. Support staff as well as professional staff participated in these meetings. In this way, the founders were attempting to mimic aspects of the **Collegial** phase, whilst nevertheless retaining control.

As the founders began to reduce their shareholdings, they also began to formalize staff involvement in the management of the business by creating a management structure which they termed the Executive. This body included five staff members and founder Margaret, who was CEO/Chair (see Table 2a for details of roles and membership). Founders Stephen and David had no formal role in the Executive, though David continued to be responsible for the firm's financial management.

INSERT TABLE 2 HERE

In time, members of the Executive became frustrated by the amount of time involved in these discussions and the lack of authority associated with their roles.

> The Executive was a sort of information-sharing shop. When it came to really key issues it was clear that the founders still made the decisions. (Executive Member)

Within two years the Executive was replaced by the Management Board (see Table 2b), where founder Margaret remained Chair and Chief Executive and Gareth (a highly experienced professional who had joined the firm two years previously) took over David's responsibility for Finance. Founders David and Stephen had no formal role in the governance structure but continued to wield considerable informal power. Whilst attempting to formalize a more **Collegial** form of governance, the reality remained resolutely **Founder-focussed.**

> Where the founders disagreed with the way that the management group were doing things, you could feel decision-making drifting back to them. They often used to meet in one of the upstairs rooms. Everyone knew they were talking about the business – the door was shut and decisions were being taken, even though the Board was supposed to be managing the business. (Board Member)

A small group of senior employees were particularly frustrated by the founders' power and wanted to be more involved in decision-making. They had joined BoutiqueCo relatively recently and had come from senior positions in competitor firms.

> These people were used to taking business decisions. They weren't soaked in our culture so they were quite destabilizing. (Founder - Stephen)

Their frustration was not simply about lack of involvement but also about lack of ownership. As discussed earlier, these individuals displayed many of the entrepreneurial characteristics associated with professionals. Whilst the founders had hoped to realize their investment over time through a management buy-out, they recognized that the success of the firm was making this difficult to achieve. As the fee income and profitability of the firm increased, the implicit value of the shares rose too high to be affordable for existing employees. The founders were not willing to sell their shares at a substantial discount. The firm was stuck in the **Founder-focussed** phase and unable to move to the **Collegial** phase.

The increasing size of the firm was creating pressure for governance change but the increasing value of the firm meant that the ownership and power of the founders remained entrenched. As the senior professionals became increasingly frustrated, a crisis of **Exclusion** loomed. This crisis became manifest when the founders were approached by a potential acquirer. Now grown to 40 employees, the firm was highly profitable and growing rapidly. The founders recognized it was an opportune time for

them to realize their investment. Nevertheless, initial reactions among the founders were mixed.

> The approach came at about the time we had come to recognize that we needed a Senior Partner of some kind. We had been concerned about how we could realize our asset. We could see a synergy between the two businesses and financially the number they talked about was really high. (Founder – Stephen)

> There was a good strategic argument for working with this company. We had already done some work with them. There was quite a lot of money on the table. We had always known we would sell one day. (Founder – David)

> I felt very sad about the bid because I felt that the dream had gone. We were going to become part of a big group. But I did feel excitement about the money too…I had never thought about selling the firm to a third party. I had assumed we would go for a management buy-out. (Founder – Margaret)

The founders negotiated in private with the bidder (and did not involve the Board in their discussions). They were concerned about unsettling staff until they had reached an agreement with the bidding firm and called a meeting of all staff to announce their decision.

> The atmosphere was electric. People were absolutely stunned. (Board Member)

> It was rather a shock. It was the first time we had been TOLD that something was going to happen rather than consulted. (Secretary)

> There was a sense of betrayal. I think people thought – 'Ha. They are just going to get a pile of money out of this. They have dumped us.' (Founder - Stephen)

Over the next nine months, three senior staff resigned, fee income plummeted, the acquiring firm withdrew its offer, and four staff were made redundant. At an offsite meeting the remaining staff gathered to consider the future of the company.

> It was an astonishing and emotional event. Feelings ran very high. People cried. People stormed out. A lot of stuff was processed that needed to be got through…but we recognized that the firm could no longer be founder-managed. (Associate)

> We had a really cathartic day. A lot of harsh things were said. The firm demanded to know if the founders' hearts were still in it…There was a huge sense of mourning but also a demand that the founders show some real emotional and physical commitment to rebuilding the firm. And the founders did display that emotional commitment, very visibly so. (Associate)

The Board was partially restructured (see Table 2c) and founders David and Stephen became a part of the formal management team once again. A series of steps were taken to introduce more rigorous systems for sales and cost management.

> Things were looking more healthy. We had much better procedures. Much more discipline…Within three months we had successfully turned the firm around. But where to next? (Board Member - Gareth)

There was strong pressure from the non-founders to change the governance structure. As the existing staff could not afford to buy-out the founders' shares at market value, the only available option was a sale. The move to the **Collegial** phase could not occur, in spite of the founders' rhetoric of inclusion, because the founders were not willing to sell at a discount.

> We stated clearly that we must break the parent-child relationship between the founders and the rest of the staff. We concluded that we had to break the capital structure and that this time the change would not be made *in camera* by the founders acting alone. (Board Member)

Founder Stephen was tasked with finding an appropriate candidate and Gareth was asked to take over from founder Margaret as CEO (see Table 2c). All founders remained on the Board.

Within 15 months BoutiqueCo was sold and ceased to exist as an independent entity. The 30 person firm was acquired by a privately owned corporation of 5300 staff which operated a strong and centralized management structure. Any attempt to develop a **Collegial** approach to governance was abandoned. In order to end the problematic

'parent/child relationship' between the founders and the employees, they concluded that they would have to accept a new parent for all of them. BoutiqueCo therefore failed to make the transition from the **Founder-focussed** to the **Collegial.** This was an 'aborted excursion', in Greenwood and Hinings' terminology. In Greiner's terminology, the ultimate consequence was organizational 'death'.

From Delegated to 'Corporate': the Disconnection crisis

The origins of MegaPartners go back over 100 years and, over time, the firm had developed a dominant position in its national market. Turning its attentions to the global market it went on to undertake a series of international mergers in rapid succession which caused the firm to double in size in the space of two years. At the start of the research study it employed approximately 5000 professional and administrative staff and was owned by 500 partners.

In the lead up to, and aftermath of, these mergers, MegaPartners' Management Committee introduced changes to the firm's governance structure and management systems. These changes included more formalized budgeting and reporting procedures and more globally standardized approaches to recruiting and business development. Taken individually, none of these changes was substantive. Looked at collectively, they represented a consolidated attempt to introduce centralized controls over a disparate global network of offices. The partners grew increasingly concerned.

> There was a perception that we'd become an incredibly bureaucratic organization - that virtually anything that we wanted to do had lots of pieces of paper attached to it - like if we wanted to develop our business plans there was a process of doing it within the practice area, and something had to be done within the product group, and something had to be done within an office, so you would get some poor guy in Spain who happened to be looking after several different product groups and practice areas, who now had to write something like 14 business plans. (Global Head of Business Development)

It was not just the partners in the international network of offices who resented the imposition of these controls. The partners in the original firm also cherished their autonomy and were not ready to accept a more systematized approach to management. Although the main office was relatively large, with over 250 partners, within this office the individual practices were still able to retain elements of the Collegial structure. As much as possible, the partners preferred to rely upon traditional methods of mutual monitoring and control, electing their own practice leaders, for example, as well as their Managing Partner and Senior Partner.

Although a vote of the full partnership was still required for all key management decisions (e.g. election to management roles, election of new partners and enforced departure of underperforming partners), the Managing Partner and Senior Partner began to assume increasing authority for the day-to-day management of the global firm. The Managing and Senior Partner were behaving as if the firm had moved into the **Delegated** phase of governance, although the partners had formally delegated only

limited authority to them. A substantial proportion of MegaPartners's partners began to perceive that the firm was becoming **'Corporate'**. This impression was reinforced by certain symbolic changes, such as the Managing Partner and Senior Partner's decision to change their titles to CEO and Chairman. Partners meanwhile perceived that the Management Committee was becoming more remote or **'Disconnected'** from the partnership.

> Management were struggling with a whole load of quite difficult issues post merger, and they became more and more closed-in on themselves…They took decisions themselves, didn't talk to other people. I think, to the average partner, that appeared very arrogant. (Management Committee Partner)

> I think we were just getting on with trying to mould the new firm but, in doing that, we sort of became more authoritarian automatically. The old partners really noticed the difference. I think there was probably a note of over-confidence as well. I think we thought we were really clever to have pulled off the mergers and were eager to do really well. (Management Committee Partner)

This was the context in which the CEO and Chairman approached the annual global partner retreat. The perceived attempt to move towards a '**Corporate**' style of governance was about to provoke a crisis of **Disconnection.**

The 500 partners gathered in a ballroom at the conference hotel. From the start of the event, partners objected to the overall design and format of the meeting, which they

deemed to be too highly structured and 'infantilizing'. They were asked to sit in small groups at round tables and given set periods of time to work together on allocated tasks before reporting back to the meeting. External facilitators were brought in to lead the discussion and partners were asked to record their thoughts on flip charts. While this approach is relatively common at corporate off-site meeting, it was a novel approach for the partners. As *owners* to the firm they expected *extensive* time to debate the topics that *they* deemed to be important.

The first task they were set was to consider the introduction of a partner appraisal programme, proposed by senior management. The Chairman and CEO believed that a standardized and transparent system would ensure fairness and consistency in the treatment of partners across the global network, and was preferable to the existing approach which relied upon informal discussions between partners and practice heads.

The reactions of the partner group to this initiative were intense.

> My table said: we think this is unacceptable, this is something that we should be rejecting straight away…The next table stood up and said the same thing. There was then I suppose about seven hours of discussions…There was genuine hostility in tone against the entire management…There was absolutely not a single partner who spoke in favour of any of the proposals that were out there. (Business Group Head)

Part of the second day of the conference had been set aside for the election of a new CEO. The current CEO's term of office was coming to an end and he had already publicly identified his preferred candidate (Michael). However, responding to strong encouragement from many partners, a second candidate put himself forward (Alistair).

> I think our CEO…just assumed that his nominee, Michael, would be elected. But there was so much anger built up by the partners…that there was a strong sense that someone else ought to stand. Alistair was very different from the style of our CEO…much more consensus-building, much more sort of charming if you like, and much less hard than them. (Partner)

> Alistair was obviously seen as an anti-management candidate, even though he was on the Management Committee, whereas Michael – because he was the preferred candidate by the CEO - was viewed as the management candidate and therefore had lost before he started. (Business Group Head)

Alistair gave a speech which, while light on specific details, contained the promise to 'give the partnership back to the partners'.

> It was a brilliant speech. In about 30 minutes Alistair touched every single point of insecurity among the partners and said basically – don't worry, everything is going to be all right. (Partnership Secretary)

At the partner conference Alistair was elected CEO by a substantial majority. As one member of staff explains it:

> We sort of rushed headlong down a corporate-style approach and then rushed headlong, or rather arse-end, away from it. (Business Group Head)

Over the next few years Alistair made concerted efforts to rebuild the sense of connection between partners and management. Shortly after his election, the titles of Managing Partner and Senior Partner were reintroduced to replace the titles of CEO and Chairman. He also went beyond such symbolic changes. In promising to 'give the partnership back to the partners', Alistair committed himself to an exhausting programme of dialogue with the global partnership group. His relentless international travel programme and willingness to listen to all partners' concerns helped to allay partners' fears across the global network and resolved the crisis of Disconnection. However, he found it difficult to translate this activity into effective action. In retreating from the '**Corporate**' style of governance, Alistair had relinquished any possibility of exercising **Delegated** authority and had, in effect, reverted to a more **Collegial** style of governance.

This collegial approach proved ineffective for a large global partnership. The partners became increasingly concerned as many merger-related issues remained unresolved and profitability declined steadily. Alistair responded by appointing a new COO, Lloyd, who had previously been a very successful leader of a core business area within the firm. Lloyd was well respected for his commercial skills but somewhat feared for his

confrontational personal style. Using the impending financial crisis as a means of leveraging his own authority, Lloyd introduced wide-ranging budget cuts and tougher management controls. Although authority was not formally **Delegated** to him by the partners, he nevertheless acted 'as if' it had been. In the absence of resistance from the partnership he was able to introduce relatively draconian controls that would have been unacceptable under the previous regime. The slide in profitability was reversed.

When Alistair did not put himself forward for re-election after a single four year term, only one candidate decided to stand – Lloyd. Promising tougher management and even higher profits, he was elected unopposed. A revised partner appraisal system was introduced shortly afterwards.

Over the next few years, in an attempt to drive internal efficiencies and improve profitability, many more changes to the governance systems and structures were introduced which the partners might previously have decried as '**Corporate**'. However, the titles of Managing Partner and Senior Partner were retained. The senior management were keen to demonstrate that they were not **Disconnected** from the partnership as a whole:

> I think partners demand trust from management and demand to be respected. They need management to be accountable. And so as long as management is trusted and has the respect of the partners, and partners feel that the management feels accountable to them, then I think actually partners would be able to cede a little bit more in terms of autonomy to management. (Business Group Head)

In retrospect some of the partners recognized that their concerns about the apparent 'corporatization' of the partnership were bound up with their more personal concerns about the previous management team who were trying to bring about the changes. Presented with a different rhetoric, at a different time, by a different management team, these moves towards a more '**Corporate**' style of governance were viewed as less threatening and to some extent an inevitable consequence of rapid and profitable growth.

Discussion and conclusions

As argued earlier, the existing literature on governance in professional service firms presents a variety of dichotomized models which, whether focusing on legal form or organizational archetype, ignore the more complex variety of forms of governance prevalent within the professional service firm sector. In reality a professional service firm may adopt multiple forms of governance over time. The study therefore asked: **how does governance change over time as a professional service firm increases in size and complexity?**

The study developed a multi-stage model of governance in professional service firms. It emphasized that this process of change is not necessarily sequential, linear, or inevitable, and that shifts in the balance of power can be reversed in response to 'crises' of governance. Two detailed case studies showed how unresolved governance problems

can precipitate organizational crises which may result in dramatic shifts in the power dependencies within the firm and reversals in the process of governance change.

The model is based on Greiner's classic but generic model of the stages of organizational growth. The model is descriptive rather than prescriptive, in that it presents a process *widely represented* in the firms researched as part of this study, rather than arguing that all firms *should* or indeed *must* pass through all stages in sequence. It instead represents an analytical device for dismantling the rigid dichotomies which are perpetuated within the PSF governance literature.

As explained earlier, the need for a PSF-specific multi-stage model of governance arises because the stages that Greiner identifies do not map easily onto the context of professional service firms. In addition, Greiner's approach encompasses certain assumptions which are not applicable or are specifically misleading in the context of professional service firms. The differences between Greiner's model and the PSF-specific model developed here arise from the distinctive nature of power dependencies in a professional service firm. It is worth exploring these differences in detail as they highlight the different ways in which the central questions of *power*, *benefit*, and *accountability* are answered in a professional service firm compared to the 'generic' organization which Greiner presents.

Greiner argues that the first key transition is between the **Creativity** and **Direction** phases. Following a crisis of **Leadership**, the original founders are replaced by a professional management group. At this point management and ownership become

separated within the firm and more comprehensive management systems and structures are introduced. *Power* and *accountability*, therefore, shift from the owners to the professional managers, though *benefit* continues to reside with the owners.

The reality in professional service firms is more complex. In the move from the **Founder-focussed** to the **Collegial** phase (following the crisis of **Exclusion**) *power*, *benefit*, and *accountability* remain densely interconnected and the preserve of fee-earning senior professionals active in the business. Before the professional service firm can start to experience the concentration of *power* that Greiner highlights, a professional service firm will pass through an additional stage, the **Committee** phase. During this phase management responsibilities, systems and structures become more explicit. However, *power*, *benefit*, and *accountability* remain contiguous and widely diffused among the fee-earners/owners/senior professionals.

The professional service firm develops a cadre of professional managers at a relatively advanced stage in its development (compared to Greiner's generic model). In a professional service firm a crisis of **Frustration** leads to the formal 'Delegation' of authority by the partners/directors to a small group of peers. When Greiner speaks of the **Delegation** phase, however, he is referring to something quite different – the stage at which management find that they are overloaded and must delegate responsibilities to middle management.

The term 'middle management' is not widely used within professional service firms, in part because the focus on flat hierarchies and project-based working gives rise to

relatively simple and informal organizational structures in comparison with a conventional corporation of equivalent size. Thus the same term, ‘delegation’, applies to two fundamentally different management issues in the two models because of the fundamentally different nature of power dependencies in professional service firm compared to the generic organization that Greiner describes.

In summary, therefore, the need for a PSF-specific multi-stage model of governance relates to the distinctive characteristics of professional work and the professionals who work within such firms. The individual professional (or rather the technical expertise, client relationships, and professional reputation associated with that individual) is essential to the delivery of a customized professional service. In order to deliver a customized professional service and retain their professional independence, professionals require, or at least expect, a degree of autonomy from managerial control. It is these distinctive power dependencies which ensure that power remains diffused throughout the organization and the central issues of *power*, *benefit* and *accountability* remain contiguous within the governance structure until an advanced stage in the professional service firm’s development.

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Figure 1:
A multi-stage model of governance in professional service firms

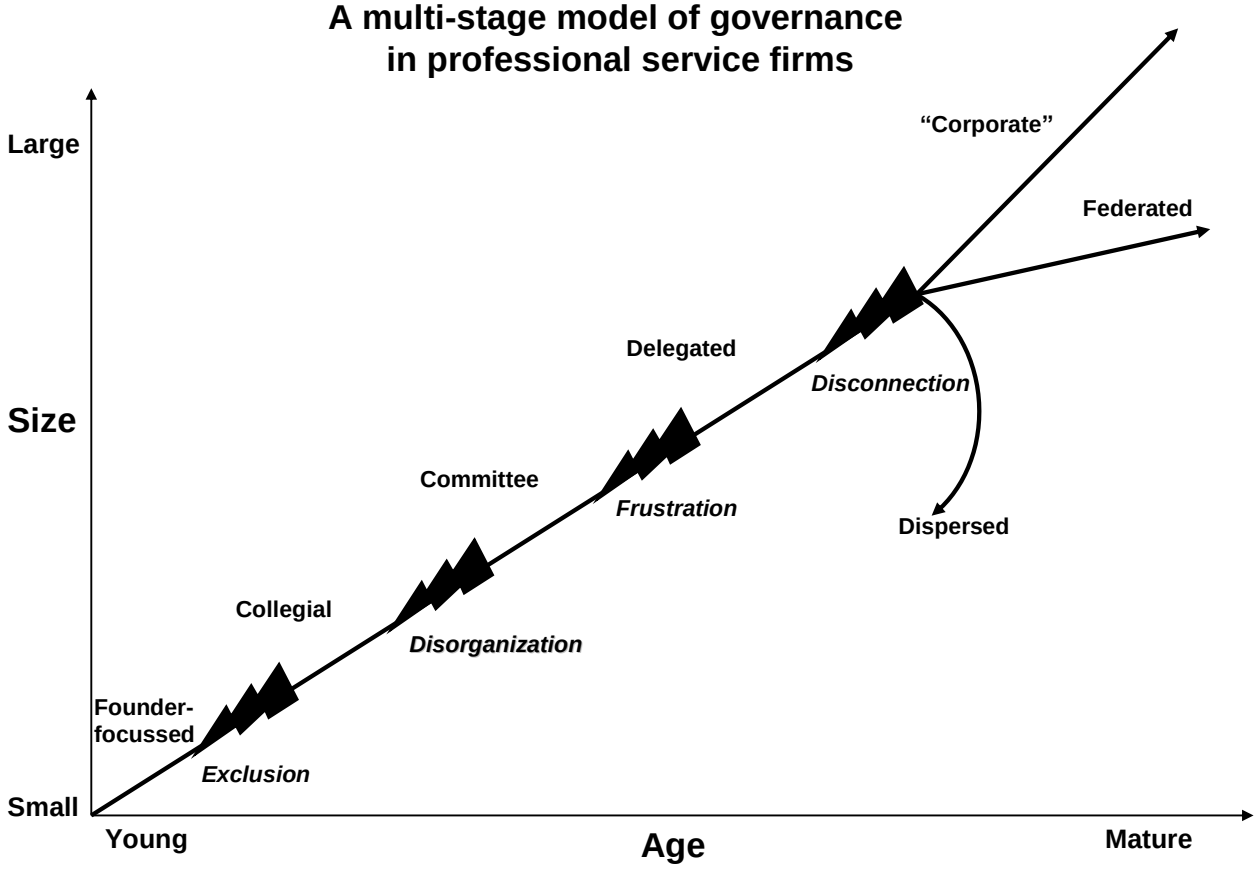

Table 1

Multiple Stages of Governance in Professional Service Firms

Illustrative Examples from Five of the Case Studies

Founder-focussed	**Classic**	**Committee**	**Delegated**	**'Corporate'**
Consulting firm (1) 'The ten senior vice presidents were the only guys who confronted Bob [the Founder] and got away with it … We were at a senior management conference. Bob handed out badges to us which said 'No whining' and told us to put them on. Then he said, 'I've sold the company'.' (Vice President)	*Consulting firm (2)* 'The partners had a huge amount of autonomy when it came to developing business. There was no attempt to control what they were doing. It was almost anarchic.' (Partner)	*Actuarial firm (1)* 'We had a Central Committee that appointed membership to all the other committees – the Operations Committee, the Finance Committee, the Marketing Committee etc.… The committees met monthly. There was no decision-making between meetings and decision-making was only by the consensus of those committees.' (Partner)	*Accounting firm (1)* 'As accountants we deal with the consequences of bad management in our clients. When we come across a colleague who really knows how to manage we are generally happy to let him get on with running our firm – though we do of course keep a careful eye on what he's up to.' (Partner)	*Accounting firm (2)* 'The decisions of the Managing Partner are absolute as long as he has the confidence of the partnership. As very few decisions are actually voted on it is very important for the Managing Partner to ensure that he keeps in tune with his colleagues.' (Partner)

Table 2: Evolution of Management Structure – BoutiqueCo

Table 2a – Year 5 – The Executive	
People	**Roles**
Margaret	Chief Executive (Chair)
Brian	People and Recruitment
Chris	Resource Management
Phil	Project Management
Gareth	Quality
Steve	Sales

Table 2b – Year 7 – The Board	
People	**Roles**
Margaret	Chief Executive (Chair)
Gareth	Finance
Ian	Project Management
Chris	Sales
Ronan	Marketing
Julian	People and Recruitment

Table 2c – Year 8 – The Board	
People	**Roles**
Margaret	Chief Executive (Chair)
Gareth	Finance
David	Board Member
Stephen	Board Member
Others	Roles Unchanged

Table 2d – Year 9 – The Board	
People	**Roles**
Gareth	Chief Executive
David	Finance Director
Eric	Marketing Director
Margaret	Consulting Services Director
Chris	Sales and Resourcing Director
Julian	Personnel Director
Stephen	Governance Director

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