
Professional as Agent and Co-Producer: Asymmetry and Mutuality in the Value Creation of Professional Service Firms.

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Structured Abstract

Purpose – This conceptual paper addresses the nature of value creation in professional service firms (PSFs). An extensive number of scholars have been looking at PSFs within law, consulting and engineering to understand knowledge as sources of competitive advantage. A dominant part of this literature build on agency theory to suggest that information asymmetry is an important characteristic and precondition of value creation in professional services. This paper identifies a contradiction in the notion of information asymmetry in reference to professional services firms.

Design/methodology/approach – The paper reviews theoretical contributions explaining the value creation processes in PSFs. While the context of professional services might be considered marginal in reference to agency theory, knowledge has been identified as one of the key sources of competitive advantage in the 21st century, and understanding how to develop and leverage such sources of advantage has gained extensive interest. In addition, the context of knowledge intensive and professional services has been referred to as extreme and strategically relevant to understand knowledge based value creation.

Originality/value – We argue that it is necessary to revisit the assumption of information asymmetry for two main reasons: First, any asymmetry that is proposed to exist is that of knowledge rather than information. Secondly, value creation in the context of PSFs is characterized by mutuality rather than asymmetry as co-production with clients as a core component in PSFs value creation. While PSFs might have superior esoteric professional knowledge, buyers often have superior knowledge of their own context and problem. Both of these types of knowledge are relevant in the value creation in PSFs due to the contextual and customized nature of the services they provide.

Practical implications – Two important contributions are suggested in the paper: First, the characteristics of value creation of PSFs should be revised and extended by the

inclusion of knowledge asymmetry and mutuality. This is important for practitioners in that the co-operative and mutual nature of value creation needs to be recognized and nurtured, which has impact of the conduct of both suppliers and buyers of professional services. Secondly, this more complex nature of value creation needs to be recognized from an institutional perspective in that the certification of professionals should incorporate and promote the mutuality and the importance of client needs while at the same time emphasising esoteric professional knowledge and attitude and the desire to deliver what is objectively best for the client.

Keywords – Information Asymmetry, Knowledge based value creation, Professional Service Firms, Co-production.

Paper type – Academic Research Paper

1 Introduction

This conceptual paper addresses the nature of value creation in professional service firms (PSFs). There is a growing interest in developing a better understanding of knowledge as a source of advantage, and an increasing number of scholars are looking at PSFs to understand the human capital and knowledge as source of advantage in firms (Donaldson, 2001; Greenwood, Li, Prakash, & Deephouse, 2005; Hitt, Bierman, Shimizu, & Kochhar, 2001; Løwendahl, 1997; Løwendahl, Revang, & Fosstenløyken, 2001; Teece, 2003; Von Nordenflycht, 2007). Moreover, Løwendahl, Revang, and Fosstenløyken (2001) suggest that when attempting to understand knowledge development and value creation, insight is more likely to result from a study of a strategically chosen extreme cases such as PSFs than from random selection among traditional firms (Starbuck, 1992). Consequently, through the study of PSFs we aim to develop a better understanding of knowledge based value creation in general.

In particular, this paper identifies a contradiction in extant descriptions concerning the value creation in PSFs by addressing the applicability and assumptions of agency theory in reference to professional services. A broad range of literature on knowledge intensive and professional services build on agency theory to suggest that information asymmetry is an important characteristic and precondition of value creation (Clark, 1993; Gallouj, 1997; Greenwood et al., 2005; Jaakkola & Halinen, 2006; Løwendahl, 1992, 1997; Mills & Moshavi, 1999; Semadeni, 2010; Sharma, 1997; Stabell & Fjeldstad, 1998). In these types of services, information asymmetry is used to illustrate a situation where the PSF has more knowledge in their area of expertise compared to the client (Holmstrom, 1985), also referred to as asymmetry of expertise (Von Nordenflycht, 2010). Thakor and Kumar

(2000) explain this asymmetry as a disequilibrium of expertise and experience between the professional and their customers. This notion of asymmetry of expertise and information asymmetry seems to be based on assumptions regarding the nature of value creation in PSFs as ‘transactional’, where the less competent client receives knowledge from the more competent provider. This ‘transactional’ perspective of value creation also seems to embed an assumption of knowledge as objective, applicable and transferable from PSFs to buyers.

At the same time, a number of scholars have emphasized professional service value creation as co-produced (Auh, Bell, McLeod, & Shih, 2007; Bettencourt, Ostrom, Brown, & Roundtree, 2002; Mills & Morris, 1986; Mills & Moshavi, 1999; Sharma, 1997) rather than ‘transactional’. In fact, due to the high level of customization, the demand for client-professional contact, and credence nature, professional services have been used as an extreme case and particularly relevant empirical setting for understanding customer participation and co-production in services in general (Chan, Yim, & Lam, 2010). By applying a service (Vargo & Lusch, 2004) and co-produced logic of value creation (Normann & Ramírez, 1993; Ramírez, 1999) transfer of de-contextualized information as a primary trait of value creation within professional services could easily be questioned. Thus, one might even question the applicability of the concept of information asymmetry. Based on the co-productive perspective and the need for changed assumptions and contextualization of value that this perspective demands, this paper addresses the following research questions: What role does information asymmetry play in the conceptualization of PSF value creation as co-produced? How can information asymmetry and co-production as characteristics of PSFs be linked to value creation and capture in these types of firms?

By building on insights from agency theory (Sharma, 1997) and by recognizing contextual and tacit elements of knowing (Nonaka, 1994; Polanyi, 1966; Tsoukas, 2003; Tsoukas & Vladimirou, 2001), this paper argues that the concept of knowledge asymmetry is a more accurate characteristic of value creation in professional services than information asymmetry. However, while the PSF might have superior esoteric professional knowledge, the buyer has an advantage in terms of knowledge of the context in which the problem is to be solved. Thus, we argue that value creation in PSFs is not only about the content knowledge – an area in which the professional is an expert. It is also about knowing the context of the problem – and in this area, the client is most often

the expert. Based on the co-productive perspective it is the combination of these two types of knowledge that enable value creation. Thus, the paper conceptually argues (1) that the essential asymmetry in professional services is that of knowledge rather than information and (2) that knowledge mutuality should be added as a key concept in defining the value creation logic of PSFs.

2 Agency theory to explain value creation in PSFs

Sharma (1997) has been extensively cited (i.e. Greenwood, Deephouse, & Li, 2007; Greenwood & Empson, 2003; Greenwood et al., 2005) as a source extending traditional agency theory on the client-professional exchange. While it might be admirable to attempt to develop ‘grand’ theories that can explain a wide range of phenomena within its field, different theories are likely to have applicability and explanatory power depending on the circumstances under which a phenomenon takes place. This is also true for agency theory (e.g. Fama & Meckling, 1976; Eisenhardt, 1989), which has been suggested to have very broad applicability (i.e. Nilakant & Rao, 1994). Sharma (1997) proposes that the use of agency theory to hired professionals is suitable, but that it has to be applied in an altered way than traditionally done.

Sharma (1997) points out that three key features of professional services are different than the manager-employee exchange: (a) power asymmetry following possession of expert knowledge, (b) lack of oversight due to opaque nature of services, and (c) co-production. Thus, the key main assumptions underlying agency theory needs to be revised to fit the professional-client exchange. First, the assumption of information as a commodity needs to be revised. In the case of professional-client relationships, the agency problem is not primarily related to division of labor and information asymmetry – but to asymmetry and division of knowledge (Sharma, 1997). This knowledge asymmetry is different from information asymmetry in the sense that the knowledge is not a commodity. Rather, the knowledge is asymmetric as it cannot be comprehended by a none-expert. Also, the knowledge asymmetry between professionals and clients concerns know-how and relates to the lack of knowledge of applied solutions, whereas the traditional information asymmetry concerns knowledge about what the agent is doing (ibid.).

In addition to the assumptions about the nature of knowledge as esoteric, Sharma also points to the relevance of altruism and social embeddedness in professions which also is

likely to limit opportunism. Thus, Sharma proposes that the application of traditional agency theory to professional-client relationships needs adjustment compared to mainstream agency theory. In Table 1, an overview of the key differences across the traditional owner-manager and principal-professional agency perspective can be found.

Dimension	Principal-professional	Owner-manager
Unit of analysis	<ul style="list-style-type: none"> • Exchange between lay client and professional agent 	<ul style="list-style-type: none"> • Contract between principal and agent
Information assumption	<ul style="list-style-type: none"> • Incomplete market for esoteric knowledge 	<ul style="list-style-type: none"> • Information as a purchasable commodity
Human assumptions	<ul style="list-style-type: none"> • Mixed motive (altruism and self-interest) • Social embeddedness 	<ul style="list-style-type: none"> • Self-interest
Organizational assumption	<ul style="list-style-type: none"> • Knowledge asymmetry • Coproduction of service involving both principal and professional 	<ul style="list-style-type: none"> • Information asymmetry • Agent delegated the task by passive owner principal
Key idea	<ul style="list-style-type: none"> • Principal-professional relationships should efficiently accommodate power asymmetry arising from knowledge gap in agent's favor 	<ul style="list-style-type: none"> • Principal-agent relationships should reflect efficient organization of information and risk-bearing costs.

Table 1: Comparison of owner-manager and principal-professional agent theory (adapted from Sharma (1997: 774))

Moreover, agency theory has to be adjusted to the reversed position of power across the principal and the agent resulting from the professional's expertise. In particular, asymmetry of expertise has been used to define what a professional and knowledge intensive service is (Von Nordenflycht, 2010). In particular, Sharma (1997) builds on agent theory while recognizing that co-production moderates the likelihood of opportunism resulting from asymmetry of expertise.

Hence, Sharma (1997) also explains how PSF value creation is characterized by co-production. The simultaneous characteristics of information asymmetries and mutual co-production can be viewed as contradictory, and its compatibility and relevance to the nature of value creation in knowledge intensive services has to a limited degree been addressed. A number of scholars have emphasized professional service value creation as co-produced (Auh et al., 2007; Bettencourt et al., 2002; Mills & Morris, 1986; Mills & Moshavi, 1999; Sharma, 1997), and many authors studying professional services refer to both information asymmetry and co-production as traits of professional services

(Løwendahl, 1997, 2005; Mills & Moshavi, 1999; Sharma, 1997; Skaggs & Youndt, 2004).

However, these authors arrive at this characterization by reviewing a large body of literature without questioning conflicts in underlying assumptions and compatibility. The increasing relevance of co-production (Ramirez, 1999; Vargo & Lusch, 2004) suggests that understanding this form of value creation is essential. Due to the demand for client-professional contact and customization, and its credence nature, professional services have been used as an extreme case and particularly relevant empirical setting for understanding customer participation and co-production in services in general (Chan et al., 2010; Ramírez, 1999). Thus, understanding value creation in professional services as co-produced has implications for key assumptions of agency theory beyond those proposed by Sharma. In particular, co-production has implications in three main areas of agency theory assumptions that will be addressed in the following sections:

1. The nature of value creation: from exchange to co-production
2. From knowledge asymmetry to knowledge asymmetries
3. From asymmetries to mutuality

3 The nature of value creation in PSFs: from exchange to co-production

Sharma (1997) suggests that professional services are largely about the exchange of esoteric expert knowledge. This emphasis on esoteric knowledge is likely to be rooted in the notion of professions as an institutional protector of a particular set of esoteric knowledge within a particular jurisdiction (Abbott, 1988; Larson, 1977). However, as we acknowledge co-production in professional services, value and knowledge is not primarily transferred from the professional to the client. Within the area of professional services, co-production has been defined as '*engaging customers as active participants in the organization's work*' (Auh et al., 2007; Lengnick-Hall, Claycomb, & Inks, 2000). Thus, the client takes part in the service creation (Barnard, 1938; Bowen, 1986; Lovelock & Young, 1979; Mills, Chase, & Margulies, 1983; Mills & Margulies, 1980; Mills & Moberg, 1982; Mills & Morris, 1986; Whitaker, 1980) and value and knowledge is co-created by clients and professionals (Auh et al., 2007; Bostrøm, 1995; Chan et al., 2010).

At the same time, the value creation in professional services has been described as customer problem solving (Stabell & Fjeldstad, 1998), where the professional helps the client move from an existing to an aspired or desired state (Simon, 1977; Stabell &

Ejeldstad, 1998). Thus, it is in the client organization that the most important part of the value of the professional service is created (Lapierre, 1997). Thus, while it might be proposed that the client takes part in professional service production, the roles could as easily be changed to propose that it is in fact the professional that take part in the client organization as this is where the value creation takes place. Thus, the concept of knowledge exchange does under these conditions seem problematic. In fact, an important implication of co-production is a revised understanding of the nature of value creation. Going through the historical root of co-production, Ramirez (1999) suggests that co-production is different from the industrial understanding of value creation as a sequence of exchange and consumption. In co-production, goods are not exchanged. Rather, value is created at the same time as the service is produced and consumed. Thus, using exchange of esoteric knowledge as a primary unit of analysis for professionals does not seem adequate if value is assumed to be co-produced.

4 From single to dual knowledge asymmetry

Building on information economics (Nayyar, 1990, 1993; Nayyar & Templeton, 1991) information asymmetry within professional services have been claimed to reflect the knowledge intensity and difference in knowledge levels across the buyer and supplier in the particular knowledge area where the PSF is an expert. Later scholars have referred to this as knowledge asymmetry (Sharma, 1997) or asymmetry of expertise (Von Nordenflycht, 2010). The asymmetry has been portrayed in research on professional services as a situation where the clients are seen as helpless victims of consultants and other externally hired professionals (Alvesson & Johansson, 2002; Clark, 1995b; Clark & Fincham, 2002; Clark & Salaman, 1996; Sturdy, 1997). In this respect, Sharma also introduce the notion of lay clients.

The asymmetry implies that while the supplier is likely to have an understanding of the actual quality of what will be delivered, the buyer might not (Clark, 1993, 1995a). Thus, it is difficult for clients to distinguish the quality of one company's services (Nayyar, 1990, 1993) and resources (Skaggs & Snow, 2004) from another. Also, the credence nature (Darby & Kerni, 1973; Howden & Pressey, 2008) of most professional services makes it difficult for the client to objectively evaluate the outcome and the actual competence of different suppliers.

One particular effect of information asymmetry is that it prohibits the signaling effect of price to work efficiently so that higher prices reflect higher quality (Akerl f, 1970; Armbr ster, 2006; Holmstrom, 1985; Nayyar, 1990, 1993; Skaggs & Snow, 2004). At the same time, it is difficult to observe and reverse services. As the outcome is often highly uncertain, it is difficult to determine whether a service is good or bad. This difficulty is heightened by the fact that professionals are highly autonomous individuals with desires to maximize their own interest (Sharma, 1997).

By taking a co-productive perspective and recognizing the actual nature of value creation in professional services the relevant knowledge in professional services is not limited to esoteric expert knowledge. The demand for customization implies that the buyer and supplier work together to find out what the desired state is and the best solution to the identified problem given the desired state. Co-production has been found to enable value creation through effectiveness and customization (Chan et al., 2010; Prahalad & Ramaswamy, 2004; Schneider & Bowen, 1995; Xie, Bagozzi, & Troye, 2008). This customization is largely dependent on contextual knowledge of clients and industries, which has been pointed out as essential knowledge in knowledge intensive and professional services (Morris & Empson, 1998; N tti & Ojasalo, 2008; Starbuck, 1992; Sveiby & Lloyd, 1987). In these knowledge areas, the client is often the ‘expert’, and there exists a knowledge asymmetry, in the sense that the client knows more about the context compared to the professional. In this area, the client might be the expert and the professional the lay party in the exchange. Thus, the labeling of professionals as the experts relative to the lay clients could be questioned.

5 Mutual asymmetries and mutuality as a basis for co-production

While asymmetry refers to the difference in dependence and power (Emerson, 1962; Pfeffer & Salancik, 1978), mutuality concerns the degree to which the parties are interdependent – which means the degree to which they are dependent on each other (Casciaro & Piskorski, 2005). If this analogy were to be used on knowledge asymmetries across professionals and their clients, an asymmetry exists where the content knowledge of the professional or the context knowledge of the client is more important for value creation compared to the other form of knowledge. Where the knowledge of both the professional and the client are essential in enabling value creation – as typically is likely to be the case for value co-production – mutuality exists.

In building on a co-productive approach to professional services, the mutuality is essential to enable value co-creation. Researchers have found that mutuality rather than asymmetry in dependence enables co-operation and embedded ties which include trust, joint action and problem solving which enhance performance for firms (Gulati & Sytch, 2007). Such embedded ties are particularly important in professional services.

Research on buyer-supplier relationships at the same time suggests that asymmetric dependence is likely to be exploited and characterized by conflict and lack of co-operation (Anderson & Weitz, 1989; Geyskens, Steenkamp, Scheer, & Kumar, 1996). In fact, existing research has pointed out that as the dependence asymmetry increases, the willingness of the parties to solve conflicts (Lawler & Yoon, 1996) and absorb constraints decreases (Casciaro & Piskorski, 2005; Piskorski & Casciaro, 2006). Thus, it seems that asymmetry easily drives out the co-operation effects of mutuality and makes co-production difficult. Thus, a key idea in professional services should be to manage the mutuality and dual asymmetry across clients and professionals rather than emphasizing the asymmetry and opportunism of each party as proposed by Sharma (1997). Consequently, a distinction between the principal-professional logic presented in extant research and a client-professional logic underpinned by a co-production logic should be drawn. In table 2, the main characteristics between these two logics are presented.

Dimension	Client-professional	Principal-professional
Unit of analysis	<ul style="list-style-type: none"> • Co-production between client and professional 	<ul style="list-style-type: none"> • Exchange between lay client and professional agent
Information assumption	<ul style="list-style-type: none"> • Incomplete market for contextual and esoteric knowledge 	<ul style="list-style-type: none"> • Incomplete market for esoteric knowledge
Organizational assumption	<ul style="list-style-type: none"> • Knowledge mutuality • Coproduction of service involving both principal and professional 	<ul style="list-style-type: none"> • Knowledge asymmetry • Coproduction of service involving both principal and professional
Key idea	<ul style="list-style-type: none"> • Principal-professional relationships should efficiently and effectively accommodate mutuality arising from demand for esoteric and contextual knowledge 	<ul style="list-style-type: none"> • Principal-professional relationships should efficiently accommodate power asymmetry arising from knowledge gap in agent's favor

Table 2: Client professional versus principal-professional line of thought

6 Conclusion

The change in the nature of competition in many professional service industries implies that they need to move from an expert oriented transactional logic of value creation to a co-produced oriented logic (Vargo & Lusch, 2004). In this process, not only do the characteristics of these firms need to be rethought. The underlying assumptions of value creation need to be extended to encompass the co-production perspective. Through a review of extant literature on the appropriateness of information asymmetry as a characteristic of PSF value creation under a co-productive perspective, we have identified three important assumptions that has to be reconsidered. Professionals and PSFs cannot be seen as experts that deliver services independently of the client, which typically has been done within the traditional perspectives on professions (Larson, 1977). Rather, as described above, they solve client problems in co-operation with clients and their context knowledge is a key input factor in addition to the professional esoteric knowledge. To leverage and use both these types of knowledge, a mutual rather than a transactional perspective needs to be applied.

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