

## *Teams, Creativity, and the Firm*

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This paper will examine the intersection of intellectual property law and theories of the firm. The existing literature in this area has almost exclusively applied the property-rights theory of the firm pioneered by Grossman, Hart, and Moore. We have two claims. First, we will show that the property-rights theory of the firm leaves significant gaps in our understanding of the production of intellectual property goods. Second, we will explain how other theories of the firm—especially those associated with the work of Coase, Alchian and Demsetz, and Williamson—can help fill those gaps.

The property-rights analyses suggest that as intellectual property rights become stronger, parties can better reduce hold-up threats by more effectively allocating residual-control rights *ex ante*; market transactions over residual-control rights can then supplant vertical integration as a mechanism for organizing innovative and creative production. On this view, optimally strong property rights reduce the frequency of integration. But the property-rights theory cannot explain organizational behavior when intellectual property rights are weak (or nonexistent) and there is correspondingly little (or nothing) for parties to transfer. This is because that theory depends on the ability to transfer residual-control rights. And, crucially, a primary input of intellectual production—the creative function of the mind—cannot be owned in the property-rights sense. Parties cannot effectively allocate residual-control rights to creative mental inputs to the production of intellectual property goods; these creative mental inputs therefore cannot form part of the property-rights firm.

Nonetheless, we do see organizations of creative inputs that look like firms. For example, movies are made by hierarchies with a director or producer who allocates and reallocates resources without resort to a market. Similarly, there is an emerging market for hierarchically-authored novels. We intend to show that these firms are designed not to reduce hold up but to capture the value of collaborative creation that is facilitated by team production in a managed hierarchy. Viewing these organizations as firms, we suggest a broader approach incorporating other theories of the firm (with some focus on team production) to explain how the production of intellectual property goods is organized.

This approach has important payoffs for our understanding of organizational theory in the production of intellectual property goods. We do not reject property-rights theories entirely; while those theories can help explain the integration of intellectual or creative inputs with complementary assets in larger production and development functions, they

do not provide a satisfactory explanation for the organization of the intellectual inputs themselves. Thus, while current theories of intellectual property and the firm suggest that suboptimally weak property rights lead to larger firms, we suggest that for the production of much of intellectual products, weak property rights (and rights in creative inputs are generally weak) will tend to make firms smaller. Moreover, while existing theories suggest that advances in contracting will tend to make firms small, we suggest that advances in contracting will often cause firms to grow larger because benefits other than the reduction of hold up can be obtained by integration.

We also explore the implications of our analysis for particular intellectual property doctrines. Consider, for example, the derivative works right. This doctrine strengthens copyright protection in exactly the manner that we suggest will allow collaborative firms to integrate creative inputs by enabling specialization in the monitoring of particular kinds of creative inputs. A strong version of this right would give the copyright holder control over a broad range of follow-on work; a weak version would give very little control. Thus, contrary to existing theories, we argue that the stronger the derivative works right, the larger the firm.

In short, the organization of collaborative creative inputs into a firm cannot be explained by a property-rights theory because the sources of the inputs often cannot be integrated in the property-rights sense of obtaining rights of residual control. In those instances, the theories we explore here provide a better explanation of how inputs to the production of intellectual property are organized.