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Towards an integrated framework of professional partnership performance: The role of formal governance and strategic planning

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Abstract

Conventional wisdom identifies human capital and organizational reputation as the critical resources explaining professional partnership (PP) performance. PPs have increasingly adopted organizational practices like strategic planning and formal governance, however, which have long been alien in highly professionalized contexts. In order to test the influence of both these classic resources and the newly adopted practices on PP performance, as well as the mediating mechanisms— that is, client attraction and retention as well as organizational efficiency—through which this influence is channeled, we develop an integrated theoretical framework of PP performance. We test the resulting hypotheses using survey and objective data collected on 196 Dutch law firms. Our findings provide new insights into the drivers of PP performance and the complex interrelationships between PP resources and newly adopted practices.

Keywords

client attraction and retention, human capital, managed professional business, professional partnership, reputational capital

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Introduction

The professional partnership (PP) is a prevalent type of professional service firm (Greenwood and Empson, 2003) that has long been the dominant form of enterprise organization in professional industries (Hansmann, 1996; Von Nordenflycht, 2007). Today, it continues to be the default organizational form in classic professions like law and accounting (Von Nordenflycht, 2010), in spite of legal reforms that have rescinded most of the formal barriers to external ownership in these contexts (Pickering, 2012, 2015). By definition, PPs are internally owned (Hansmann, 1996) and develop and maintain their human and reputational resource base through a unique set of organizational practices (Sherer and Lee, 2002). PPs use these practices to offer their clients knowledge-intensive and customized services (Greenwood et al., 2005), and to respond to the demands of the highly-institutionalized contexts in which they operate (Leicht and Fennell, 2008; Von Nordenflycht, 2010).

PPs play an increasingly important role in the economy for three reasons (Empson et al., 2015). First, several PPs rank high amongst the world's largest and most profitable businesses (Aharoni, 1993; Greenwood et al., 2005). In contemporary service-driven economies, law firms like Clifford Chance and Allen and Overy, and accounting firms like KPMG and PricewaterhouseCoopers, are the new 'blue chip' firms realizing steady growth and returns. Second, PPs are 'knowledge engines' (Lorsch and Tierney, 2002: 15), which develop and diffuse innovations (Alvesson, 1995), contributing to their clients' value creation processes by applying professional knowledge to organizational problems (Hansen et al., 1999). Third, by pledging their reputation to vouch for the quality of their clients' actions, PPs function as 'gatekeepers' (Coffee, 2006), without which global exchange and investment relationships could not exist (Aharoni and Nachum, 2013).

Owing to their economic significance, PPs have attracted the scrutiny of management scholars interested in explaining their performance (e.g. Greenwood et al., 2005, 2007; Hitt et al., 2001, 2006). This research has yielded the insight that human capital (Hitt et al., 2001) and reputation (Greenwood et al., 2005) are especially important drivers of PP performance. A comprehensive understanding of the drivers of PP performance is yet to emerge, however, as quantitative studies are few in number and as there are questions about the generalizability of previous case-based research (Brock, 2006; Empson et al., 2015). Furthermore, facing heightening efficiency demands arising from increased competition and deregulation (Quack and Schüßler, 2015), PPs in various fields have fundamentally increased their strategic scope (Cooper et al., 1996; Malhotra et al., 2006) through organizational development initiatives like internationalization (Aharoni, 1993; Cooper et al., 1998; Hitt et al., 2006), mergers and acquisitions (Empson, 2001; Greenwood et al., 1994), and strategic alliances (Koza and Lewin, 1999).

Reflecting on these strategic scope changes in PPs, researchers have documented a shift away from the archetypical 'P^2 organizational template' (Greenwood et al., 1990)—in which human capital and reputation go hand in hand with 'weak strategic capability, coupled with low analytical emphasis' (Cooper et al., 1996: 628)—in the direction of the alternate organizational template of the Managed Professional Business (or MPB; Cooper et al., 1996), in which '[s]trategic control becomes much more important and … strategic planning systems are put in place' (Cooper et al., 1996: 632).[1] Such archetype change amongst PPs, away from the P^2 in the direction of the MPB, has brought about the adoption of several remarkable peripheral features, like more intense marketing efforts and increased use of cross-functional teams (Cooper et al., 1996; Lander et al., 2017). Yet, most observers agree that the most momentous and potentially upsetting shifts involve the adoption of formal governance and strategic planning practices (Brock, 2006; Empson et al., 2015; Pinnington and Morris, 2003). These observed shifts in the direction of greater formalization amongst PPs have sparked several debates in the literature, which have thus far not been resolved satisfactorily by means of systematic, quantitative research (Empson et al., 2015).

The first debate involves the relationship between formalization and PP efficiency. Some believe that 'the widespread adoption of new management structures, functions, and systems such as performance appraisal systems, management by objectives, strategic business units, marketing, business development, cross-selling, chief executive, and senior management team structures' has resulted in greater 'market share, efficiency, and – importantly – profit' (Brock et al., 2007: 237) for PPs. Other scholars, however, expect to find no link between formalization and efficiency, as many of these practices might have been adopted for legitimacy reasons alone, or even a negative link, because the formalization of professionals' work environments might lead to outright resistance and productivity-diminishing power struggles (Kärreman and Alvesson, 2009; Lawrence, 2004). The second debate concerns the effect of formalization on the quality of PPs' stock of human and reputational resources. Some commentators have simply suggested that '[b]usiness-like organizations need business-like governance structures' (Brock, 2006: 165), implying that far-sighted professionals would willingly embrace formalization as a means of retaining control over their increasingly complex organizations. Others have noted, however, that professionals 'do not treat their practices as "businesses"' (Greenwood et al., 1990: 736), and that the ideas of 'a directive, topdown approach to strategic management' and of 'clear internal controls circumscribing and channeling the behaviors' of professionals are 'not compelling' (Greenwood et al., 1990: 750). If PPs were to act on these ideas, they might therefore face unwanted turnover of key professionals and a lowered willingness among their retained members to engage in collective reputational maintenance work (Empson, 2001; Greenwood et al., 1990). The third debate concerns formalization's impact on the continued importance of human and reputational resources for PP performance. Some observers have noted that, in spite of formalization, human capital and reputation will continue to be PPs' most critical performance drivers (Greenwood and Empson, 2003; Pinnington and Morris, 2003). Others, however, have noted that formalization will likely engender the 'commodification' (Suddaby and Greenwood, 2001: 940–943) of professionals' esoteric knowledge, leading to their 'proletarianization' (Brock, 2006: 163) and to a lessening of their grip on PP performance.

These three debates have inspired us to formulate and address three research questions in this article. First, does the adoption of organizational practices, like formal governance and strategic planning, contribute to PP efficiency (Cooper et al., 1996), and in turn to PP performance (Brock et al., 2007)? Second, how do these new organizational practices affect PPs' human and reputational resource base? Third, do human and reputational resources remain the principal drivers of PP performance, even as many PPs are undertaking organizational change efforts in the direction of the MPB (Greenwood and Empson, 2003; Pinnington and Morris, 2003)? We address these questions with the help of quantitative survey and objective data collected on 362 partnered lawyers admitted to the Dutch Bar, representing 196 law firms. Our sample of law firms represents a 'classic' professional industry (Von Nordenflycht, 2010), in which the PP remains to be the default legal form, but in which individual firms have abandoned the P^2 archetype and adopted MPB-type characteristics to varying degrees.

Theory and hypotheses

Traditional drivers of professional partnership performance

PPs exhibit features setting them apart from other organizational forms. High degrees of knowledge intensity, client customization and subjective quality assessment force them to look beyond generic organizational practices (Løwendahl, 2005). Building on Mintzberg's description of the 'professional bureaucracy' (Mintzberg, 1979), Greenwood et al. (1990) conceptualized these features into a coherent description of the P^2-archetype, highlighting four differences between PPs and other organizations. First, senior PP members, who own and manage the firm, continue to be involved in the delivery of professional services. Second, professionals affiliated with PPs apply difficult-to-codify and largely inalienable knowledge to complex problems. Third, decision-making in PPs is decentralized, allowing for the tailoring of professional services to idiosyncratic client demands. Fourth, members of PPs enjoy levels of autonomy that are unseen in other organizational forms (Hall, 1968; Montagna, 1968).

These four features necessitate PPs to seek out two types of competitively valuable resources. First, PPs must accumulate high-quality *human capital*, or 'the knowledge, skills, and abilities residing within and utilized by individuals' (Subramaniam and Youndt, 2005: 451). A distinctive human resource base is difficult to build up, however, because highly qualified human capital is scarce and mobile between different firms (Groysberg and Lee, 2009). Second, because the quality of professional services is difficult to assess directly for clients, regulators and potential employees alike (Alvesson and Robertson, 2006; Gilson and Mnookin, 1985; Starbuck, 1992), PPs must also build a strong *firm reputation*—an image of the firm held by its key stakeholders that captures 'the outcome of a competitive process in which firms signal their key characteristics to constituents to maximize their social status' (Fombrun and Shanley, 1990: 234). Because PP reputation thus substitutes for direct experience of the firm's product quality, it is a critical resource for attracting and retaining clients (Hitt et al., 2006; Løwendahl, 2005; Maister, 1997).

Human capital. Perhaps the most important status signal for professional services is the perceived quality of the professionals delivering them (Greenwood and Empson, 2003; Grosse, 2000; Hitt et al., 2006; Løwendahl, 2005; Maister, 1997; Nachum, 1996). Direct contact with professionals is the main 'channel' through which clients interact with PPs, and the principal lever through which PPs can influence client satisfaction. Important quality cues are: persuasiveness as a communicator (Sharma and Patterson, 1999), ability to meet deadlines (Karantinou and Hogg, 2009), and continuous availability (McNeilly and Feldman Barr, 2006). Some professionals, often referred to as ‘stars’ or ‘rainmakers’ (Groysberg and Lee, 2009; Lorsch and Tierney, 2002), are even able to attract clients through their personal reputation.

Reputational capital. PP reputation serves as a broader informational signal helping clients select and decide to retain or replace a professional service provider (Hitt et al., 2006; Løwendahl, 2005; Maister, 1997). Reputation is important because it contains information facilitating clients’ *ex ante* and *ex post* comparisons concerning performance differentials between PPs (Greenwood and Empson, 2003; Grosse, 2000; Nachum, 1996). In the *ex ante* phase it is hard for prospective clients to assess which firm would best be able to cater to their needs, owing to the intangible and opaque quality of professional services. This challenge is often referred to as the client choice problem (Goode, 1957). As a result, prospective clients often select PPs based on their reputation. In the *ex post* phase, clients may find it difficult to assess the quality of services delivered by PPs (Alvesson and Robertson, 2006; Gilson and Mnookin, 1985; Starbuck, 1992), because of knowledge and information asymmetries between client and professional (Sharma, 1997). Clients thus remain reliant on PP reputation to assess the quality of professional services, even after delivery.

Newly adopted practices and organizational efficiency

Whereas prior studies have found human and reputational capital to be key performance drivers for PPs (Greenwood et al., 2005; Hitt et al., 2001), it is unclear whether these traditional resources still matter for the performance of contemporary PPs. This is because the contexts in which PPs operate, as well as PPs themselves, have undergone dramatic changes over the last few decades. Specifically, PPs have come under considerable pressure from clients to simultaneously develop new services (Anderson-Gough et al., 2000) and lower costs (Morris and Pinnington, 1998). To meet these challenges, many PPs have embarked on growth trajectories involving mergers, product diversification and internationalization. These developments have brought an end to the era in which PPs were ‘an oasis of organizational stability’ (Gilson and Mnookin, 1988: 567), and have necessitated many firms in the fields of accounting (Greenwood and Suddaby, 2006) and law (Pinnington and Morris, 2003) to replace P^2 practices (Malhotra and Morris, 2009; Morris and Pinnington, 1998) with increasingly formal practices that jointly define the MPB organizational template (Cooper et al., 1996). These practices primarily involve formal governance and strategic planning (Leicht and Fennell, 1997; Malhotra and Morris, 2009).

Formal governance. The implementation of more formal governance practices potentially allows PPs to become more effective at forming and implementing organizational objectives (Cooper et al., 1996; Pickering, 2015; Pinnington and Morris, 2003). Such practices entail formalized operational and quality controls, which reduce the cost of time-consuming peer monitoring practices (Pinnington and Morris, 2003). They also encompass systematic performance measurement and performance evaluations, enabling PPs to take action against poor performance and reward good performance. Because these relatively formal and hierarchical governance practices substitute for costly face-to-face governance, they help safeguard the manageability and accountability of PPs on a strong growth trajectory and potentially increase PP efficiency (Anand et al., 2007; Hitt et al., 2001).

Strategic planning. Strategic planning was long seen by professionals 'as irrelevant or even detrimental to success of their firms' (Løwendahl, 2005: 77), assuming that it would lead to too much rigidity (Miller and Cardinal, 1994). Absent strategic planning, however, the strategy of a PP resembles the aggregate outcome of all partners' individual pursuits. Decisions are then made with little eye for the benefits of concerted organizational action (Lorsch and Tierney, 2002; Pinnington and Morris, 2003), which comes at the expense of organizational efficiency. Strategic planning potentially improves PP efficiency in three ways. First, through planning, PPs can selectively invest in practice areas with high profit and growth potential, while divesting from areas in which fees are below average (Løwendahl, 2005). Second, strategic planning enables PPs to better exploit economies of scale and scope by consciously deciding which service offerings will be commodified and diversified. Third, planning stimulates strategic foresight, making PPs less vulnerable to strategic myopia. In sum, strategic planning and formal governance help PPs pursue efficiency objectives (Hitt et al., 2001; Lorsch and Tierney, 2002).

Efficiency and professional partnership performance. A common idea is that PPs tend to implement these new practices to increase their *organizational efficiency*, defined here as the ability to achieve a favorable cost position, low overhead percentage and high human capital productivity (Hitt et al., 2001; Maister, 1997; Von Nordenflycht, 2010). Increasing organizational efficiency is assumed to be the most direct route through which commercial objectives can be achieved (Pinnington and Morris, 2003). Formal governance and strategic planning are also adopted because they can counter the effect of the PP becoming an 'unwieldy' organizational form for firms on a growth and diversification trajectory (Greenwood and Empson, 2003). The introduction of formal governance and strategic planning in PPs is thus a functional response to increasing organizational complexity (Brock, 2006).

We expect efficiency to increase PP performance in three ways. First, the greatest source of fixed costs for most PPs is the salary costs of junior professionals. Greater efficiency in terms of a higher proportion of billable hours or higher fees per salaried employee thus improves PP performance, as it increases the numerator of the input–output ratio (Løwendahl, 2005). Second, PP performance benefits from increasing the partner/associate leverage of the firm, as the salary costs for junior professionals tend to be substantially smaller than the sum of the fees they generate, leaving more residual earnings to be distributed among the partners (Maister, 1997). Third, partners can lower junior professionals' salary costs by codifying and commodifying professional knowledge, which can then be applied across a range of clients to cash the value of the firm's reputation (Morris et al., 2010; Suddaby and Greenwood, 2001). See Hypothesis 1:

> *Hypothesis 1:* Formal governance and strategic planning practices improve organizational efficiency, which in turn positively influences professional partnership performance.

Newly adopted practices and the professional partnership resource base

There are two alternative views on the influence of these new practices on the traditional drivers of PP performance. The conventional 'herding cats' perspective (Løwendahl, 2005; Von Nordenflycht, 2010; Von Nordenflycht et al., 2015) theoretically predicts that formal governance and strategic planning jeopardize the ability of PPs to secure human and reputational capital. In relation to human capital, the conventional reading is that professionals are strongly attached to their self-determination, and perceive of formal supervision and control as a breach of their professional autonomy (Greenwood and Empson, 2003; Lorsch and Tierney, 2002; Pickering, 2015; Starbuck, 1992). Managing professionals is thus said to be more about 'guiding, nudging and persuading' (Malhotra et al., 2006: 175). In relation to reputational capital, the traditional P^2 with its informal governance practices serves as an important informational signal. Many clients see the informally governed P^2 as an 'exemplary' form of governance for knowledge-intensive firms (Greenwood and Empson, 2003), which reassures them in their choice for a professional service provider (Empson and Chapman, 2006; Sharma, 1997). Changing the nature of governance and strategizing in PPs could then impair clients' reputational assessment of the organization (Hitt et al., 2006; Løwendahl, 2005; Maister, 1997).

Yet there is also an alternative view on how formal governance and strategic planning impact human and reputational capital, which has been labeled the 'aligning the stars' perspective (Cooper et al., 1996; Lorsch and Tierney, 2002; Pinnington and Morris, 2003). It suggests that the adoption of formal organizational practices in fact helps PPs secure human and reputational capital (Hitt et al., 2006), especially as the environment in which they operate becomes increasingly competitive (Von Nordenflycht et al., 2015). We elaborate on this alternative perspective below.

Formal governance, human and reputational capital. Formal governance practices not only serve to improve PP efficiency, but may also strengthen the PP's human capital base, especially during post-entry selection processes. Most PPs in the legal industry follow a variant of the Cravath model, in which the decision to tie a junior lawyer durably to the firm as an equity partner or to terminate that person's labor contract is postponed until six to 12 years of employment (Sherer and Lee, 2002). During this period, PPs benefit from the fact that this deferred form of gratification motivates an entire cohort of junior lawyers, whereas in the end substantial benefits only have to be shared with those individuals who are retained as partner (Galanter and Palay, 1991). Under this model, however, the decision concerning which experienced professionals to retain and which to let go of is of crucial importance to the human capital base of the PP. Adopting formal governance procedures helps to make this decision more meritocratic by basing it on predefined output-based performance criteria, systematic performance measurements, and regular performance appraisals of all junior lawyers in the firm (Cooper et al., 1996; Malos and Campion, 2000). PPs can thus use formal governance to improve upon their human capital base.

Better governance also helps law firms avoid reputation-jeopardizing incidents. The reputation of a PP is in part determined by the care and discretion with which client interests are handled on a day-to-day basis (Løwendahl, 2005). Adequate governance, which amongst other things involves the implementation of formal financial and quality controls, can reduce the likelihood that difficult-to-monitor professionals engage in actions that jeopardize the PP's intangible assets (Treviño et al., 2006). Formalized controls complement rather than supplant the monitoring responsibilities of senior professionals (Pinnington and Morris, 2003), and ensure service delivery of consistent quality (Von Nordenflycht et al., 2015). Formal governance also makes individual professionals' contributions to collective reputation-building efforts more transparent. Developing a good organizational reputation requires significant collective efforts, like working against the highest possible professional standards and foregoing lucrative but publicly frowned-upon business opportunities. Formal governance systems help register and control such efforts, and are therefore a useful antidote against social loafing or freeriding. We therefore hypothesize:

Hypothesis 2a: Formal governance practices positively influence the human capital and organizational reputation of professional partnerships.

Strategic planning, and human and reputational capital. One of the functions of strategic planning in PPs is to improve the quality and allocation of their human capital base. PPs use strategic planning tools to scan their environment for emerging opportunities (Ansoff, 1980; Hambrick, 1982) and to engage in deliberate decision-making on selective investments and divestments in different practice areas. Capacity-building in emerging practice areas is a time-consuming process, so sensing new opportunities early allows law firms to establish first-mover advantages in terms of dedicated human resource acquisition. Also, by allocating skilled professionals to projects for which there is current demand, strategic planning can overcome the tendency of partners to hold on to the greatest talents in their teams ('human capital hoarding'), even if they would flourish more elsewhere in the firm. Strategic planning thus improves the acquisition of human capital and its allocation across profit centers (Løwendahl, 2005).

Similarly, the adoption of strategic planning practices can better PPs' reputation, because of signaling effects (Certo, 2003; Connelly et al., 2011). Strategic planning is a time- and attention-consuming organizational practice, which requires substantial investments in terms of data collection, analysis and interpretation (Ansoff, 1980; Hambrick, 1982). Only high-quality law firms, which have the financial wherewithal to engage in systematic strategic analysis and to free up costly seniors' time, can be expected to adopt the practice in earnest. We therefore expect that when a law firm's clients or competitors observe it to engage in strategic planning, they will interpret this as a key signal testifying to the firm's overall high quality (Certo, 2003; Connelly et al., 2011). We therefore hypothesize:

Hypothesis 2b: Strategic planning practices positively influence the human capital and organizational reputation of professional partnerships.

Client attraction and retention and professional partnership performance. The active involvement of clients in the delivery of professional services makes their attraction and retention an important mechanism through which PPs can exploit their human and reputational capital base to engender performance (Karantinou and Hogg, 2009; McNeilly and

Feldman Barr, 2006; Sharma and Patterson, 1999) and ensure survival (Broschak, 2015). Several mechanisms link client attraction and retention to performance. First, because attracting new clients is costly and requires relationship-specific investments with uncertain payoffs, improvements to PPs' client attraction function are directly tied to the bottom line (Brown and Swartz, 1989). Second, existing clients are an important source of additional revenue in PPs—especially those with diversified practices—owing to the potential for cross-selling (Morris et al., 2010). An initial client contact offers PPs opportunities to exploit latent synergies in their human capital base, as interdisciplinary collaboration allows them to become a one-stop service provider. Third, an important cost-saving mechanism involves client-specific learning. Delivering professional services requires substantial investments in close client relationships (Kärreman et al., 2002; Morris and Empson, 1998). These investments can be leveraged through client retention, allowing PPs to recoup investments from multiple transactions. We therefore hypothesize that:

> *Hypothesis 4:* Human capital and organizational reputation improve client attraction and retention, which in turn positively influences professional partnership performance.

Methods

Sample description and data collection

We tested our hypotheses on a sample of Dutch law firms, all of which are PPs, as internal ownership structures are still ubiquitous in the Netherlands. As the quality of the human and reputational capital base differs across Dutch law firms, and as these firms have adopted new organizational practices to varying degrees, our sample provides a suitable testing ground for our theoretical framework.

Although we were able to obtain an objective measure for our dependent variable of gross profit per partner (GPPP), our data are mostly survey-based, for two reasons. First, being inside-owned PPs, Dutch law firms are only subjected to rudimentary disclosure obligations. Second, because Dutch corporate law does not provide for the legal form of the Limited Liability Partnership (LLP), most Dutch law firms emulate the LLP form through the legal construction of a limited company that is owned exclusively by the limited companies through which the partners conduct their business. This has the unfortunate consequence of locating disclosure obligations at the limited companies owned by the partners, which typically have revenues way below the level at which extensive disclosure obligations become mandatory.

We conducted an online survey using Global Park software (www.globalpark.com). This survey focused on organizational practices and resources within law firms as well as lawyers' perceptions of their firms' performance. The Dutch Bar Association (www.advocatenorde.nl) endorsed our study and provided us with a mailing list that included all lawyers working for the 491 independent law firms employing six or more lawyers. We sent out two waves of electronic surveys. The first resulted in 359 completed responses. The second was sent out as a reminder two weeks later, providing us with an additional 293 responses. Our total sample thus encompassed 652 lawyers (45.6% firm response rate).

Table 1. Sample description.

Organization size	Sampling frame[a]	In sample	Percentage
6–10 lawyers	284	84	29.6%
11–60 lawyers	183	88	48.1%
>60 lawyers	24	24	100%

[a]Source: Coppes (2008).

As some of the practices we are interested in are most visible at the highest echelons of these law firms, we based our main analysis on the subset of partner-level responses. The number of partners amongst our respondents was 362, and they collectively represented 196 law firms (firm response rate 39.9%). The breakdown of our sample over the size strata represented in our sampling frame is provided in Table 1.

Measures

Scale development. We relied as much as possible on psychometric scales validated in prior research (Babbie, 2009; Dillman, 2006). When such scales were not available, we used canonical scale development processes to ensure construct validity (Hinkin, 1998; Steenkamp and Van Trijp, 1991). These processes involved: (i) inductive and deductive item generation; (ii) content validity assessment and item reduction with the help of an expert panel consisting of 10 academics specialized in strategy and organization and 10 practicing lawyers; (iii) internal consistency assessment; (iv) confirmatory factor analysis (CFA) for goodness of fit assessment; and (v) convergent/discriminant validity assessment. All multi-item scales were measured with seven-point Likert items, where 1 always represented 'strongly disagree' and 7 'strongly agree' (see Appendix A for the full instrument).

Multiple respondents. We used an individually administered survey to uncover organizational properties. On average, we had more than one respondent per firm. To use all available information without giving disproportionate weight to firms with multiple respondents, we averaged scores when multiple respondents were present. To establish the appropriateness of averaging, we first determined the rate of agreement between our partner respondents across all multi-item scales included in our model. We computed an intraclass correlation coefficient for each averaged scale included in the survey within firms (LeBreton and Senter, 2008). We then averaged these intraclass correlations between firms, yielding an overall intraclass correlation of .70. This value is usually interpreted as signifying strong agreement between respondents (Landis and Koch, 1977). Furthermore, to establish the appropriateness of averaging for each multi-item scale individually, we computed two interrater agreement measures recommended for this purpose by Kumar et al. (1993): the agreement ratio $r_{wg(j)}$ (James et al., 1984) and the agreement percentage (Shortell and Zajac, 1990).[2] Whereas no consensual cut-off point exists for the latter metric, LeBreton and Senter (2008) have proposed that for the former, values above .70 are acceptable. On average, the agreement ratio equaled .87, and the agreement percentage .90, across all our multi-item scales. We concluded that aggregating individual responses was appropriate, and decided to base our empirical estimates on the averaged score per firm.

Gross profits per partner. We used GPPP, defined as the pre-tax returns extracted from the firm by each owner, as our dependent variable (Greenwood et al., 2005; Hitt et al., 2001, 2006; Kor and Leblebici, 2005). GPPP data were obtained from a trade publication (Coppes, 2008), complemented with write-in responses to a corresponding survey item. We used a log-transformed measure of GPPP to correct for outliers.

Client attraction and retention. Client retention plays a mediating role in our theoretical framework, serving both as a dependent and as an independent variable. We developed a new four-item scale to measure it. The construct had standardized factor loadings ranging from .69 to .84, and showed sufficient internal reliability ($\alpha = .75$). All items were statistically significant ($p < .05$). The construct's agreement ratio and agreement percentage equaled .82 and .80, respectively,[2] suggesting that adequate interrater agreement had been achieved (LeBreton and Senter, 2008).

Law firm efficiency. Law firm efficiency similarly plays a mediating role in our framework. In prior studies, this variable is frequently measured as law firm leverage (defined as the partner/associate ratio; Maister, 1997), but based on the available date we could not compute the leverage ratio. We therefore constructed a three-item survey scale. Its factor loadings ranged from .68 to .90, and showed sufficient internal reliability ($\alpha = .72$). All items were statistically significant ($p < .05$). The construct's agreement ratio equaled .79, whereas the agreement percentage was .86.[2]

Human capital. To capture the quality of law firms' human capital base, we used a five-item scale developed by Subramaniam and Youndt (2005). Internal reliability analysis revealed its inter-item coherence ($\alpha = .88$). Moreover, all standardized factor loadings exceeded .75 and were statistically significant ($p < .05$). The agreement ratio and agreement percentage both reached .95.[2]

Law firm reputation. Firm reputation was measured using a four-item scale developed by Combs and Ketchen Jr (1999). Internal reliability analysis revealed it to be internally consistent ($\alpha = .88$). Three of the four standardized factor loadings exceeded .80. All were statistically significant ($p < .05$). The construct's agreement ratio and agreement percentage were .92 and .95, respectively.[2]

Formal governance. We measured the presence of formal governance mechanisms related to coordination of projects and practices and the use of formal cost and revenue targets (Rogers et al., 1999). This scale also includes internal quality, financial and budgeting control systems (Cooper et al., 1996; Morris and Pinnington, 1998). The resulting 10-item scale proved to be internally consistent ($\alpha = .88$). Standardized factor loadings ranged from .42 to .87, and were all significant ($p < .05$). The agreement ratio reached .85, whereas the agreement percentage was .88.[2]

Strategic planning. The strategic planning scale we used was adapted from Rogers et al. (1999). It contains seven items pertaining to the extent to which the organization: (i) is flexible in adapting its strategy to adjust to unforeseen contingencies and (ii) has the required skills for engaging in broad, strategic analyses. Reliability analysis confirmed its internal consistency ($\alpha = .88$). Standardized factor loadings ranged from .76 to .82, and were all significant ($p < .05$). The agreement ratio and agreement percentage were .82 and .80, respectively.[2]

Law firm size. We used an objective measure of law firm size, operationalized as the number of lawyers employed by the focal firm. Data were provided by the Dutch Bar Association. We used a log-transformed measure to correct for outliers.

Firm diversification. We measured diversification by asking our respondents to indicate the practice areas in which their firm was active, based on a list of 17 possible specializations recognized by the Dutch Bar Association. We subsequently grouped these 17 areas into six substantive areas of law, to differentiate between related and unrelated diversification. The six areas were: (i) the private law practice, containing family law, labor law, construction law, immigration law and general legal representation; (ii) business law transactions, including contract law, intellectual and regular property law, competition law, arbitrage, bankruptcy law and transport law; (iii) corporate law, including business law, banking law and debt collection practice; (iv) tax law; (v) criminal law; and (vi) public law practice. Firm diversification was measured on a 0–1 index. If a firm practiced in all six areas it would receive a score of 6/6 = 1, whereas firms practicing in a single area only would receive a score of 1/6 = .17.

Internationalization. We included a dummy variable coded as 1 if a firm operated one or several offices outside the Netherlands, and 0 otherwise.

Law firm age. To control for firm age, we included a natural log-transformed variable capturing the number of years since founding, derived from a write-in item in our survey.

Construct validity and reliability

Convergent/discriminant validity. A construct displays convergent validity when its indicators are positively and significantly related (Carmine and Zeller, 1979). Through structural equation modeling (SEM), convergent validity is examined by estimating the factor loadings of the items on their associated latent variable (Steenkamp and van Trijp, 1991). The measurement model shows all factor loadings to be sufficiently large and statistically significant, demonstrating the convergent validity of our measures. Also, the fit statistics for our model, estimated through confirmatory factor analysis (CFA), showed good fit with the data ($\chi^2 = 1179.27$; d.f. [degrees of freedom] = 480; $p = .0$; CFI [comparative fit index] = .942; RMSEA [root mean square error of approximation] = .084; NNFI [non-normed fit index] = .936 and SRMR [standardized root mean square residual] = .115).

A pair of constructs possesses discriminant validity when they do not correlate highly with each other, which indicates that they measure theoretically distinct concepts (Carmine and Zeller, 1979). Discriminant validity can be assessed by comparing the fit of an unconstrained CFA model (in which all correlations are freely estimated) with that of one in which a pair of constructs is constrained to unity (made to correlate fully by setting the covariance between latent constructs to 1). The constructs possess discriminant validity when the unconstrained model consistently demonstrates a better fit, as measured by a lower chi-square value. We estimated all possible pairwise constrained models, finding that all pairwise constrained models had significantly higher chi-square values than the unconstrained benchmark. From this, we conclude that all our constructs possess discriminant validity.

Social desirability. Some of our variables (particularly human capital and reputation) might elicit socially desirable or self-aggrandizing responses from the respondents. Although such social biases cannot altogether be avoided, steps can be taken to reduce their impact. Following the suggestions by Nederhof (1985), we have done this by, first, administering an online survey that provided anonymity to the respondents. Respondents thus knew up-front that their variable scores would not be traceable to them. Secondly, for the human capital and reputation scales, we asked for aggregated firm-level scores on these variables, rather than (overly personal) individual-level scores or respondents' own contributions to these variables. The use of aggregated subjects (i.e. firm rather than respondent), as well as anonymity through an online survey have likely led to a reduction of the impact of social desirability and self-aggrandizing biases on our data quality.

Results

Model specification

We analyzed our data with maximum likelihood SEM, using LISREL 8.80 software. SEM suits our theoretical framework, as it allows us to test for mediating relationships. With SEM we can also correct for indicator measurement error. Table 2 presents descriptive statistics, zero-order correlations and reliability coefficients for our latent variables.

Estimation, fit, hypotheses tests and control variable results

Estimation and fit. Our theoretical model fitted the data reasonably well ($\chi^2 = 1566.80$; d.f. = 638; $p = .000$; CFI = .919; RMSEA = .086; NNFI = .911, and SRMR = .172). In addition to these model fit measures, the significance and hypothesized direction of many path coefficients also indicate that the model adequately represents the data (see Figure 1 and Table 3).

Hypothesis tests. Hypothesis 1 proposed that formal governance and strategic planning are positively associated with efficiency, which in turn drives PP performance. Our results only partly support this conjecture. Whereas strategic planning helps improve efficiency ($\beta = .23$, $t = 2.66$), formal governance does not ($\beta = .13$, $t = 1.33$). Likewise,

Table 2. Descriptive statistics, correlations and reliability coefficients.

Variable	Mean	SD	1	2	3	4	5	6	7	8	9	10
1. Log gross profits per partner	4.97	1.21										
2. Client attraction and retention	5.32	.75	.21	(.75)								
3. Efficiency	4.19	1.00	.08	.02	(.72)							
4. Human capital	5.52	.76	.07	.31	.04	(.88)						
5. Reputation	5.82	.77	.09	.35	.04	.12	(.88)					
6. Formal governance	4.38	1.04	.14	.07	.11	.12	.11	(.88)				
7. Strategic planning	4.62	1.07	.15	.09	.20	.16	.15	.20	(.89)			
8. Organizational size	1.24	.43	.29	.05	.11	.07	.08	.43	.42			
9. International	.12	.32	.17	.03	.07	.06	.03	.28	.29	.61		
10. Organizational diversification	.54	.20	.14	–.12	.08	–.32	–.11	.33	.27	.46	.21	
11. Organizational age	1.40	.42	.24	–.02	.06	–.07	–.01	.23	.21	.46	.18	.44

SD = standard deviation.

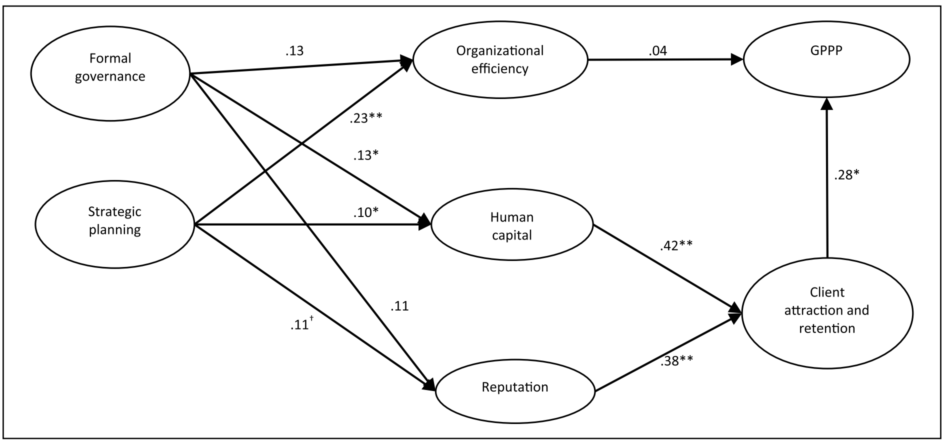

Figure 1. Model results for performance shaping factor (PSF) performance.
Paths involving control variables are not displayed. GPPP = gross profit per partner.
* <.05 significance level.
**<.01 significance level.

the relationship between efficiency and GPPP is positive but not significant (β = .04, t = .98). Hypothesis 2a suggests that formal governance has a positive relationship with human and reputational capital (‘aligning the stars’). This hypothesis is partly supported, as formal governance has a positive influence on human capital (β = .13, t = 2.12) but not on reputation (β = .11, t = 1.22). Hypothesis 2b suggests a similarly positive effect of strategic planning on critical PP resources. Our results support this assertion: strategic planning improves both human (β = .10, t = 2.23) and reputational capital (β = .11, t = 1.91, p < .10). In corroboration of the aligning the stars narrative, professionals thus appear to appreciate strategic planning and formal governance, and the objectivity they

Table 3. Structural equations modeling results.

Relationship	Partners (*n* = *196*)	
	β	*t*
Size → Human capital	.23	1.57
Size → Reputation	.18	.94
Size → Formal governance	.62	3.58
Size → Strategic planning	.85	3.32
Size → GPPP	.55	2.06
Internationalization → Human capital	–.09	–.64
Internationalization → Reputation	–.14	–.62
Internationalization → Formal governance	.11	.56
Internationalization → Strategic planning	.20	.74
Internationalization → GPPP	.05	.26
Diversification → Human capital	–1.41	–6.43
Diversification → Reputation	–.86	–2.94
Diversification → Formal governance	.71	2.21
Diversification → Strategic planning	.55	1.17
Diversification → GPPP	.04	.09
Human capital → Client attraction and retention	.42	3.57
Reputation → Client attraction and retention	.38	4.62
Formal governance → Efficiency	.13	1.33
Strategic planning → Efficiency	.23	2.66
Formal governance → Human capital	.13	2.12
Formal governance → Reputation	.11	1.22
Strategic planning → Reputation	.11	1.91
Strategic planning → Human capital	.10	2.23
Client capture → GPPP	.28	2.05
Efficiency → GPPP	.04	.98
Age → GPPP	.42	1.29
Model fit	χ^2 = 1566.80; d.f. = 638; *p* = .0; RMSEA = .0864; CFI = .919; NNFI = .911; SRMR = .172	

GPPP = gross profit per partner, d.f. = degrees of freedom, CFI = comparative fit index, RMSEA = root mean square error of approximation, NNFI = non-normed fit index, SRMR = standardized root mean square residual.

bring to appraisal, coordination and control procedures. Finally, Hypothesis 4 suggested that human and reputational capital are important antecedents of client attraction and retention, which in turn drive PP performance. Our results support this conjecture, as both the effects of human capital (β = .42, t = 3.57) and reputation (β = .38, t = 4.62) are significant, as is the effect of client attraction and retention on GPPP (β = .28, t = 2.05).

Control variable results. We expect increasing levels of size, diversification and internationalization to result in organizational complexity, which PPs deal with mostly through increased formalization. In terms of size, we indeed find that larger firms make more extensive use of strategic planning (β = .85, t = 3.32) and formal governance (β = .62, t = 3.58). Larger firms also have higher GPPP (β = .55, t = 2.06). Size does not affect human capital (β = .23, t = 1.57) or reputation (β = .18, t = .94). In terms of diversification, we find that more diversified firms have lower-quality human capital (β = –1.41, t = –6.43) and reputation (β = –.86, t = –2.94). Diversification has no effect on strategic planning (β = .55, t = 1.17) or GPPP (β = .04, t = .09), but more diversified firms do have higher levels of formal governance (β = .71, t = 2.21). Internationalization had no effect on human capital (β = –.09, t = –.64), strategic planning (β = .20, t = .74), formal governance (β = .11, t = .56), reputation (β = –.14, t = –.62) or profits per partner (β = .05, t = .26). Finally, we found no significant effect of organizational age on GPPP (β = .42, t = 1.29).

Discussion

Towards an integrated theoretical framework of professional partnership performance

Despite the importance of PPs for contemporary economies, we know relatively little of their governance, strategic management and performance (Mawdsley and Somaya, 2015). Specifically, most prior empirical work on these topics within the PP setting has been qualitative in kind (e.g. see Boussebaa, 2009; Carter and Mueller, 2002; Kärreman and Alvesson, 2009; Lawrence, 2004; Mangen and Brivot, 2015; Smets and Jarzabkowski, 2013). The issue with studies such as these is that although they are descriptively ‘thick’, they are simultaneously narrow in terms of their empirical scope, which calls into question the generalizability of their findings (Empson et al., 2015). In fact, several commentators have observed that most of what we think we know about MPB-type organizations is derived from a study of only two Canadian law firms (Brock et al., 2007; Pinnington and Morris, 2003). In response to the call that especially

> [m]ore research is needed on those European … contexts where the traditional archetype of professional organizations has not been so well established to ascertain the generalizability of the changes [in PP practices] observed in [the literature on professional organizations].

We therefore conducted a quantitative survey study on 196 Dutch law firms to address three salient questions.

The first question we addressed was: *Does the adoption of organizational practices, like formal governance and strategic planning, contribute to PP efficiency, and in turn to PP performance?* Against our theoretical expectations, we found that formal governance does not increase organizational efficiency in PPs, even though strategic planning does. More saliently, even, we also found no evidence supporting the claim that increased organizational efficiency enhances PP performance. Our second research question was: *How do the new organizational practices of formal governance and strategic planning affect PPs’ human and reputational resource base?* On this issue, we found support for the ‘aligning the stars’ narrative (Lorsch and Tierney, 2002), in that we uncovered a positive relationship between the more formal governance and strategic planning practices that many PPs have recently implemented, and the development of their human and reputational resource base. Formalization thus appears to be appreciated by professionals and other organizational onlookers, in that they apparently seek to be affiliated with and attribute higher status to PPs seeking to maintain or regain control over their increasingly complex organizations through the implementation of practices that lead to more objective and structured governance and strategy processes. The third question we raised was: *Do human and reputational resources remain the principal drivers of PP performance, even as many PPs are undertaking organizational change efforts in the direction of the MPB?* Through our study, we were indeed able to confirm the findings reported in prior research, notably that human and reputational resources continue to be preeminent performance drivers for PPs. Yet our study has also extended this conventional wisdom by showing that the performance effects of these drivers are mediated by client attraction and retention, consistent with the critical role that clients play in the marketing, customization and delivery of professional services. We proceed to discuss the implications of these findings for performance shaping factor (PSF) theory and research.

Formalization and its effects on efficiency and performance

We have tested the common beliefs that PPs adopt new organizational practices like formal governance and strategic planning to improve their efficiency, and that greater efficiency will ultimately be conducive to higher GPPP (Cooper et al., 1996; Maister, 1997). To our surprise, we only found a significant link between strategic planning and PP efficiency, and that PP efficiency itself is wholly unrelated to GPPP. Whereas this finding challenges any straightforward functional narrative of the reasons behind the adoption and implementation of these practices in PPs, they do not rule out the existence of a more complex relationship between formal governance and strategic planning on the one hand, and PP efficiency and performance on the other (Empson et al., 2013). More specifically, this relationship may be characterized by bidirectional causality. As PPs grow through mergers and acquisitions, internationalize to foreign markets, and diversify into new practice areas, the complexity of their operations increases. In response, PPs are likely to adopt new organizational practices to help them safeguard or restore the efficiency of their operations (see Table 4).

Another example of potential bidirectional causality exists between diversification on the one hand and human and reputational capital on the other. At first glance, the strongly negative relationships between these constructs suggest that diversified firms experience difficulties in the struggle for legal talent and in maintaining their reputations. It is equally possible, however, that law firms diversify in response to their poor positions in the labor market and in the market for legal services. More longitudinal research using panel data and endogeneity corrections is needed to disentangle such causal complexities between change drivers, PP resources and the adoption of formal practices (Empson, 2012; Empson et al., 2013). Also, our central constructs are formal governance and strategic planning, which are suggested to increase with increased size and complexity. The firms in our sample are small in comparison with other types of organizations, however, and predominantly domestic. A future research opportunity is therefore to further investigate the generalizability of our findings against a sample of larger law firms, such as those residing in London's 'Magic Circle'.

Table 4. Size-based comparison.

	International	Diversified	Age	Formal governance	Strategic planning	Human capital	Reputation	Client attraction and retention	Efficiency	GPPP
Size 6–10	.02	.45	1.24	3.95	4.12	5.49	5.74	5.15	4.21	4.64
	(.11)	(.18)	(.39)	(1.06)	(.99)	(.80)	(.82)	(.82)	(.98)	(1.43)
Size 11–60	.07	.58	1.46	4.59	4.89	5.51	5.92	5.46	4.22	5.11
	(.25)	(.19)	(.40)	(.94)	(1.02)	(.74)	(.69)	(.70)	(1.03)	(1.03)
Size >60	.70	.71	1.75	5.12	5.39	5.66	5.74	5.43	4.19	4.97
	(.47)	(.11)	(.30)	(.57)	(.61)	(.67)	(.82)	(.59)	(1.00)	(1.21)

GPPP = gross profit per partner; mean = standard deviation.

Governance and strategic planning and professional partnership resource dependencies

The conventional narrative in the literature, also known as the 'herding cats' hypothesis (Løwendahl, 2005; Von Nordenflycht, 2010), is that PPs rely on informal governance practices because professionals highly appreciate their autonomy. Because talented professionals are highly mobile and thus enjoy strong bargaining power relative to the PPs that employ them (Von Nordenflycht, 2010), it has been conjectured that they will easily trade in PPs with formal governance for ones that are less inhibitive towards their professional autonomy (Greenwood and Empson, 2003; Lorsch and Tierney, 2002; Pickering, 2015). Our study, however, suggests that the adoption of more formal governance and strategic planning practices in fact *help* PPs to develop and maintain their human and reputational resource base more effectively. Although this finding may look puzzling at first sight, it makes more sense when understood in light of the unique resource dependencies of PPs compared with other organizational forms.

The alternative 'aligning the stars' narrative (Lorsch and Tierney, 2002) predicts that PPs with better-developed formal governance and strategic planning will in fact come to enjoy *better* human capital and organizational reputation. Professionals and other organizational onlookers are apparently willing to put up with more formalization, provided that it results in tangible benefits, such as a more objective and predictable ascension to ownership, better marketing and customization of professional services, and enhanced safeguards against professional misconduct. The adoption of formal governance and strategic planning practices thus helps PPs manage their unique resource dependencies, and develop and maintain their human and reputational resource base more effectively (Leblebici and Sherer, 2015). Although there thus seem to be functional benefits to managing PP resources through more formalized measures, what this means for professional values remains unclear (Adler et al., 2008). The introduction of more formalized controls has been suggested to lead to a replacement of the professional ethic of service by a more commercial and managerial attitude (Brock, 2006). Whether this substitution of professional values leads to the erosion of public service is an important area for future research, and we would therefore welcome more studies exploring the link between the adoption of formal practices by PPs and their proneness towards professional misconduct and other forms of unwanted behavior.

Client attraction and retention: A crucial link

Whereas several prior studies on PPs have documented a positive effect of human and reputational capital on GPPP (Greenwood et al., 2005, 2007; Hitt et al., 2001, 2006), the mechanisms through which traditional PP resources affect GPPP have largely gone untested (Mawdsley and Somaya, 2015), in spite of the fact that many suggestions have been made. Human capital has been argued to increase GPPP because the superior abilities of top lawyers allow them to handle more complex cases, as their credentials and exceptional skill levels enable them to command fee premiums and prestige (Hitt et al., 2001, 2006). Similarly, a variety of causal mechanisms linking PP reputation to GPPP have been suggested in prior studies. For example, highly reputed PPs may have a superior position in the labor market for freshly graduated lawyers, might save on marketing costs because clients are naturally drawn to highly prestigious firms, and possibly incur price premiums because of the brand value of their name (Greenwood et al., 2005, 2007). Because these suggestions have largely gone untested, considerable ambiguity exists concerning the mediating mechanisms linking PP resources to GPPP.

In this study, we have been able to take away some of this ambiguity by demonstrating that the performance-enhancing effect of PPs' human and reputational resources is largely channeled through client attraction and retention (Broschak, 2015). This finding underscores that a critical and synergistic relationship exists between PPs and their clients throughout the process of marketing, customizing and delivering professional services. An important part of the value of human and reputational resources, therefore, is that they increase the joint value created in the relationship between PPs and their clients, and that they enable PPs to appropriate this value because clients expect a reduction of joint value creation when switching to a less qualified or less reputed service provider (Blyler and Coff, 2003). We welcome future studies zooming in on this type of joint value creation between PPs and their clients, and on the factors that affect a PP's ability to appropriate at least a portion of this jointly created value.

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Notes

1. We thus distinguish the PP, which is a legal form, from the P^2 and MPB, which are two alternative archetypical forms of professional organizational governance, of which elements can be found in extant PPs to varying degrees (Cooper et al., 1996; Pinnington and Morris, 2003).
2. These metrics are computed as follows: the *agreement ratio metric*, $r_{wg(j)} = \dfrac{J\left(1-\frac{\bar{s}^2_{x_j}}{\sigma^2_E}\right)}{J\left(1-\frac{\bar{s}^2_{x_j}}{\sigma^2_E}\right)+\left(\frac{\bar{s}^2_{x_j}}{\sigma^2_E}\right)}$

   where $\bar{s}^2_{x_j}$ is the mean of the observed variances for J essentially parallel items, σ^2_E is the variance expected when there is complete lack of agreement among the judges, and J is the number of items included in the multi-item measure (James et al., 1984).

   The *agreement percentage metric* is determined by first computing the average score per item across all judges rating an object, then determining the percentage of judges whose average per-item scores fall within the +1 to –1 range around this average, and finally dividing this percentage by 100. These metrics are reported for each multi-item measurement scale.

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Appendix A: Measurement scales

Human capital

1. Our lawyers are highly skilled.
2. Our lawyers are widely considered the best in their practice area.

3. Our lawyers are creative and bright.
4. Our lawyers are experts in their particular area and function.
5. Our lawyers develop new ideas and knowledge.

Reputation

Comparing this company to all other law firms

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

Formal governance

1. We use tight budget controls.
2. Trends in performance are closely monitored.
3. We keep close watch on costs incurred in various practice areas.
4. We keep close watch on costs incurred by each lawyer.
5. We intensely monitor profits made by each practice area.
6. Planning helps us achieve coordination of goals and projects within our firm.
7. Planning helps us achieve coordination and organizational unity within our firm.
8. All employees undergo formal periodic performance appraisals.
9. In my firm a lot of time is invested in the development of procedures that ensure financial integrity.
10. The quality of the services we deliver is regularly compared with our self-set standards.

Strategic planning intensity

1. We often adjust our goals to meet changes in the market.
2. In our planning we must deal with strategic issue turnover.
3. We really plan all the time rather than at regular intervals.
4. We develop formal plans for potential services and markets.
5. We have a written business plan. (*new item*)
6. We systematically search for new services, customers and investments.
7. Our planning deals with a broad range of strategic issues.

Client attraction and retention

Over the past 3 years, my firm successfully …

1. … retained its largest clients.
2. … retained the large majority of its clients.
3. … attracted a large number of new clients.
4. … realized its long-term goals.

Efficiency

Over the past 3 years, my firm successfully …

1. … controlled its cost position.
2. … achieved a low overhead percentage.
3. … developed or maintained a very efficient organizational structure.