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Managing Professional Firms: How Partner Compensation Supports Strategic Choices

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This article presents a study about professional firms' partner compensation system based on the 'pie-splitting' research conducted by David Maister among American law firms. Greater internal demands from professionals and higher quality of services required by clients induce professional firm leaders to reflect about their managerial structure, internal processes and human capital development (DeLong, Gabarro & Lees, 2007). A key topic to be addressed in order to better understand strategic dilemmas of professional firms is partner compensation. In the literature, it is widely discussed how to equitably reward partners, considering external and internal criteria, but a lack of research and structured models can be found. This study intends to help professional firms' managers in defining the criteria for partners' compensation in order to support internal and external strategy of their firm. The goal of the research is to expand and verify the results of Maister's study. The research will be the first carried in Italy including in the sample the top 100 Italian professional law firms. Authors intend to identify the skills and behaviours mostly rewarded in professional firms and to test whether there are differences in the criteria that firms consider in splitting the partnership pie. Moreover, future steps of the research will investigate whether the compensation system applied by a professional firm is designed in a way that it supports the firm's strategic decisions.

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1. Introduction

Professional firms are usually run without a formal managerial structure. Changing the context and increasing the number of partners and the volume of activities, they experience high tensions resulting in a high turnover of people and loss of clients.

The nature of professional services is changing, as firms experience greater internal demands from their professionals and greater external demands from clients (DeLong, Gabarro & Lees, 2007). On one side, we find partners' ambitions and associates' development needs that often are not being met; on the other side, we have clients expecting a higher level of customization, being helped in areas where firms may have little or no expertise, and new types of relationship moving from a professional-client toward a firm-client relationship. Professional firms are characterized by being people intensive businesses where they manage intangible assets (knowledge, experience, reputation) and offer intangible services provided typically by highly skilled people. Labour, or human capital, is a critical type of intangible asset on which firms increasingly rely (Lev, 2001). The broadest definition of human capital in the organizational behaviour literature is that it is the knowledge and/or skills possessed by the firm's workforce (Lev, 2001; Barney, 1991; Becker et al., 2001). Firms that rely

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on human capital usually require cooperative efforts, knowledge exchange, collaboration between workers, and a collegial sharing environment (Schulz, 2001).

Motivating professionals is harder today than it used to be, and it is more important to the success of the professional service firm (Maister, 1997). The lengthening of the partners' appointment, the pace, the competitive intensity and the workload are greater than ever while economic remuneration hasn't increased accordingly. Theories of motivation (McClelland, 1975) suggest that high-need-for-achievement personalities are motivated by extrinsic rewards combined with very challenging work. Drivers for achievement, power and affiliation determine professionals' commitment while compensation and bonuses "recognize" and keep score of their results.

In this environment, senior partners and professional firm leaders face several challenges to effectively manage their firms and retain best professionals. Their main objective is to generate profits by developing synergy and economies of scale and by reducing complexity and dissension among partners. Although such leaders went into their profession to be technical experts and problem solvers, they have to spend a great deal of time dealing with human capital and managerial issues.

The most troublesome topic in professional firm management is partner compensation (Maister 1997). In fact, the division of profit implicitly communicates accepted behaviours and strategic directions of the firm such as, business development, long-term sustainability, people development, or entrepreneurship. As David Maister underlined, an effective compensation system must meet internal and external equity. Internal equity requires that, whatever the rules are, they must be applied in a consistent manner. External equity requires that the compensation system in the firm reflects the economic realities of the open market.

Even if it is so complex and crucial to the success of a firm, profits sharing in professional firms occur typically following a random and semplicistic calculation. It is not uncommon to find firms without any scheme defined and without any performance appraisal and communication plan. Typically, compensation is defined by the founder of the firm in a one-afternoon session and it is personally communicated in an accidental circumstance.

This method could have worked in the past where law firms were characterized by a low mobility of partners from one firm to another. But as this market develops, "many firms will be forced to make significant shifts in the relative rewards they allocate to different types of partners" (Maister, 1997).

This article intends to explore the different systems of partner compensation in order to outline the main criteria applied by firms and to make explicit the decision-making process underpinning the division of partnership profits. The "literature review" section describes the findings of past studies concerning the topic of partner compensation in professional service firms. First of all it points out the peculiarities of professional firms and the spectrum of different practices that PFs can engage in. Then, the paper analyses the literature concerning a troublesome topic in the world of professional firms such as partner compensation systems and the importance of clear and transparent performance measures within firms. In the following paragraphs the link between compensations systems and strategies of professional firms is described and the lack concerning this topic in literature is highlighted. The "research design" section describes the objective of the research and its link to the research conducted by Maister on American professional firms. The “methodology” section explains the definition of the sample and the way the research will be conducted. In the last section the expected results are described as well as their implications and the way the results will be able to fill an existing gap in the literature and to contribute to the current body of knowledge.

2. Literature Review

2.1 The Peculiar Characteristics of Professional Firms

Professional service firms are knowledge intensive organisations that provide expert to clients; examples of professional services include accounting, engineering, management consultancy and legal services (Lowendahl, 2005; De Brentani and Ragot, 1996).

In fact, there are some peculiar characteristics of professional service firms that distinguish them from other types of organizations. First of all, professional firms’ primary assets (like knowledge, experience and reputation) are intangible. Second, the service they deliver is intangible too. Furthermore, the services provided are customised or adapted to individual customers’ needs (Nachum, 1999; Fitzgerald et al., 1991; Maister, 1997). Third, in professional firms highly skilled and trained people provide services in direct contact with the customer, developing customer-centric relationships (Chang and Birkett, 2004).

In other words, professional firms’ uniqueness rotates around some peculiar features. In fact, professional firms are organized to create value by selling and delivering promises to their clients. The value creation is achieved through intellectual capital, and not through machines and tangible assets, as it happens in other business organizations. Moreover, the main assets are human: for this reason a strong recruiting and retention system in professional firms is necessary, as well as the development of an effective knowledge-management program. Another key asset of professional firms are relationships. Given the importance of human assets, the relationships that professionals have within the firm and with the clients are critical for professional firms in achieving competitive advantage. In fact, in many cases the firm discovers that clients were loyal to a specific professional and not the firm as a whole.

The governance of a professional firm is also different from that of a typical corporation in which owners and shareholders are a different group of people from managers and employees. In professional firms, in fact, the different groups of people (owners, managers, and employees) tend to overlap, thus generating a complex relational context.

The nature of professional services is changing nowadays, as firms experience greater internal demands from their professionals and greater external demands from clients (DeLong et al., 2007). In fact, high-quality work and dedication are no longer sufficient for a successful law practice. In the last three decades, a range of factors have had significant impact on professional firms, including competitive threats from other professions, an intensive use of technology, and the fact that knowledge is depreciating much faster than ever before (Riskin, 2005).

Professional firms' leaders have to manage both the external environment of clients and competition and the internal environment of people and processes. According to DeLong et al., to be successful a professional service firm needs not only to achieve success in each quadrant of the figure below, but also to achieve balance among the four quadrants.

Figure 1: Table of the internal and external environment (Source: DeLong et al., 2007)

External strategy relates to the development of a unique vision that meets clients' needs and creates economic value for the firm. Internal strategy involves organizing coherent governance mechanisms, formal and informal structures and compensation systems. Internal processes include human capital management (recruitment, training, motivation…), knowledge management and decision making. External processes, finally, ensure that promised services are delivered through client management and the firm's ability of adaptation to competitive dynamics.

2.2 The Spectrum of Professional Firm Practices Proposed by Maister

Professional firms can vary in a significant way in their focus, practice, product intensity and markets. David Maister has described these differences in his book Managing the Professional Service Firm, where he developed three different types of practices that professional firms may engage in: efficiency-based, experience-based and expertise-based. Each type of practice varies in its staff, its leverage (ratio of partners to staff) and its margins (DeLong et al., 2007).

Figure 2: Maister's segmentation of practices (Source: compiled from Maister, 1997 and DeLong et al., 2007)

	Efficiency-based	**Experience-based**	**Expertise-based**
Client problem	Efficient solutions to common problems	Customized solutions to generic problems	Unique solutions to unique problems
Application	Skill	Judgment	Creativity/innovation
Critical success factors	- Established systems, methods and methodologies - Efficient delivery	- Experience - Knowledge - Depth	- Unique analysis - Creativity - State-of-the-art knowledge - Pioneering concepts
Selling proposition	"Faster, better, cheaper"	"We've been there before; we can help you through this"	"Smartest brains around"
Recruiting process	Major role of less skilled professionals and more paraprofessionals.	Major role of less skilled professionals and more paraprofessionals. The specific experience in some engagements would allow the firm to implement systems and procedures and hence require less mature talent. Training approaches quite formal. Lower need for an up-or-out system: better a system of "permanent associates". Clear career opportunities for juniors.	The firm should seek for top graduates from the best schools. Since standards would be high, a rigorous up-or-out promotion system would ensure that the firm retained only the best.
Mix of professionals	Most junior time possible. Maximum use of paraprofessionals. Increasing use of technology.	High percentage of junior professional time needed. Relevant percentage of senior progessional time needed.	High percentage of senior professional time is needed
Development techniques	Highly targeted and specialized brochures, use of advertisements promoting specific services.	Rather than relying on individual talents, the firm needs to create an institutional reputation. Ability to create collective knowledge derived from past engagements. Promoting the firm's specialized knowledge through brochures, clients newsletter, seminars on topics.	Writing articles, books, giving speeches, being quoted in the media, establishing credentials as "expert"
Governance form	The value-added that the firm brings to its clients is less embedded in individual people and more in the firm's operating systems, procedures. Formally organized as corporations, with equity ownership held by a small group. Transfers of ownership are accomplished by selling stock at fair market value.	The value-added that the firm brings to its clients is less embedded in individual people and more in the firm's collective experience. A greater senso of equity ownership should prevail. New partners or shareholders might be required to buy their future participation in firm profits by contributing to partnership capital or purchasing shares. Greater need for formally recognized departments and areas of specialization.	A collegial partnership of peers headed by a leader who symbolizes the firm's committment to high standards. Autonomy of the individual partner. Little use of formal internal structuring. No individual should be said to "own" the firm. Rights to participation in the firm's future profits should be "given away" by senior professionals in order to retain top talent.
Location strategy	Multiple-location firms	Multiple-location firms	Single location relying on the development of national or regional reputation to attract clients
Compensation approach	Wage systems, with provisions for overtime payment for junior personnel	Straight salary, with increases deriving from seniority	Profit-sharing and bonus pool sustems for junior professionals

The three types of practices meet the three key benefits that clients seek in a professional firm: expertise, experience and efficiency.

Figure 3: Three types of clients with different needs (Source: compiled from Maister, 1997)

Type of client	Looks for	Type of product to deliver	Billing rate	Needs
Client with a complex, high-risk and unusual problem	Creative, talented, innovative professional or firm	High costumization	Almost any cost	Expertise
Client that recognizes that his problem has been faced in the past	Experience with similar problems	Low costumization	Medium price	Experience
Client that knows that his problem can be handled competently by a broad range of firms.	Prompt start, quick disposition, low cost	No costumization	Low price	Efficiency

As we have seen, once that the professional firm has chosen the strategy to focus on, every aspect (practice development, compensation system, economic structure, governance) will be affected by its positioning.

Clients seeking expertise are those having a large, complex, high-risk and unusual problem, that needs to be faced by creative and talented individuals or firm, almost at any cost (Maister, 1997). The expertise-based practice serves clients that have to deal with problems they have never seen before. A high level of creativity is required, in order to solve complex problems with new ideas. Clients go to an expertise-based firm when they feel they are in such an unfamiliar issue that they absolutely need “the smartest people around” (DeLong et al., 2007) and they are willing to pay whatever price for this service. Financial margins of this kind of practice are typically very high, while leverage is very low because partner-level professionals must be intimately involved because of the complexity of these though projects.

Clients seeking experience are those that recognize that their problems have probably been faced by other companies and that require less customization (Maister, 1997). The experience-based practice is targeted to clients that are not completely satisfied with a fast and cheap solution to an issue they may have: they are seeking for a firm that has deep experience on that particular type of problem. Few junior staff can be employed on experience-based projects: this kind of practice enjoys low leverage, but it can claim higher margins because clients are willing to pay more for the experience offered.

Clients seeking efficiency are those that know that their problem can be handled competently by a broad range of firms, so they will chose the professional firms based on its quick disposition and low cost. Efficiency-based practice is characterized by “procedure” projects, which involve standardized procedures and methodologies. These standardized procedures make it possible for junior staff to execute the practices quickly and accurately. This is why efficiency practices are typically low margin but very high leverage.

Understanding the differences between expertise, experience and efficiency practices is crucial to the success of the professional firm. On the one hand, the firm can choose to follow a practice area down its life cycle, on the other hand it can gradually abandon maturing practice areas and move into new practice areas. A third option, maintaining a firm with different practices at various stages of the life cycle, is a challenging managerial task (Maister, 1997).

One critical way in which professional service firms vary is in the market segments they serve. To succeed, a firm must be clear about what business its individual practices are engaged in, which requires a deep understanding of how the markets for professional services are segmented (DeLong et al., 2007).

It is important to underline that firms generally run a mix of projects that cover a range of practice types, but rarely a firm's projects covers all three of the practice types described. In fact, as Maister points out, it is almost impossible for a professional firm to accommodate at the same time the various needs of the different types of clients. For example, a firm that wishes to attract the "high expertise" engagements must organize its affairs and methods of doing business in such a way that will make it an unlikely candidate to be chosen by a client who gives more importance to efficiency and vice versa (Maister, 1997). Any firm can be successful by competing in any practice segment if it knows where it is and what it needs to be successful there. What is crucial is that firm leaders must be clear on what segment they are serving, provide the direction and develop the commitment in order to ensure success in that segment (DeLong et al., 2007).

2.3 A New Spectrum of Professional Firm Practices

Starting from Maister's warning about the tendency toward the maturing or commoditization of practice, DeLong, Gabarro and Lees have further developed Maister's spectrum of practices previously described. The authors of the book When professionals have to lead state that it is relatively difficult for firm leaders to remain calm and focused about their purpose when more firms are joining the market. In this highly competitive environment, the borders between efficiency-based, experience-based and expertise-based firms become thinner.

As DeLong points out, today's pressure toward commoditization and the actions undertaken by some firms in each segment to counteract this phenomenon have resulted in a redefinition of the practice segmentation in professional firms. In fact, in the midst of the commoditization, some firms either have tried to maintain their margins by upgrading the services they offer, or have realigned themselves to adapt to a new, lower-margin, segment and then competed to succeed in it. DeLong suggests to move then from the three types of practice segments in professional firms proposed by Maister to a table of four types of practice segments based on the nature of the services offered and their underlying economics. To succeed, a firm must be clear about what segment it serves and must be aligned in its objectives to meet the segments' needs.

Figure 4: Practice segmentation in professional services (Source: DeLong et al., 2007)

	Standardized Services	Customized Services	Expertise-driven services	Rocket science services
Client problem	Efficient solutions to common problems	Help in making an informed choice from a variety of options and guidance through the process	A major, complex issue of which the client has little or no experience	A major "bet your company" issue: the client has never experienced anything like it
Key skill	Efficient, low-cost delivery of established methodologies, models and processes	Providing user-friendly advice that reduces anxiety in the selection process and thereafter	Real-time diagnosis and judgment	Providing innovative and novel solutions
Critical success factors	- Established methodologies, models and processes; - Efficient and low-cost delivery systems; - Highly effective training practices	-Established methodologies, models and processes; - Efficient and low-cost delivery systems; - Interpersonal/relationship skills; - Managing the "sales" costs	- Experience with similar problems; - In depth tecnhical knowledge and/or functional knowledge; - Strong relationship skills	- Highest level diagnostic skills; - Creativity; - State-of-the-art knowledge; - Pioneering concepts
Profit drivers	- High volume - High leverage	- Above-average fees - Good leverage	- High fees - Low leverage	- Premium fees - Very low leverage - May refer work to other providers
Selling proposition	"Better, faster, cheaper"	"Use us, we'll help you make a better choice and provide you with ongoing support"	"We've seen similar problems before. Trust us, we'll help you with your problems"	"Smartest brains around"

The standardized service segment requires codified knowledge able to provide solutions for generic problems. Well-established methodologies, models and processes allow the firm to provide low-cost services to its clients. The firm's selling proposition is "We can deliver the work better, faster and cheaper": it is the least differentiated segment. Partners have minimal involvement in the execution of the work, which is mainly performed by junior and mid-levels. Support, feedback, work flow management and horizontal communication are critical to success in this segment.

Customized Services' clients want more than standardized and fast service: they look for a solution suited to their particular situation, but they are still price-sensitive and expect efficient and low-cost delivery. This type of service requires a high level of established models, methodologies and processes, but it also requires professionals with excellent selling and relationship-building skills, as these are critical to building a trusting relationship with the client and marketing customized solutions. Firms providing customized services leverage junior and mid-level professionals to execute much of the work, but senior involvement in this segment is more crucial than in the standardized services because experienced judgment in choosing which options to present to the client is required, as well as guidance to the client in the selection process of the best option.

Firms delivering expertise-driven solutions deal with clients that have little or no experience with their issue which is typically complex or ill-defined. Firms operating in this segment offer experience with similar problems as well as specialized knowledge. Practices in this segment can be charged to clients with relatively high fees because of the experience and expertise they receive. Mid- and partner-level professionals' involvement is quite intensive in this segment, consequently the leverage is low.

Clients seeking for rocket-science solutions usually face issues for which depth of expertise or experience is not enough and therefore they are ready to pay premium fees tor a professional firm with rocket science skills. These practices demand an even higher involvement of senior members, who have to create new knowledge every day, than in the expertise segment: consequently the leverage is lower. This segment contains the smallest number of firms or practices. Professionals that join such firms know they will receive immediate feedback on their work, challenging assignments and top compensation. Nevertheless, they also know that in rocket science firms often there is no private life. A challenge of firms focused on this segment is to keep all the professionals feeling included in an intense and competitive environment.

2.4 Partner Compensation Systems in Professional Firms: A Troublesome Topic

The tough market in the first few years of the twenty-first century resulted in many firms taking on engagements for which their people and resources were poorly suited, and at margins that were not sustainable without changing their business model. In time, some firms learned not to promise professionals' expertise that they then could not deliver. They also learned to select clients, by avoiding those not willing to pay for the experience they had to offer. As a result, many firms are no longer trying to be what they are not and they are orienting their efforts in understanding what segments they want to serve and what it takes to be effective in these segments.

One of the most recurrent issues in any professional service firm is how to equitably reward performance (Millard, 2005). In some firms, the compensation of employees is based mostly on the level of seniority and years of service. In others, star performance "solo operators" are generously rewarded, while those with a lower visibility and with excellent team work skills may be penalized. In some firms, the process of determining compensation and bonuses is transparent, while in others it may be enigmatic (Millard, 2005). The consequence is that very few firms are entirely satisfied with their partner profit sharing systems (Jarrett-Kerr, 2012).

As Maister pointed out, the most troublesome topic in professional service firm management is partner compensation. This is because in the division of profits there are different issues that need to be clarified. For example, the right balance between recognizing current performance and long-term contribution is necessary, but still not easy to achieve. When deciding the division of profits, there are many questions that might arise: who should get more, the partner who trains associates well or the one that excels in the business getting? The one who works more billable hours or the most creative professional? Also, who in the firm should take these decisions?

Lawyers constantly strive for perfection, and yet there is no such thing as a perfect way of allocating and distributing a law firm's profits among its partners. The big question to decide is whether the firm needs to renovate its compensation system or to persevere with the current one. Even if there is no such thing as the perfect compensation system, it seems that many partner compensation schemes are in need of either a complete renovation or of some substantial changes (Jarrett-Kerr, 2012).

2.5 The Importance of a Clearly Defined Compensation System and of Transparent Performance Measures

Compensation decisions operate as internal and external signals of the firm. The information about which features are most rewarded affects the firm's culture and atmosphere. But, most of all, it influences how partners choose to spend their time.

Rewarding professionals solely on the basis of traditional financial measures may lead them to make decisions that enhance current performance and bring monetary rewards with little regards for the future (Rappaport, 1978). A proposed solution to counteract this undesirable behaviour is to link compensation to a firm's strategic context through the use of appropriate performance measures in compensation contracting (Rappaport, 1978).

Agency theory suggests that the extent of reliance on performance-based compensation systems depends upon the informativeness of available performance measures (e.g. Holmstrom, 1979; Banker and Datar, 1989; Lambert and Larcker, 1987). According to these models, uninformative measures increase the likelihood that an agent's effort will go unrewarded. Consequently, the benefits from performance-based compensation types are positively related to the informativeness of the performance measures in the compensation contract (Ittner, Larcker and Pizzini, 2007).

According to Jarrett-Kerr, firms should be trying to move from informal, subjective and opaque methods of judgement and valuation to a clearer, more transparent and objective model of compensation. The model should be that clear that a lawyer entering the firms would be able to answer to the most frequent question among young professionals: "What do I have to do to succeed in this firm?" (Jarrett-Kerr, 2006). If the performance measurement system clearly communicates the importance of human capital and makes known the value the firm places on its human capital through its measurement system perhaps employees will be more likely to share in the firm's vision, align their actions with the firm's objectives, and be more willing to give up their competitive advantage through the sharing of knowledge (Widener, 2006). In this sense, the compensation system can affect a firm's strategic direction (Maister, 1997).

A compensation system should be related to the firm's strategic goals. For example, if the leaders think that the mentoring of juniors is a worthwhile pursuit, then there should be some form of reward in the compensation system otherwise the message delivered to partners is that it is valueless and it will be done only through their altruism and sense of teamwork (Anderson, 2001).

Furthermore, there isn't a perfect system that will satisfy all partners, meet all strategic goals and never need to be changed. A compensation scheme is a system that needs to change or adjust according to the firm's needs, in order to meet the demands of changing times: either to satisfy partner concerns or to adapt the system with ever-changing firm goals (Anderson, 2001).

2.6 From a Seniority-Based Compensation System to a Performance-Based One

Historically, in professional firms partner compensation has been a system based on seniority. Some firms use a lockstep model, where the only variable taken into account is how long a professional has been a partner. Others relate compensation on a number of factors, but seniority counts more than any other factor in the decision process.

The biggest weakness of the seniority system is that it fails to reward differences in performance among partners of equivalent tenure, easily discouraging partners (Maister, 1997).

In spite of the weakness of the lockstep systems, some of the most successful professional firms continue to use it. It certainly is a system that minimizes discussions of partners' relative contributions, moving the attention from internal issues to the external challenges, such as winning and serving clients. But as Maister highlighted, the lockstep system seems to have survived mostly among firms who have not registered declines in overall profitability: a status that in recent times has become harder to maintain, even for the most prestigious professional firms.

Nevertheless, as many firms have learned, the path to a performance-based compensation system, rather than a seniority-based one, is fraught with difficulties. Many professional firms measure their success by the number of hours billed or dollars earned (Green, 2005), and in order to avoid the subjective assessments of partners' work and the evaluation of intangible qualities, they divide partnership profits solely according to measurable criteria, such as business origination, hours billed, and so on.

The problem is aggravated by the difficulty of judging soft areas (the intangible assets) of performance. In fact, the complexity of professional services work limits consumers' and managers' abilities to judge the performance of professional service providers (Goodale et al., 2008). It is much easier, for example, to measure the billable hour and its conversion into cash (Jarrett-Kerr, 2006). In many firms the billable hours are the only measure of performance, since they are considered to be directly proportional to the revenue earned, while time not spent on billed work is seen as wasted (Millard, 2005).

Such methods fail to reward many important contributions that can't be measured (a partner that spends time training juniors, or a partner that solves troublesome administrative problems) and lead to the underdelegation problem: partners who are too busy don't pass on work to others, since numbers are all that count in the compensation decisions (Maister, 1997). In fact, because so much time is devoted to serving paying clients, professionals are challenged in their ability to pursue other aspirations and commitments, such as training young lawyers and rendering pro bono service (Green, 2005).

Another weakness of a compensation system based solely on quantifiable activities is that it is short-term oriented. In fact, it seems not to recognize the time that a partner spends in developing new practice areas, or in developing the firm's reputation: activities that might bring new profits in the years to come. In fact, non-billable time spent by employees or partners often determines new perspectives for the long-term strategy of the firm. In particular, non-billable time could be spent constructively to develop the asset base of the firm (researching future client needs, developing new services that meet these needs, improving administrative systems in the firms, developing the professional skills of the members of the firm, training junior staff, etc.).

The balance between a reward based on revenue generation and a reward that considers also asset-building activities is often difficult to meet (Jarrett-Kerr, 2006). Yet, as the professionals become more competitive, a long-term view is crucial and time end efforts must be spent in developing new expertise areas and penetrating new industries and geographical areas (Maister, 1997).

In order to run an effective compensation-setting process, Maister suggests the setting of a small compensation committee among partners that must set clear rules and criteria by which partners are appraised. These rules and criteria should be stated in a written compensation policy, which needs to be updated and circulated in the firm every year. An important thing to consider is that the committee should not give different criteria the same weight in every partner's case. In fact, as professional firms grow, individuals contribute in different ways. For example, more emphasis on billable hours earlier in a partner's career and more on business getting or management later on can be an acceptable way to adapt the weighting of the criteria with time. Furthermore, since in a firm different groups of professionals might have different goals (one group may be dedicated in the generating of business, another group can specialize in a new area in which billable hours are small in the short term, and so on), a "management by objectives" is needed (Maister, 1997). Compensation systems should also be based on relative improvements in performance of each professional, not on absolute levels (Maister, 1997). This means that for each year's compensation decision, last year performance of the partner must also be considered.

2.7 The Importance of a Well-Defined Strategy within Professional Firms

A clearly defined strategy helps a professional firm differentiate itself not only in the client market, but also in the market for future employees. Professionals are highly educated and well informed about opportunities offered in different firms, and the competition for them is intense. As a result, today firms must make bigger efforts to recruit, develop and retain the professionals they need in order to sustain their strategy and their growth.

In a professional firm there are two key strategic dimensions. The first one concerns "domain decisions": prioritizing projects and clients (what do we deliver, to whom, where, when and how); the second one refers to "resource base decisions", and it involves activities such as recruiting, developing and retaining the best professionals (Lowendahl, 2005). A professional service firm must start its strategic development process by identifying a distinct strategic position: the market sectors it wants to compete in and how to differentiate its services from those offered by competitors (DeLong et al., 2007). This activity involves taking decisions on what type of clients the firms wants to serve, what type of services to offer, how to differentiate them from those of competitors, how to ensure that all aspects of the firm are aligned to deliver them, and so on.

2.8 How the Compensation System Can Support the Firm's Strategic Objectives

For many firms, partner compensation has long been managed in isolation from their overall business strategy, which is mostly focused on external factors, such as markets and clients (Jarrett-Kerr, 2011). However, Jarrett-Kerr has identified four main ways in which a compensation system can support the firm's strategic direction.

First, the system can help to strengthen a unified understanding of where the firm wants to go. Second, the compensation and profit-sharing system can support the firm's strategy by esteeming and rewarding those who create value. Third, the system can encourage professionals to work towards some distinguishing features, which enable the firm to differentiate from competitors. Fourth, a compensation system can help a firm to achieve its growth objectives whether those objectives entail a growth in size and (or) in substance and depth of skill (Jarrett-Kerr, 2011).

According to Wesemann, professional firms need a procedure for dividing and distributing their profits and that system ought to reflect the values of the partners and be highly accepted by them. The difficulty is that many partners are not motivated solely by economics. As a result, it is hard to make a partner change his behaviour through changes in the compensation system because the reward may not be sufficiently significant to be a motivating factor (Wesemann, 2008). However, in many firms partners look to the compensation system as a clue to what behaviour the firm is seeking from its members. In this context, subtle changes in the factors recognized in setting compensation may have relevant consequences in the message sent to the partners about the expectations of performance (Wesemann, 2008).

In looking at a compensation system, the most important issues seem to be what specific performance or which behaviours are being rewarded and how partners are being compensated in relation to each other (Wesemann, 2008). Since the prestige of partners, their tacit knowledge gained through experience and their social capital can be helpful in the implementation of a firm's strategy (Hitt, Bierman, Shimizu, & Kochhar, 2000), it is important that these qualities and skills are rewarded by the firm and that its compensation system rewards the behaviours and actions that are required to support the firm's strategy (Millard, 2005).

Maister suggests that once a compensation system has been implemented, there is only one test it has to pass: whether or not it encourages the behaviours needed for the firm's success. To apply this test, it has to be clear what makes the firm succeed and which are the skills and the behaviours of partners that will allow the firm to achieve its strategy. In fact, compensation decisions are an integral part of what defines the firm, its objectives and its strategy. Professional firms frequently fail to accomplish the goal of motivating partners to focus on behaviours that will make the firm succeed. This happens either because the firm's compensation committee rewards wrong aspects of performance, or because partners don't know clearly what is being rewarded (Maister, 1997). In fact, there is often a mismatch between what professional firms say they value in their partners (in terms of performances, skills and competencies) and what they reward (Jarrett-Kerr, 2012). The key is to ensure that the behaviour and the activities relevant to achieve the firm's strategy are identified and that the firm's compensation system rewards and encourages those activities and behaviours (Millard, 2005).

The aim of this study is to bridge the gap identified in literature concerning the professionals' features considered crucial in achieving a firm's strategy according to the partner compensation system applied in the firm. In particular, on one side, the authors intend to identify the skills and behaviours mostly rewarded in professional firms and to test whether there are differences in the criteria that firms consider in splitting the partnership pie; on the other side, the authors would like to test whether the compensation system applied by a professional firm is designed in a way that it supports the firm's strategic decisions.

3. Research Design

The authors will refer to a study of compensation practices conducted in 1987 among law firms in the United States by David Maister, an expert on the management of professional service firms. The scope of Maister's research was to test how different firms would deal with different types of partners when taking decisions on profit shares. The experiment had a great success, and still today its clients use it to receive feedbacks by professionals within their firms.

The aim of this research is to expand Maister's study in the Italian professional firm's framework in order to test whether the same results gained by Maister will be obtained in a different context. In particular, the authors intend to verify whether there are different criteria that guide decisions on remuneration of partners in professional firms and whether these criteria are coherent with the achievement of the firm's business strategy.

For the scope of his research, Maister identified seven archetypal partners of a standard firm and provided quantitative and descriptive information on each. Those who participated in the study were asked to indicate what the compensation would be for each archetype in their firm, relative to the compensation of an average partner.

Here is a brief description of each archetype identified by Maister:

- Partner A, (38-year-old) is the average partner: the typical lawyer;
- Partner B, (34-year-old) is the rising young superstar: young and entrepreneurial, has built a loyal group of associates around him;
- Partner C, (55-year-old) is the unproductive older partner: seems to have run out of gas; suspect some personal problems at home;
- Partner D, (42-year-old) is the individualistic solo operator: a "prima donna", likes high visibility cases, a little too glib;
- Partner E, (41-year-old) is the hardworking "back-room" lawyer: "journey-man" lawyer, works hard, but brings in little business, relies on others, a "partner associate";
- Partner F, (49-year-old) is the executive committee member actively maintaining a practice: tries to do everything, major force in the firm;
- Partner G, (49-year-old) is the struggling branch manager: manages branch office, which has poor profitability;
- Partner H, (60-year-old) is the major rainmaker who doesn't put in many billable hours: passes on clients and work for others to handle.

Additional statistical and descriptive information on each archetype had been provided by Maister (see chart below). All numbers, except age, are expressed as percentages of the average for all the firm's partners. The participants to the study had to fill in the last row of the chart.

Figure 5: Maister's chart of partner archetypes in a standard firm

	Partner A	Partner B	Partner C	Partner D	Partner E	Partner F	Partner G	Partner H
Description	*The typical lawyer*	*Young and entrepreneurial; has built a loyal group of associates around him*	*Seems to have run out of gas; suspect some personal problems at home*	*A prima donna solo operator; likes high visibility cases; a little too glib*	*"Journey-man" lawyer; works hard, but brings in little business; relies on others; a parter associate*	*Executive committee member; thies to do everything; major force in the firm*	*Manages branch office, which hsa poor profitability*	*Major rain-maker; passes on clients and work for others to handle*
Billable hours worked	100	141	74	105	115	92	95	35
Non-billable hours worked	100	152	51	92	60	243	156	150
Dollars managed	100	198	33	45	55	129	90	112
Write-off performance	100	120	50	102	101	150	63	132
Unbilled dollars	100	105	59	40	93	121	80	108
Collections performance	100	110	72	50	95	115	83	103
Business getting	100	200	25	73	15	175	74	312
Billing rate	100	64	129	104	103	112	108	139
Age	38	34	55	42	41	49	49	60
Department	Corporate	Real estate	Probate	Tax	Litigation	Corporate	Corporate	Corporate
Quality of legal work	Average	Excellent	Average	Excellent	Average	Above Average	Slightly Above Average	Average
External respect in community	Average	Excellent	Not known outside	Very Visible	Not well-known outside	Very well-known	Thought to be well-known	Superb
Cooperativeness with other partners	Average	Not Good: somewhat territorial	Very cooperative	Not very cooperative	Very willing	Very well-liked	Not perceived as cooperative	Not cooperative
Ability to develop associates	Average	Outstanding	Poor	Poor	Average	Outstanding	Not enough evidence	Not good
Committee work & firm management	Average	Not much	Willing but rarely chosen	None	Will serve when asked	Extensive	A great deal	Used to be involved but not anymore
COMPENSATION	100	?	?	?	?	?	?	?

Responses obtained through Maister's survey yielded some interesting findings by showing amazing differences in the pie-splitting practices of different firms. For example, partner H, the one with more experience and excellent business-getting skills, would receive the highest compensation in most of the firms of Maister's sample. In fact, bringing business is one of the abilities that professional firms award generally the most. However, results differed significantly in how much more each firm would assign to partner H. Ignoring the bottom and the top tenths of responses, partner H could gain from 110 to 250 per cent of the firm average.

The responses of the participants also highlighted the different weights each firm gives to the factors of seniority, business getting, billable hours, management responsibilities and collections performance. For example, the partner most highly rewarded after partner H was partner F: the executive committee member who works close to the firms average on billable hours and more than double the average of non-billable hours. Comparing the rewards of partners H and F, there was significant disagreement among the surveyed firms as to which of these two should receive the higher compensation: 54 per cent gave more to partner H, but 46 per cent gave more the partner F. The exercise was intended to explore the different choices and reactions. Business getting is important, and partner H excels at this. However, partner F's relative strengths, billable hours and firm management are also important. In fact, the different firms split about evenly on the matter of who is more valuable to the firm.

4. Methodology

The goal of the research is to investigate the criteria that different firms consider when taking profit sharing decisions and to outline a framework explaining the role of compensation system in executing the firm's strategy. In order to answer the first need, a survey methodology has been selected to achieve a greater number of respondents and to collect comparable results about criteria for profit sharing, while focus groups and in depth interview will take place in a second moment to understand law firms' strategies and compensation patterns.

The sample of the survey has been defined following a dimensional and an opportunity criterion. Therefore, the sample included the list of the Italian top 100 professional firms edited in 2012 by the journal "Top Legal" and some relevant firms indicated by opinion leaders of the sector. Every year "Top Legal" publishes a list of the first 100 law firms in terms of turnover in Italy. It also indicates the profits per equity partner, the income per partner, the number of partners operating in the firm, the number of associates, the total number of lawyers, the total number of "of counsel" and of the trainees operating in the firm.

A pilot survey has been created presenting the seven archetypal partners identified by Maister and asking respondents to indicate the compensation they would assign to each of the archetypes described. The pilot survey has been sent to a small sample of 10 Italian professional firms. The aim was to receive a feedback on the applicability of the survey to the context of Italian professional firms. In fact, based on feedbacks on the ways the survey could fit the Italian context and methods of profit sharing among firms, the survey has been adapted and then sent by email to our selected sample.

Figure 6: The survey administered to the top 100 professional firms in Italy

	Partner A	**Partner B**	**Partner C**	**Partner D**	**Partner E**	**Partner F**	**Partner G**	**Partner H**
Description	*The typical lawyer*	*Young and entrepreneurial; has built a loyal group of associates around him*	*Seems to have run out of gas; suspect some personal problems at home*	*A prima donna solo operator; likes high visibility cases; a little too glib*	*"Journey-man" lawyer; works hard, but brings in little business; relies on others; a parter associate*	*Executive committee member; thies to do everything; major force in the firm*	*Manages branch office, which hsa poor profitability*	*Major rain-maker; passes on clients and work for others to handle*
Department	Corporate	Real estate	Probate	Tax	Litigation	Corporate	Corporate	Corporate
Age	38	34	55	42	41	49	49	60
Quality of legal work	Average	Excellent	Average	Excellent	Average	Above Average	Slightly Above Average	Average
External respect in community	Average	Excellent	Not known outside	Very Visible	Not well-known outside	Very well-known	Thought to be well-known	Superb
Cooperativeness with other partners	Average	Not Good: somewhat territorial	Very cooperative	Not very cooperative	Very willing	Very well-liked	Not perceived as cooperative	Not cooperative
Ability to develop associates	Average	Outstanding	Poor	Poor	Average	Outstanding	Not enough evidence	Not good
Involvement in the firm management	Average	Not much	Willing but rarely chosen	None	Will serve when asked	Extensive	A great deal	Used to be involved but not anymore
Billable hours worked	100	141	74	105	115	92	95	35
Non-billable hours worked	100	152	51	92	60	243	156	150
Business getting	100	200	25	73	15	175	74	312
Dollars managed	100	198	33	45	55	129	90	112
COMPENSATION	100	?	?	?	?	?	?	?

All numbers (except age) are expressed as percentages of the average for all the firm's partners.

The collection of the completed surveys and the analysis of the answers received will allow us to understand the skills valued most among professional firms in Italy.

An in depth interview session to a sub-sample of the respondents will be carry out once the collection of the surveys and their analysis will be finalized. The objectives of the interviews are two: on one hand the aim is to know what is the current strategy of the firm, on the other hand the aim is to assess whether the most rewarded partners' skills and behaviours by the compensation committee are the ones that allow the firm to pursue its strategy.

5. Expected Results

This research will be focused on the partner compensation system applied by professional firms in Italy. For the scope of the study, a survey has been administered to the top 100 professional firms based in Italy and an interview session of a sub-sample of respondents will be put in place subsequently.

An adapted version of a survey administered by David Maister has been sent via email to the selected sample. The answers to the survey will allow the authors to identify the partners' skills and behaviours mostly rewarded among professional firms operating in Italy. For this purpose, each archetypal partner has been linked to a particular strength or feature, in order to facilitate the interpretation of the results of the survey. Beside partner A, which represents the traditional lawyer and a standard performer, the other seven archetypes have been linked to their major strength as follows:

- Partner B = ambition
- Partner C = seniority
- Partner D = visibility
- Partner E = commitment
- Partner F = dedication
- Partner G = entrepreneurship
- Partner H = business getting

The aim of this research is dual: on one side, the authors intend to test whether there are differences in the criteria that firms consider in splitting the partnership pie and thus identify the skills and behaviours mostly rewarded among firms (following the links proposed above); on the other side, the authors would like to test whether the compensation system applied by a professional firm is designed in a way that it supports the firm's strategic decisions.

As Maister points out, different strategic positions of the firms in the marketplace require different compensation systems. That is why differences in the criteria firms use in splitting the partnership pie are "understandable and, indeed, desirable" (Maister, 1997). Starting from this assertion, knowing a firm's compensation system, it will be possible to assess its contribution to the achievement of the firm's strategy chosen to compete on the market. In fact, firms offering different types of services and thus focused on different target segments, differ in the way they weight the different skills and behaviours of partners.

For example, considering DeLong's description of the four types of practice segmentation (standardized, customized, expertise-driven or rocket-science), it could be said that a firm offering standardized services will tend to weight more the quality of legal work of partners than other skills possessed by its partners. Other characteristics awarded by firms operating in this segment could be the ability to develop associates and the cooperativeness with other partners, since, as highlighted before, work flow management and horizontal communication are critical to the success of the segment.

Firms operating in the customized services practice segmentation seem to value more skills such as the business getting, the ability to develop associates and the quality of legal work among their compensation criteria. This is because in this segment it is important to have established models, methodologies and processes, but also professionals with excellent selling and relationship-building skills.

Expertise-driven firms seem to award more partners with seniority, highly respectable in the community and with billable hours worked above average. In fact, firms in this segment require significant experience and expertise in the field. Firms offering expertise-driven solutions will tend to compensate more partners with seniority, that enjoy external respect in the community, that have good business getting skills and whose billable hours are above the firm average.
Firms offering rocket-science services tend to weight more than other skills the seniority, the billable hours worked and the non-billable hours worked. This segment needs senior partners with experience, able to create new knowledge every day and who are completely dedicated to their work.

The interviews that will be conducted following the analysis of the completed surveys will allow the authors to assess at what extent compensation systems are designed in a way that they facilitate the achievement of the firm's strategy since, as Maister highlighted, different strategies of the firms in the marketplace require different compensation systems.

The results will also allow the testing of whether strategic goals of professional firms are sufficiently clear because, in this case only, the partners' features to be rewarded can also be clearly decided. If strategic goals and actions that support them are clearly defined, then a compensation system that rewards these behaviors will be appropriately implemented and it will support the firm in achieving its strategic objectives.

6. Conclusions

As we have seen in the previous paragraphs, one of the most recurrent issues in any professional service firm is how to equitably reward performance (Millard, 2005), also because in the division of profits there are different issues that need to be clarified. In fact, in looking at a compensation system the most important issues seem to be what specific performance or which behaviors are being rewarded and how partners are being compensated in relation to each other (Wesemann, 2008).

Historically, in professional service firms partner compensation has been a system based on seniority, which minimizes discussions among partners and avoids issues related to the evaluation of soft areas of performance. Nevertheless, as Maister highlighted, today the seniority-based system seems to have survived mostly among firms who have not registered declines in overall profitability: a status that today is becoming harder to maintain for many professional firms. In fact, today professional service firms seem to follow a common trend by moving from seniority-based compensation systems to performance-based ones.

In a professional firm a compensation system should also be related to the firm's strategic goals (Anderson, 2001). In fact, Jarrett-Kerr has identified four main ways in which a compensation model can support the firm's strategic direction. First, the compensation model can help strengthen a unified understanding of where the firm wants to go. Second, it can support the firm's strategy by rewarding the professionals that create value. Third, it can encourage professionals to work towards some distinguishing features by enabling the firm to differentiate from competitors. Fourth, it can help a firm to achieve its growth objectives.

Future findings of the research proposed in this paper intend to bridge the gap identified in literature concerning the specific behaviors being rewarded in professional firms. The results intend also to enrich the current body of literature by testing whether compensation models of the Italian professional firms effectively support the firm's strategic direction.

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