REPUTATION AND PERFORMANCE IN LARGE LAW FIRMS

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Abstract

Reputation is a signalling device that serves as a proxy for the quality of a firm’s products, strategies and employees relative to its competitors, when communicating with clients and other stakeholders. It is especially important for professional service firms because of the complex and intangible nature of their service and because of the advantages it confers in the market for high-quality professional staff. This paper extends and refines existing research on reputation which shows positive returns to reputation for professional service firms. We use different rankings of the top 50 law firms in the UK to measure reputation and examine their relationship with financial performance as expressed in firm revenue and profits. We find positive but diminishing returns to reputation even within this group and we find a stronger relationship between reputation and profits than fee income. We conclude that reputation may be an important source of competitive advantage for leading firms but it seems to offer little leverage for others. If these results are generalizable across other professional sectors this raises the question of how the majority of firms can differentiate themselves.

**Keywords:** reputation, professional service firms, knowledge-intensive work
Introduction

Recent work on professional service firms argues that they are a distinct form of organization because of their unique inputs (expertise derived from the employment of highly trained professionals) and outputs (complex and customised solutions to client problems) (e.g. Empson, 2001; Greenwood et al., 2005; Lowendahl 2005; Maister, 1993). The nature of these inputs and outputs makes reputation critical to the survival and performance of such organizations. Professional service firms need to build and sustain reputation to attract and retain the right quality and quantity of staff (Hitt et al 2001) and to attract clients who will engage them, notwithstanding the difficulty in predicting *ex ante* the quality of their services. Within the firm commercial success will depend on the ability of partners in each particular practice to, generate a flow of work by responding to client demand, and then ensure its effective execution. Framing professional service firms as combinations of expertise-based practices, we consider how far practice reputation explains the differential performance of large law firms.

Existing research on reputation suggests that there are positive returns to reputation for corporations in general (Fombrun and Shanley 1990) and for professional firms in particular (Greenwood et al 2005) but this paper extends and refines this understanding in three ways.

First, we focus on the judgements of clients of these firms in assessing reputation. Contrary to prevailing theory, we assume that clients are knowledgeable consumers of professional services. Clients are dependent on their advisers for important services but in the arena of corporate legal services they are also discerning, repeat purchasers. Large corporations routinely employ in-house legal counsel which can make informed judgements about the
competence of their suppliers. This means they can assess the reputation of the professional firms they employ in a way that other consumers of professional services are unlikely to be able to. Second, we refine the ways in which the relationship between reputation and performance are examined by developing different measures of reputation based on the perceptions of clients rather than media measures. Third, we use multiple measures of financial performance. Greenwood et al (2005) measured performance using revenues, which are correlated with profits but here we assess performance in terms of profitability and revenues to produce a more differentiated picture of the relationship between reputation and performance.

**Reputation and the Professional Service Firm**

Reputation is a signalling device to clients and other stakeholders about a firm’s products, strategies and employees’ quality compared to its competitors (Fombrun and Shanley 1990). Firms with strong reputations obtain several benefits that either reduce the costs of attracting or keeping customers or can influence their price sensitivity. Because positive reputations signal to customers appropriate messages about the quality of a firm and its products, those firms with strong reputations have to spend less on capturing customers than others and are more likely to be able to hold on to those customers to obtain repeated sales. In addition, reputation allows firms to charge a premium price for their products, thereby generating higher profits and enabling them to attract the best people (Podolny 1993). Reputation is in effect a sorting mechanism to stratify firms into status based groups. Those with high status obtain economic benefits, which in turn reinforce their reputation.
For professional service firms reputation is highly important because of the nature of their service and because of the benefits that accrue in the market for professional staff. Indeed, Greenwood et al (2005) argue that professional service firms are a distinct category of organization because of their unique inputs (professional expertise) and outputs (complex, customized services for clients) and that the role of reputation is particularly important to them. Professional firms are highly reliant on the ability to recruit and retain appropriately qualified and experienced professional staff that are deployed on client projects individually or in teams. In the process they apply their own expertise and the proprietary know-how of the firm to produce client solutions (Morris and Empson 1998). The expertise of these staff makes them mobile and the risk for the firm is that they may choose to carry on their profession elsewhere, so that the relationship and balance of power between employer and employee is different from most other types of organization (Greenwood et al 2005). Reputation is important in attracting staff of the right quality to work for the firm and retain them by offering work assignments of the appropriate challenge and variety. Firms with the highest reputation should, inter alia, be able to attract the highest quality professionals and incur fewer costs in recruiting them than other firms.

The nature of the services that professional firms produce also means that reputation is important in the client market. Because they sell complex, customised services in which the client may actively participate in the production process, it is difficult for the client to be able to judge ex ante the quality of the product (Maister 1993). In the absence of such quality tests, clients will seek proxies or social proofs of competence (Rao et al 2001) particularly as in many cases the services that are being purchased are very costly and may be concerned with the management of important risks for the client. Corporate legal advice is such a service. In the absence of clear indicators of the difference in quality of professional services, or their
technical competence to provide the service, reputation is a means by which clients may sort firms. Because of the positive effects of reputation in both labour and client market, the relationship between reputation and performance in professional firms is predicted to be positive. Greenwood et al (2005) confirmed this relationship in their analysis of large accounting firms. However, reputational returns are not likely to be evenly distributed. In professional services, distinct status groups of elite firms exist in accounting, law, consulting and architecture (Armbruster 2006; Empson 2007; Fairclough 2007; Galanter and Palay 1993; McKenna 2006). These high status groups are most likely to enjoy the greatest reputations and the highest financial returns from them.

Professional service firms can be conceptualized as portfolios of expertise based practices. Gilson and Mnookin (1988) outline the formation and growth of a law firm, an exemplar of a professional service firm, by showing how a solo professional can employ an associate when her reputational capital creates excess demand for her expertise. Further growth via a sharing of equity with a fellow partner occurs to share risk and/or develop complementary services based on other forms of expertise. A proliferation of expertise based practices results from the decision to collaborate with other professionals. Once associates are hired into a professional service firm, this creates an in-built motor of expansion because the firm needs to create new partnership opportunities for ambitious associates in order to retain them (Galanter and Palay 1991). New practice creation is the means by which this expansion is managed: associates or partners have an incentive to carve out a niche in which they can build an individual reputation and client base, thereby securing their rights to a share of the firm’s profits (Anand, Gardner and Morris 2007). In addition, firms may expand into new practice areas to exploit client demand or to avoid the risks of commodification in their core practice areas (Greenwood et al 2005). Practices, typically based on expertise or some form of market facing
structure, therefore constitute the building blocks of professional firms; the management of the portfolio of practices is a key strategic role for central management (Angel 2007; Greenwood, Hinings and Brown 1990). Because of their long training in a particular area of expertise, professionals’ identity is focussed primarily on their practice area and because professional service firms are relatively decentralized with weak strategic controls over key activities, reputational decisions concerning the management of client relations are relatively decentralized. Further, clients seek the services of specific practices or individual experts within them in order to address their problems (Greenwood, Hinings and Brown 1990).

Therefore, the professional service firm can be understood as a collection of practices which may or may not interact with each other. Reputational perceptions among clients will be located at the level of the practice primarily. The way in which resources are distributed across this portfolio will affect the returns to reputation. In addition, reputational benefits will be related to the internal organization of the firm. For example, the benefits of reputation for the firm will depend on the proportion of its partners located in a practice with high repute: a large practice which is highly reputable will have highly positive effects on performance; a relatively small practice will have less impact on overall profits.

To summarize, we argue that professional service firms are made up of expertise based practices with different clients and reputations. The clients of large law firms, and other leading professional service firms, are knowledgeable buyers who make informed judgements about the competence of their suppliers and therefore can assess reputations in a way that mass buyers of other services or consumer goods cannot. Further, there are well-established collective categories of high status firms which are reinforced by clients and professionals themselves. In law, the so-called Magic Circle of London law firms is such a group
(Fairclough 2007). Judgements about the reputation of firms are therefore unlikely to be so influenced by negative or positive media coverage at any one time but are likely to be highly influenced by reputational measures of the specific practices being engaged and by peer assessments. Based on these arguments we formulated four research questions to guide our examination of the relationship between different indicators of reputation and performance.

1. What is the relationship between reputation, as measured by clients’ assessment of individual practice area quality, and firm-level performance?

2. How do reputational effects on performance differ between firms commonly regarded as an established “elite” and their competitors?

3. Are reputation effects on performance equally strong across firms of different sizes?

4. To what extent does the status of the client affect the reputation and performance of its legal adviser?

Research Method

Existing research on corporate reputation has often used media reports as an indicator of public perceptions such as reputation (e.g. Fombrun 1996; Deephouse 2000). Research on reputation in professional firms has been based on two measures: the number of high status clients the firm serves, and media reports. Due to the correlation between these methods, Greenwood et al (2005) used the latter measure in their study of the accounting sector in the USA. However, we adopt a somewhat different set of measures in order to examine how discerning clients, rather than the media assess the reputation of their professional advisers.
We assume that as educated buyers their assessments will not be greatly influenced by media reports. This is consistent with other research on client purchasing decisions which shows the importance of relational ties (Uzzi et al 2007).

**Reputation Measures.** To measure client perceptions of quality as the independent variable of our study, we focused on the rankings of law firms and their practices. We drew on data from a specialist legal publication, the *Chambers Directory of the UK legal profession* (Ghosh & Greze, 2007). This directory provides qualitative information on perceived law firm quality, based on a large-scale survey of clients. It is a particularly strong data source for our study for four reasons. First, it reflects the views of discerning customers of professional services. Second, it translates clients’ qualitative judgements into a rank order and thereby makes them amenable to quantitative analysis. Third, these rankings are generated independently of the law firms themselves and thereby avoid problems of self-report. Lastly, it takes the practice area as the level of analysis and records quality perceptions for over 60 practice areas. Each law firm is ranked into one of several bands according to the perceived quality of e.g. its legal ability, client service, or diligence in a specific practice area. This means that a single firm can be ranked in different bands based on its reputation in different practice areas. Given the view that professional service firms should not be perceived as monolithic entities, but as conglomerates of expertise-based practices, this is critical to producing a more nuanced and relevant image of professional service firm reputation.

In our raw data, firms are placed in bands based on their reputation score. The highest-scoring firms are in band one and lower ranked firms are in higher band numbers. However, the total number of bands varies across different practice areas. Competitors are perceived as less distinguishable in some practice areas than in others so that more firms are placed into fewer
bands. Given these differences in the raw data, we standardized the number of bands across all practice areas. To do this, the band number of a firm in practice area X is subtracted from the total number of bands listed, plus one. For example, if the raw data lists six bands of firms in a practice area, a firm in the top band will score a 6, a firm in band two will score 5, and so on. Firms not ranked score 0. Then, for each firm we divided their band score by the total number of bands listed for this practice area. In the above example, a firm in the top band will then score a 1, a firm in the second band will score 5/6 (0.83), a firm in the third band will score 4/6 (0.67), and so on. An unranked firm will still score 0. In this way, we transformed the raw data into a set of standardized, practice area related reputation scores between 0 and 1.

However, to achieve an overall measure of firm-level reputation and relate it to firm-level performance, it is not enough simply to sum up the rankings in each practice area. Each firm differs in the amounts of resources it allocates to various practice areas and the proportions of total revenues it generates from each. We adjusted our reputation measure accordingly. Based on information gathered from UK top 50 law firms we measured the proportion of the total number of the firm’s partners in each practice area as a proxy for the group’s relative size and significance for the firm’s reputation and performance. This proportion was then used as a weighting coefficient to adjust the original standardized reputation scores to reflect each practice area’s relative size and importance within the firm. It avoids undue biases by discounting the influence of reputation in a small practice area on the firm’s overall reputation score, relative to reputation in a large, core practice area. The rationale behind this step is that high/low reputation in a marginal area where the firm has little capacity cannot significantly influence the firm’s reputation and performance. Conversely, the firm’s reputation in a practice area that is central to its business and where it has substantial capacity is more consequential to its overall reputation and success.
This weighting mechanism raised a further problem, because it biases reputation scores in favour of niche firms with reputations in specific areas that dominate the firm, but may or may not be in high demand in the legal market. For example, the law firm Withers has a strong reputation in private client work. Its practice portfolio is dominated by its “Family” practice, which has an excellent score in the rankings. It will therefore compare favourably with a more diversified firm without taking into account the value of a specific practice in terms of the revenues and profits it can generate.

To address this, we proposed to weight our measure of reputation according to the fraction of revenue each practice area generates for UK law firms on average, but this information is unavailable. Therefore, we used the average fraction of partners in a practice area across all top 50 UK law firms as a second weighting factor. We argue that the higher this coefficient for a practice area, the higher its relevance and revenue-generating potential in the legal market overall.

Thus, practice group specific reputation has the strongest influence on firm-level reputation if it is central to both the firm and the market. A strong reputation in a practice that is dominant within the firm but has little revenue-generating potential in the market (as suggested by other firm’s relative absence from this area) contributes less to firm-level reputation. This produces an index of reputation for each law firm that appreciates professional service firms as a conglomerate of individual practices that differentially contribute to the firm’s reputation based on their centrality within the firm and within the legal market.
To summarize, our measure of a firm’s reputation is a product of:

- The ranking score for the firm in practice area X as calculated from its position in the *Chambers Directory* ranking.
- The size of practice area X in the firm as measured by the fraction of total partners specialising in this area.
- The average size of practice area X across the top 50 UK law firms, as measured by the average fraction of total partners specialising in this area.

summed over all its practice areas.

**Performance.** Previous studies of professional firms have noted the problem of accessing performance data (Greenwood et al 2005; Lorsch and Tierney 2002). As most firms are private partnerships, audited data on profitability are not publicly available. The measure used in previous studies is revenues per professional which is highly correlated with profitability (Greenwood et al 2005). To nuance our understanding of the relationship between reputation and performance, we used two measures of performance, Turnover (fee income or revenues) and Profit per Equity Partner (PEP), as our independent variables. PEP is analogous to a measure of shareholder return in publicly quoted companies and is commonly used as a measure of performance by professional service firms themselves. We derived these performance data on the largest fifty UK law firms by revenues from *The Lawyer UK 200 Annual Report 2007*. These data are not independently audited, but to check their reliability we asked a sample of six managing partners to verify the figures for their firms published in *The Lawyer* report. They confirmed that these figures were accurate compared to their own internal calculations.
Results

Our results are presented in a series of scatter-graphs with associated linear regression analysis tables. We address each of the four research questions in turn and supplement an additional check for bias in favour of niche firms. The remainder of the paper is structured as follows: First, we show the relationship between reputation and performance for the sample of the largest 50 UK firms. Second, we segment the sample by excluding the group of four largest firms collectively known as Magic Circle firms to see whether reputation effects differ between established elites and their competitors. Third, we further segment the data between the top 20 firms by revenue and the remainder, exploring whether reputation effects diminish among non-elite firms. Fourth, we check for bias in our own method in favour of niche firms. Fifth, we replicate the method used in Greenwood et al.’s (2005) study using different measures of client quality in order to explore to what extent the status of the client affects the reputation and performance of its legal adviser.

Reputation and Performance in the UK Top 50 Law Firms

The first research question examines the relationship between reputation, as measured by clients’ assessment of individual practice area quality, and firm-level performance. Figure 1.1 shows the scatter-graph for the relationship between reputation and turnover for the entire sample of top 50 UK law firms. Figure 1.2 illustrates the relationship between reputation and profits per equity partner (PEP) as a more profit-related measure of performance. Models 1.1 and 1.2 summarize the corresponding regressions.
Both models 1.1 and 1.2 show a moderately strong positive correlation between reputation and turnover (R=0.601) as well as between reputation and PEP (R=0.725). Notably, the relationship is stronger when PEP instead of turnover is used as the dependent measure of performance. For both relationships the linear regressions display a very high level of statistical significance.
As figure 1.1 reveals, four firms are clear outliers in terms of turnover. These are all members of the ‘Magic Circle’ a commonly recognized elite group of UK law firms, equivalent to the ‘Charmed Circle’ of Wall street law firms or the ‘Big Five’ in accounting (Greenwood and Suddaby, 2006). Our second research question concerned how reputational effects differ between such firms commonly regarded as an established “elite” and their competitors.

**Reputation and Performance in Non-elite Law Firms**

To address the second research question we segmented the results by excluding the top four firms by turnover. These are distinctive by virtue of their size, global coverage, and established recognition as a global “elite”. All are members of the ‘Magic Circle’ of firms whose collective reputation and size places them in a distinct status grouping (Fairclough 2007). The graph and model summary below present the results for the remaining forty-six firms.

**Fig 1.3 – Top 50 UK Law Firms excluding Magic Circle (Turnover)**

**Model Summary 1.3**

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
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<tbody>
<tr>
<td>.613</td>
<td>.376</td>
<td>.361</td>
<td>85.2342</td>
</tr>
</tbody>
</table>

a Predictors: (Constant), Index of Reputation

**ANOVA(b)**

<table>
<thead>
<tr>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>192301.001</td>
<td>1</td>
<td>192301.001</td>
<td>26.470</td>
</tr>
<tr>
<td>Residual</td>
<td>319654.280</td>
<td>44</td>
<td>7264.870</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>511955.281</td>
<td>45</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a Predictors: (Constant), Index of Reputation
b Dependent Variable: Turnover (£m)
The linear regression continues to display a very high level of statistical significance. There is still a moderately strong positive effect of reputation on turnover (R=0.613), which is very similar to that found above in model 1.1 when the Magic Circle was included in the sample.

To examine this in more detail, we decided to partition the sample of fifty law firms differently. Instead of excluding a recognized “elite” group of firms, we decided to divide the sample of fifty law firms according to size, as measured by their turnover. This allowed us to examine our third research question, whether the strength of reputation effects on performance differs across firms of different sizes.

**Reputation and Performance in Large and Mid-Sized Law Firms**

Even within the 50 largest UK law firms, size, as measured by turnover, varies considerably. In 2007 figures ranged from £m 1,194.0 to £m 54.3. Within this range, however, different bands can be identified within which firms are more similar in size, but more distinct from lower ranked firms. As a starting point, we divided the sample of 50 firms into two sub-samples, the 19 largest firms and the bottom 31. This partition takes into account the evident breaking point in turnover figures between these bands of firms. The size differential between firms ranked 19 and 20 is notably bigger than between any other pair of mid-ranked firms. Future research will explore other and more granular partitions, but this appeared as an intuitive starting point. We repeated our analysis to see how far the effects of reputation are limited to a specific subset of law firms, or whether their strength increases/diminishes at certain size levels. Figures 1.4 and 1.5 show the results for the relationship between reputation and performance in the top 19 firms together with the corresponding regressions.
For this group of firms the relationship between reputation and performance are moderately strong and highly significant for both measures, turnover (R=0.560) and PEP (R=0.789). The difference when measuring a firm’s performance by turnover and PEP is more pronounced for this sub-sample than for the whole sample. For the top19 firms by size, reputation less accurately predicts revenues (R=0.560 for top 19, R=0.601 for top 50), but more accurately predicts PEP (R=0.725 for top 19, R=0.789 for top 50). Again, the four Magic Circle firms stick out as outliers in terms of size in figure 1.4, but firms ranked fifth to nineteenth are more
tightly clustered in terms of reputation and turnover. Figure 1.5 shows a more homogenous picture for the relationship between reputation and PEP among the top 19 firms.

The bottom 31 firms by size are shown in figures 1.6 and 1.7. The results for this sub-sample are much weaker. The correlation coefficients and levels of significance in models 1.6 and 1.7 evidence that outside the top 19 firms, reputation has less influence on performance.

**Fig 1.6 UK Law Firms 20–50 (Turnover)**

![Graph showing data for turnover vs. index of reputation for UK Law Firms 20–50.](image)

<table>
<thead>
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<th>Model Summary 1.6</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>R</strong></td>
</tr>
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<td>.124</td>
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</tbody>
</table>

*a* Predictors: (Constant), Index of Reputation

**ANOVA (b)**

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<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
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<tr>
<td>Regression</td>
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<td>295.861</td>
<td>.450</td>
</tr>
<tr>
<td>Residual</td>
<td>19062.446</td>
<td>29</td>
<td>657.326</td>
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<tr>
<td>Total</td>
<td>19358.307</td>
<td>30</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*a* Predictors: (Constant), Index of Reputation

*b* Dependent Variable: Turnover (£m)

**Fig 1.7 - UK Law Firms 20–50 (PEP)**

![Graph showing data for PEP vs. index of reputation for UK Law Firms 20–50.](image)

<table>
<thead>
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<th>Model Summary 1.7</th>
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</thead>
<tbody>
<tr>
<td><strong>R</strong></td>
</tr>
<tr>
<td>.557</td>
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</tbody>
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*a* Predictors: (Constant), Index of Reputation

**ANOVA (b)**

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<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
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<tr>
<td>Regression</td>
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<td>65324.089</td>
<td>13.049</td>
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<tr>
<td>Residual</td>
<td>145179.588</td>
<td>29</td>
<td>5006.193</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>210503.677</td>
<td>30</td>
<td></td>
<td></td>
</tr>
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</table>

*a* Predictors: (Constant), Index of Reputation

*b* Dependent Variable: PEP (£k)
Turnover of the bottom 31 firms in the top 50 is not significantly influenced by reputation. The relationship between reputation and PEP in this sub-sample is significant, but positive reputation effects are much weaker than for the entire sample (R=0.557 for firms 20-50, R=0.725 for top 50). Future research will examine the exact location of this breaking point with more granular analyses.

**Controlling for bias in favour of niche firms**

As explained in the methods section, the lack of data on profitability at the level of the practice area precludes analyses of the direct relationship between reputation and profit. Therefore, we adjusted our measure of reputation with two weighting factors, the relative size of the practice group within the firm and the average relative size of the practice group across all top 50 law firms. This measure accounts for the fact that PSFs are conglomerates of expertise-based practice areas and that these practices may differently contribute to firm-level reputation and performance. Nonetheless, it could conceivably be biased in favour of niche firms. We define as niche firms all those with over 30% of their partners concentrated in one practice area. Although such niche firms make up only a small number of the sample (n=6) we investigated the possibility of this bias. To do this, we highlighted all six niche firms among the top 50 in figure 1.8 below. We superimposed the line of best fit given by the method of least squares error. The two lines alongside it display confidence intervals of 95%.
As figure 1.8 shows, four of the six niche firms are inside the 95% confidence interval. Of the two outside, one niche firm is significantly above, the other significantly below the line of best fit. This means that, if there was bias, it does not systematically favour niche firms. With only two niche firms standing out as anomalous results, we conclude that our overall measure of reputation does not favour niche firms. Additionally, only one of the 44 non-niche firms is just outside the interval. We take this as evidence that if there is any bias towards any form of firm, not just niche firms, this bias is negligible and the measure of reputation is robust. After checking the robustness of our practice area-related measure of reputation, we proceeded to the fourth research question, which uses a different measure of reputation: client quality.

**Reputation and client quality**

The fourth research question emerged in response to existing research in this field and replicated measures of reputation used in other studies (e.g. Greenwood et al 2005). The
question examines to what extent the perceived quality or “status” of the client affects the reputation and performance of the legal adviser. We measured client quality in terms of the number of publicly listed clients a firm serves. This is equivalent to the measure used in the study by Greenwood et al (2005), the number of SEC listed clients per firm. In theory, a firm with a greater reputation should attract more high status clients, i.e. firms listed on the stock market (Fombrun & Shanley, 1990). However, the validity of this measure is limited insofar as some firms will not compete directly for publicly listed clients so that fewer of their clients are likely to be listed on the stock market. Private equity houses and hedge funds are prominent examples of such premium clients that are not publicly listed. A further limitation on this measure is that each client is treated equally. Although, to the extent that size is correlated with reputation, larger clients should carry greater reputation and should be weighted accordingly. To address this limitation we used the total market capitalisation of each firm’s publicly owned clients, rather than their sheer number, as an adjusted measure of reputation.

Raw data for both these measures are publicly available and are produced by Hemscott, a market research company that provides information on UK listed firms. Amongst other services they also provide lists of quoted clients for a range of business advisory firms, among them large law firms. The samples of firms included in The Lawyer UK Top50 and in the Hemscott directory, however, are not identical. Hemscott limits its directory to the UK top 20 law firms in terms of the number of stock market clients or their stock market capitalisation. Of these twenty, some do not rank in the top 50 by turnover. Consequently, the sample for this analysis is more limited. Data on the number of stock market clients was available for 18 of the 50 law firms in our sample, data on clients’ stock market capitalisation only for 16.
Figures 2.1 and 2.2 illustrate the relationship between reputation, as measured by the number of stock market clients, and law firm turnover or PEP respectively. Models 2.1 and 2.2 present the corresponding regressions.

**Fig 2.1 - Top 18 UK Law Firms by # of Stock Market Clients (Turnover)**

**Model Summary 2.1**

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
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<tbody>
<tr>
<td>.012*</td>
<td>.000</td>
<td>-.062</td>
<td>386.2992</td>
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a Predictors: (Constant), Total Number of Stock Market Clients

**ANOVA(b)**

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<tr>
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<th>Mean Square</th>
<th>F</th>
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<tr>
<td>Regression</td>
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<td>356.684</td>
<td>.002</td>
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<tr>
<td>Residual</td>
<td>2387633.721</td>
<td>16</td>
<td>149227.108</td>
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<tr>
<td>Total</td>
<td>2387990.405</td>
<td>17</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a Predictors: (Constant), Total Number of Stock Market Clients

**Fig 2.2 - Top 18 UK Law Firms by # of Stock Market Clients (PEP)**

**Model Summary 2.2**

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>.178*</td>
<td>.032</td>
<td>-.029</td>
<td>316.679</td>
</tr>
</tbody>
</table>

a Predictors: (Constant), Total Number of Stock Market Clients

**ANOVA(b)**

<table>
<thead>
<tr>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>52586.867</td>
<td>1</td>
<td>52586.867</td>
<td>.524</td>
</tr>
<tr>
<td>Residual</td>
<td>1604573.411</td>
<td>16</td>
<td>100285.838</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1657160.278</td>
<td>17</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a Predictors: (Constant), Total Number of Stock Market Clients

The number of stock market clients, not accounting for their size, is a poor indicator of performance. Levels of significance are very low and correlations very weak for both turnover (R=0.012) and PEP (R=0.178), indicating a weak relationship between performance and the number of stock market clients a firm serves.
We repeated this analysis for the top 16 UK law firms by client stock market capitalisation, using this new, adjusted measure of client quality. Models 2.3 and 2.4 summarize the results of the linear regression. Figures 2.3 and 2.4 present the corresponding scatter-graphs.

**Fig 2.3 - Top 16 UK Law Firms by Client Stock Market Capitalisation (Turnover)**

**Model Summary 2.3**

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>.659a</td>
<td>.434</td>
<td>.394</td>
<td>296.0707</td>
</tr>
</tbody>
</table>

*a Predictors: (Constant), Total Market Cap. of stock market clients (£m)

**ANOVA(b)**

<table>
<thead>
<tr>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>942269.897</td>
<td>1</td>
<td>942269.897</td>
<td>10.749</td>
</tr>
<tr>
<td>Residual</td>
<td>1227209.901</td>
<td>14</td>
<td>87657.850</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2169479.798</td>
<td>15</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*b Dependent Variable: Turnover (£m)

**Fig 2.4 - Top 16 UK Law Firms by Client Stock Market Capitalisation (PEP)**

**Model Summary 2.4**

<table>
<thead>
<tr>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>.839a</td>
<td>.704</td>
<td>.683</td>
<td>194.910</td>
</tr>
</tbody>
</table>

*a Predictors: (Constant), Total Market Cap. of stock market clients (£m)

**ANOVA(b)**

<table>
<thead>
<tr>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>1263699.937</td>
<td>1</td>
<td>1263699.937</td>
<td>33.264</td>
</tr>
<tr>
<td>Residual</td>
<td>531859.063</td>
<td>14</td>
<td>37989.933</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>1795559.000</td>
<td>15</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*b Dependent Variable: PEP (£k)
In contrast to models 2.1 and 2.2, models 2.3 and 2.4 display strong results. Total market capitalisation of stock market listed clients turns out to be an excellent indicator of performance. It is strongly positively correlated with both turnover (R=0.659) and PEP (R=0.839). Again, it is notable that the relationship is stronger when PEP is used as performance measure as opposed to turnover. Despite the relatively small sample size, these relationships are so highly significant to suggest that the total market capitalisation of a firm’s stock market clients is a very accurate predictor of its performance.

Conclusions

This paper examines the relationship between reputation and performance in the top 50 UK law firms (by size). There are three main findings from the analysis. First, it shows a more differentiated picture of the relationships between reputation and performance in professional firms than has been presented previously. It does so by introducing novel methods of measuring reputation and performance. In contrast to previous studies we measure reputation based on clients’ assessment of practice area-specific quality or the total stock market capitalisation of a firm’s clients. Also, while previous studies have measured performance based on revenues only, we consider both revenues and profits. Given that profits are a conventionally powerful measure of financial performance we argue that this enhances the relevance of our findings. Our analyses confirm existing findings on the positive correlation between reputation and performance, but refine our understanding of this relationship.

Specifically, we find that reputation has different effects on different measures of performance. Across all analyses, reputation is more strongly correlated with profits than with
revenue. This difference suggests interesting conclusions about the importance of reputation as a proxy of service quality for different types of services. Reputation is particularly important for attracting premium “high margin-low volume” work, which boosts PEP while inflating turnover to a relatively lesser extent. This work is likely to be cutting-edge, very reliant on exclusive professional expertise, and difficult to assess by clients. By contrast, in the market for commoditised services that are likely to be less critical repeat transactions and have smaller profit margins reputation loses relevance as a sales argument.

Second, we show that the strength of reputation effects diminishes with firm size, measured by turnover. While the exclusion of the ‘Magic Circle’ as a recognized elite among large law firms only minimally affected results, the distinction of two size bands revealed marked differences in the strength of reputation effects between firms of different size. Beyond the top 20, reputation only had an insignificant effect on turnover and influenced profits to a much lesser extent than within the top 20. Thus, if reputation is an important source of competitive advantage for professional service firms, it seems that it is a resource which only a limited number enjoy. Put another way, reputational benefits on performance diminish relatively quickly among smaller firms. This raises interesting theoretical questions about how those firms with limited reputations compete for clients, if not on price alone, in markets which are heavily based on reputation. Similarly, the results challenge the argument that these firms compete for high-calibre professional labour on the basis of their reputation. The most elite firms may do so, because they appear to enjoy reputational advantages or at least distinctiveness, but even by the lower half of the top 50 (out of a total of over six thousand) UK law firms this distinctiveness has diminished substantially.
Third, we show that the reputation measure of client quality is related to performance but only in specific ways. On their own, the sheer number of publicly quoted clients is a very poor predictor of performance. However, if the market capitalization of the client firms is taken into account, a stronger positive result is obtained. Especially the relationship between clients’ stock market capitalisation and profits is extremely strong. This raises questions about the precise relationship between reputation and performance. Our analysis followed current theory in assuming that high-status clients indicate reputation, which in turn enhances performance. This causality may be inverted insofar as legal work for high-status clients, especially if they are listed in stock markets, is likely to be highly visible and increase the legal adviser’s reputation as well as its financial performance. In combination, these arguments suggest that the relationship between reputation and performance may be cyclical, mediated by the markets for clients and professional labour. Reputation and performance feed off each other in that a strong reputation allows the firm to recruit and retain high-quality staff, which in turn deliver cutting-edge, high margin-low volume services. These services, both highly profitable and visible, help recruit further high-quality staff and attract high-status clients, which enhance reputation and so forth.

In this paper we introduce novel measures of reputation, different from those of previous studies. While those have focused on media reports, we use rankings based on client assessments as well as client quality. We argue that our measures are more relevant than media reports in this instance because of our assumption that clients are knowledgeable and selective consumers of corporate legal services. This assumption challenges theories of the professions and the power of professional service firms to the extent that they assume an asymmetry of expertise in favour of the professional vis-à-vis the client. By arguing that these clients, large corporations that generally employ in-house legal counsel to select their
professional advisers, are knowledgeable and powerful consumers of professional services, we can start to re-conceptualise the dynamics of reputation creation in such sectors. For example, one proposition which follows from this argument is that public ranking exercises based on client opinion will have important effects on reputation creation or diminution. This helps uncover the theoretical puzzle of where reputations come from by indicating the process by which judgements about firms’ expertise are transformed into well-grounded cognitions. If clients make judgements about comparative expertise then they are arguably assessing the ability of experts, individually and collectively to deploy their knowledge to resolve client problems.

In addition, we have argued that in professional service firms, reputation has to be understood as a more micro-level phenomenon than has hitherto been assumed. This also has implications for the way we conceptualize professional service firms more generally. It seems plausible to frame reputation among knowledgeable clients at the practice or even individual level rather than at the firm level. In other words, the relevant issue for clients when seeking to engage a professional adviser is not so much the firm’s general reputation, which the client may not care much or may not be able to make a judgement about, but that of the focal practice. To the extent that it is possible to frame reputation at the level of the firm, it is likely that there are reciprocal effects between practice and firm reputation, but our argument is that influence of practice on firm reputation will be stronger than vice versa because it will follow from clients’ perceptions and behaviours (that is, their decisions whether to engage or not). Wider judgements about the reputation of the firm will follow from judgements about practices. This suggests the reputation-performance relationship is as follows: clients’ rankings of practices affect the reputation of the practices which in turn influence the overall reputation of the firm
and its financial performance. Further work is needed to understand better the interaction over time between practice and firm reputations.

As our work focuses on how practice based reputations influence judgements about firms it is plausible to argue professional service firms have multiple reputations, and are simultaneously strong in one area and weaker in others. Theoretically, we should think of professional service firms as distinctive from other organizations because they are coalitions of expertise-based practices with different reputations. The performance of professional service firms will be linked to the structure, reputation, and interaction between different practices within that coalition.

References


Empson, L. 2001, Fear of Exploitation and Fear of Contamination: Impediments to Knowledge Transfer in Mergers Between Professional Service Firms. Human Relations 54(7) 839-862


