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Determinants of Financial Success of Large Law Firms

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by

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Abstract

Prior research has established that leadership characteristics, job equity perception, and client satisfaction are all associated with a firm's financial performance. This study tested hypotheses about these variables based upon Upper Echelons Theory, Adams Equity Theory, and Stakeholder Theory, in the context of 110 large U.S. law firms. The analysis revealed that (1) the racial diversity of the firm's management committee is positively associated with the firm's financial performance; (2) the average employee salary has a positive and U-shaped relationship with the firm's financial performance; (3) the average employee salary has a positive relationship with the firm's client satisfaction; (4) client satisfaction has a positive relationship with the firm's financial performance; and (5) client satisfaction mediates the relationship between the firm's average employee salary and the firm's financial performance. These results yield insights for both research and practice.

Keywords: firm performance, demographic characteristics, salary, client satisfaction, job equity perception

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Chapter 1: Introduction

Professional service firms offer customized, knowledge-based services to clients (Agrawal, Hartman, Rasberry, & Arbogast, 2018). Firms in this sector include accounting, consulting, engineering, law, and other firms providing professional services to the public. The high growth and profitability of such firms in recent decades makes them a significant sector of the world economy (Empson & Langley, 2015). Professional service firms are not only growing in terms of their contribution to the Gross Domestic Product (GDP), but also in terms of their employment worldwide (Sweeney, Soutar, & McColl-Kennedy, 2011). As an example, the big four accounting firms had a revenue growth of 10.4% in fiscal year 2018, and reached $148.2 billion in combined global revenue. Of these firms, Deloitte alone had over 286,000 employees in 2018 (www.statista.com). The significance of professional service firms extend beyond the revenue they generate as they support the development of society and enable various industries to set their professional, legal, and accounting standards (Empson & Langley, 2015).

Since professional service firms provide knowledge-based professional services to their clients, their performance heavily depends upon their leadership and the professionalism of their employees. However, research examining the relationship between the leadership of professional service firms and their financial performance is limited (Abdelzaher, 2012). This may in part be due to the fact that a majority of professional service firms are owned by private parties with limited financial information available for public access (Pickering, 2012).

An important constituent of the professional service firms sector are law firms. According to law.com, the gross revenue for the largest global 100 law firms grew by 8.1% in 2018 to reach $114.2 billion. A law firm's lawyers can be categorized into equity partners, non-equity partners, and associates (Kay & Gorman, 2012). An equity partner is a traditional partner, who holds equity in the law firm and shares the profit of the law firm as his or her compensation. Equity partners are the owners of the law firm, responsible for the management and operation of the law firm. A non-equity partner is a salaried lawyer, who bears the name of partner but does not have equity in the firm (Kay & Gorman, 2012). Furthermore, law firms also employ junior lawyers as associates, during a partnership tracking period of six to ten years. At the end of the partnership tracking period, the associates deemed qualified are considered for promotion to become partners (Kay & Gorman, 2012). A model structure of a law firm is illustrated in Figure 1. It consists of a management committee, various departments led by respective managers, each department having one or a few partners, each of whom mentors and manages various associates assembled for each legal project. The leadership structure of law firms generally consists of management committees (Hammargren, 2006). The members of the management committee are the equity partners of the law firm, who are elected by all the equity partners of the law firm on a periodic basis. The management committee is entrusted with the management and daily operations of the law firm. Partners, including both equity partners and non-equity partners, of the law firm are the points of contact for the clients. They are responsible for assembling a team of associates to work independently or in association with other partners of the law firm to complete each legal project for their clients.

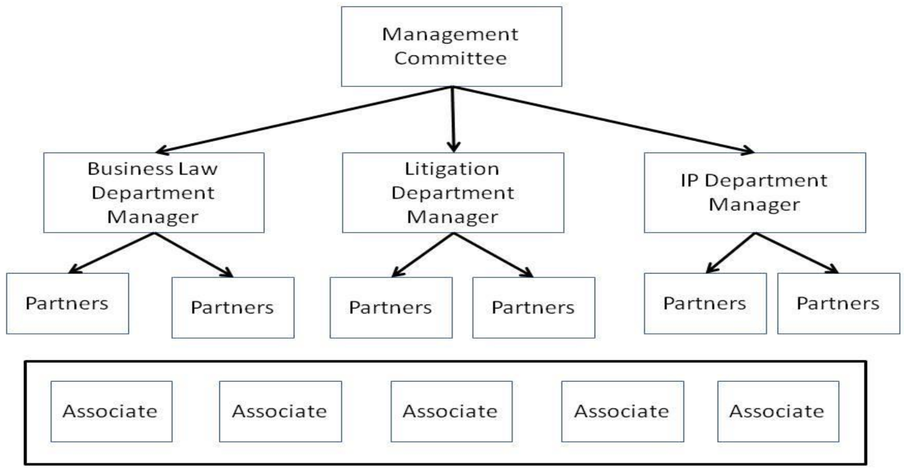

Figure 1. Model structure of a law firm

Prior research has indicated that the leadership characteristics of lawyers are associated with their financial success (Davis, 1994), and that there is an association between executive characteristics and the firm's financial performance (Peterson, Galvin, & Lange, 2012). Even though such research has shown that the leadership quality of a law firms is associated with the firm's financial success (Bassi & McMurrer, 2008), we are not aware of any research that has examined the relationship between the demographic composition and other characteristics of a law firm's management committee and the firm's financial performance.

Background of the Problem

Most large law firms have a presence in major cities in the United States and overseas (Powell & Lim, 2018). Individual offices often set their own policies reflecting different local cultures, even though the law firm's overall strategy is determined centrally (Powell & Lim, 2018). The business entity type of most law firms is a partnership. The partners are the owners of the law firm, who are responsible for the management and operation of the law firm. Partners not only develop legal expertise associated with various industries, but also develop and maintain client relationships (Kim, Kim, Kim, & Byun, 2016). Partners train, mentor, and lead associates during the process of providing legal services to clients (Kim et al., 2016). Partners are typically responsible for supervising small teams of associates to provide legal services to a specific client. The management committee oversees the day-to-day management and operation of the law firm, though major changes in the firm's strategy must usually be approved by the entire partnership (Kay & Gorman, 2012).

In a law firm's context, leadership is a process where an individual or a group brings about positive and ethical changes by influencing others (Polden, 2012). The financial success of firms can often be traced to the composition of the top management team as well as the leadership skills of its management based on research of law firms in the United States (Bassi & McMurrer, 2008). The management committee of a large law firm drives its performance by articulating a vision and setting high performance standards (Heys & Rodwell, 2006).

Statement of the Problem

Even though lawyers assume significant leadership roles in their workplace and their communities (Rhode, 2011), there exists limited research on the leadership of law firms (Forstenlechner, Lettice, Bourne, & Webb, 2007). According to Nielsen and Nielsen (2013), the diversity of the firm's top management team can impact the firm's financial performance but this relationship has not been adequately examined in literature. We attempt to address this gap in this dissertation.

To understand a law firm's financial performance, it is import to understand that law firms typically bill for their services either on an hourly rate or contingent basis (Garoupa & Gomez-Pomar, 2007). The contingent legal fee arrangement aims at achieving efficient risk sharing between law firms and their clients as compared to the hourly fee arrangement wherein the client sustains all the risk associated with the legal services (Graham & Robles, 2019). Clients pay contingent fees only if the lawyer handles a case successfully. This arrangement is used in cases where money is being claimed such as litigation involving personal injury or workers' compensation. The lawyer agrees to accept a fixed percentage (often one third) of the recovery, which is the amount finally paid to the client.

Law firms typically maintain an hourly billing arrangement, rather than contingent fee arrangement, with their corporate clients (Graham & Robles, 2019). The corporate clients are at a better position than individual clients in sustaining all the risks associated with the legal services, because they typically have sophisticated in-house legal teams to evaluate the effectiveness and efficiency of the law firms they engage (Fasterling, 2009). A corporate client's general counsel office is responsible for monitoring and evaluating the performance of the law firms retained by the corporation, as well as making decisions in replacing existing law firms with other law firms based on the legal needs of the corporation. If a law firm cannot live up to its expectations, the corporate client will likely terminate the relationship and switch to another (Fasterling, 2009). Furthermore, under the hourly fee arrangement, corporate clients have better control over the law firm, while the contingent fee arrangement leaves the corporate clients with minimal or no control at all (Garoupa & Gomez-Pomar, 2007).

Associates and non-equity partners of a law firm are paid salaries and bonuses based on their services billed to the clients. The equity partners of the law firm are owners of the law firm. They do not receive a salary, but rather, they receive a monthly draw against the law firm's profits, i.e., the billable income from clients after the deduction of salaries to associates and non-equity partners, as well as the firm's other operational expenses. The compensation of an equity partner is therefore based on the law firm's revenues, even though his or her percentage share is determined by the partnership agreement. The partnership agreement incorporates considerations such as performance, contribution to the firm over a period of time, billable and non-billable hours, collections, accounts receivable, write-offs and write-downs of bills, and disbursements. If the salaries paid to associates and non-equity partners for a set number of billable hours are higher, the lower will be the amount left for the equity partners of the law firm to share.

Purpose of this Study

This study aims to research and evaluate the relationships between the demographic composition of the management committee, the average employee salary, the client satisfaction, and the financial performance of the firm in the context of the top 200 U.S. law firms by revenue. Specifically, we test hypotheses that the demographic composition of the management committee, the average employee salary, and client satisfaction are positively associated with the financial performance of the law firm. We also test the hypothesis that the average employee salary has an inverse U-shaped relationship with the law firm's financial performance as well as with client satisfaction. Finally, we test the hypothesis that the relationship between the average employee salary and the law firm's financial performance is mediated by the client satisfaction. The proposed research model is shown in Figure 2. In this model, the dependable variable is the law firm's financial performance. The independent variables include the demographic composition of the management committee, the average employee salary (i.e., the average salary of associates and non-equity partners), and the client satisfaction with the law firm.

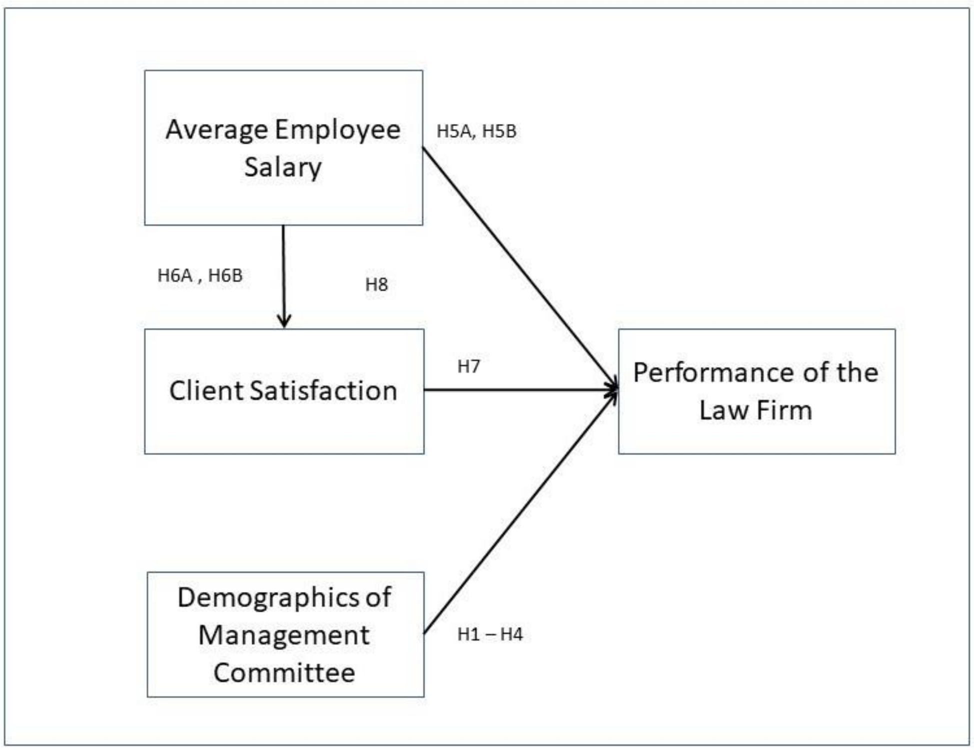

Figure 2. Proposed research model

Research Questions

This research has three questions pertaining to large U.S. law firms, with the unit of analysis being the law firm.

RQ1. Is there a relationship between the demographic composition (race, gender, size of professional network, and professional experience) of the management committee and the law firm's financial performance (H1 – H4)?

RQ2. Is there a relationship between the average employee salary (i.e., the average salary of associates and non-equity partners) and the law firm's financial performance (H5A, H5B)?

RQ3a. Is there a relationship between the average employee salary and the law firm's client satisfaction (H6A, H6B)?

RQ3b. Is there a relationship between the law firm's client satisfaction and the law firm's financial performance (H7)?

RQ3c. Is the relationship between the average employee salary and the law firm's financial performance mediated by the law firm's client satisfaction (H8)?

Description of Variables

For this research, the key demographic characteristics of a law firm's management committee include its racial composition, gender composition, average size of the committee members' professional networks, and the average number of years of professional experience of the members. This demographic data is maintained by the law firms' human resources (HR) departments.

Racial and Gender composition: The racial composition of the law firm's management committee is often measured as a percentage (Fish, 2019) as is its gender composition (Atif, Liu, & Huang, 2019).

Professional networking: Professional associations provide their members opportunities to socialize and develop work relationships with other professionals in the field (Ki & Wang, 2016). Hence the average number of memberships maintained in various legal professional associations by managing committee members can be used as a measure of the size of the committee's professional network (Ki & Wang, 2016). This information is maintained by the HR departments of large law firms.

Professional experience: The average number of years that management committee members have pursued their legal careers can be used as a measure of the management committee's professional experience (Hoffmann, Iliewa, & Jaroszek, 2017). This information is also maintained by the HR departments of large law firms.

Average employee salary: Associates and non-equity partners are the primary employees of a law firm (Kay & Gorman, 2012). Thus the average annual income of the associates and non-equity partners can be used as the measure of the average employee salary of the law firm. This information is available in a public database.

Client satisfaction: Clients of a firm can be interviewed to measure their satisfaction with the firm (Bal & Boehm, 2019). Client satisfaction with the top 200 U.S. law firms by revenue is available in a public database.

Firm's financial performance: The average annual profit per equity partner can be used to measure the law firm's financial performance (Rule & Ambady, 2011). This information is available in a public database.

Chapter 2: Theory and Hypotheses

Theoretical Framework

Upper Echelons Theory serves as the framework for examining the first research question, i.e., the relationship between the management committee's demographic composition and the law firm's financial performance. Performance of an organization is viewed as the result of the values and capabilities of the leaders of the organization. Therefore, the characteristics of the firm's top management team, i.e., its upper echelons can influence its business strategies as well as performance (Hambrick & Mason, 1984). Upper Echelons Theory has been used to demonstrate that the demographic composition of the top management team, such as gender, age, functional background, tenure, and educational background, can create competitive advantage for the firm and thus predict firm financial performance (Shammugam & Marimuthu, 2018). The theory predicts that top management teams make strategic decisions based on their interpretation of situations, which in turn is a function of their background characteristics, such as experiences, personality, and personal values (Lopatta, Tideman, Ottcher, & Wichern, 2019). The theory emphasizes the relevance of top management team characteristics for the firm's financial performance (Egerová & Nosková, 2019). Based on the Upper Echelons Theory, the demographic composition of a law firm's management committee will be associated with the financial performance of the firm.

Racial and Gender Diversity

Diversity refers to the differences in background, demographic, and functional dimensions of the top management team (Gachugu, Awino, Iraki, & Machuki, 2019). The legal profession is a less diverse profession than medicine, accounting, and academia according to the Bureau of Labor Statistics (Rhode, 2017). Even though over one-third of the legal profession was female in 2015, only about 18% law firm equity partners were female, and only 15 out of 143 chairs and managing partners of the one hundred largest law firms in the United States were female (Rhode, 2017). Furthermore, over the last two decades, large law firms have been pursuing greater racial diversity in attorney hiring and retention (Woodson, 2011). However, even though large law firms now retain large number of black attorneys as their junior associates, these black associates are leaving these law firms at faster rates than white associates due to poorer career experiences and employment outcomes (Woodson, 2011) and hence do not reach the upper echelons.

Throughout the twentieth century, successful leadership has been described as being assertive, independent, autocratic, and task-oriented, which is often consistent with the characteristics of male leadership styles (Hammargren, 2006; Schein, 2001). Catalyst's (2004) research was amongst the first to demonstrate that gender diversity in top management was positively associated with the firm's financial performance. Other research has found that female participation in senior management is positively associated with the financial performance of firms pursuing an innovation intensive strategy (Dezsö & Ross, 2008). Furthermore, participation of women at senior levels of firms leads to flexibility in terms of work design and firm culture, which in turn led to higher financial performance of the firms (Heys & Rodwell, 2006). When the leaders of an organization value gender diversity, the organization is deemed to value such gender diversity. The gender diversity of the top management team may provide an organization with a friendly and productive working environment for both male and female employees, in turn resulting in high firm performance (Lee & Kim, 2019). Thus gender diversity of the top management team may lead to strategic changes that benefits an organization, and in turn result in high firm performance (del Carmen Triana, Richard, & Su, 2019).

That the top management team's diversity can have a significant impact on the firm's financial performance (Li & Hambrick, 2005) has been confirmed in recent research based on an analysis of 300 Malaysian public companies which determined that racial diversity of the board of a public company is positively related with its financial performance (Shukeri, Shin, & Shaari, 2012). Based upon these findings, we believe that the racial diversity of the law firm's management committee will have a positive relationship with the financial performance of the law firm. According to the Upper Echelons Theory (Hambrick & Mason, 1984), the racial and gender diversity of the management committee of a law firm can be used to predict the financial performance of the law firm. Hence we hypothesize:

H1: The racial diversity of the management committee is positively associated with the law firm's financial performance.

H2: The gender diversity of the management committee is positively associated with the law firm's financial performance.

Professional Networking

Professional networking is increasingly being recognized as a powerful predictor for the financial performance of a firm, because it bridges the gaps and disconnects of social structure to help a firm achieving competitive advantage based on Burt's theory of brokerage (Jaffee, McEvily, & Tortoriello, 2005). Even casual acquaintances can provide crucial information and therefore the professional networking of partners enables the firm to accumulate knowledge and learn (Argote, 1999). The professional networking of the management committee enables the law firm to have better connections with clients, peers, competitors, and legal industry in general. Following the findings of Jeffee, McEvily, and Tortoriello (2005), the size of the professional networking of the management committee of a law firm can have a positive relationship with the financial performance of the law firm. Based on Upper Echelons Theory as well as Burt's theory of brokerage, professional networking of the management committee of a law firm can be used to predict the performance of the law firm. Hence we hypothesize:

H3: The professional networking of the management committee is positively associated with the law firm's financial performance.

Professional Experience

Law firms invest heavily in knowledge management, due to the highly knowledge intensive nature of the legal work, as well as the high risk involved in the knowledge loss through turn over (Forstenlechner et al., 2007). Thus law firms focus greatly on their partners' professional experience, i.e., the intrinsic information and expertise they possess, to create business value (Forstenlechner et al., 2007). According to Forstenlechner et al. (2007), the experience of the management committee of a law firm may have a positive relationship with the financial performance of the law firm. Based on the Upper Echelons Theory, average years of experience of the management committee of a law firm, can be used to predict the performance of the law firm. Hence we hypothesize:

H4: The professional experience of the management committee is positively associated with the law firm's financial performance.

Average Employee Salary

Adams Equity Theory serves as the framework for examining the second research question, which concerns the average employee salary of a law firm and its relationship with the firm's financial performance. Adams (1965) suggests that people are motivated to seek pay recognition for their performance. According to Adams Equity Theory (Adams, 1963, 1965), when employees believe that they have been treated fairly, they are more likely to be motivated and such motivation will be transformed into positive work behavior and attitude, which in turn impacts the financial performance of the firm. This theory proposes that employees will be dissatisfied if their contributions are greater than the rewards, and their dissatisfaction is manifested through their low commitment level, increased absenteeism, and unruly behavior (Yean & Yusof, 2016).

Adams Equity Theory predicts that the inputs and the outputs of employees of a firm need to be fair in order to achieve high level of employee job satisfaction, and thus high firm financial performance. Outcomes are defined as rewards employees receive as the result of the employment (e.g., pay), and inputs are defined as jobs employees perform (e.g., work effort) (Kollmann, Stöckmann, Kensbock, & Peschl, 2019). Employees are satisfied and high firm financial performance is achieved, when employees' inputs are in equity with their outcomes (Kollmann et al., 2019).

The job equity perception of Adams Equity Theory is defined as an employee's perception of justice by comparing his or her own input-output ratio with the input-output ratios of the peers within or outside the organization (Inuwa, 2017). The job equity perception of Adams Equity Theory can be further divided into four components, including others outside, others inside, self-outside, and self-inside (Robins, Judge, Millet, & Boyle, 2013).

Others outside (JEOO) refers to an employee's perception of his or her job equity comparing to the job equity of the peers outside the organization (Aidla, 2013). It is not unusual for lawyers to switch firms during their career progress. Most lawyers move from one law firm to another law firm within the same geographic region. The career track of lawyers at the large law firms in the United States goes through associate, non-equity partner (if applicable), and equity-partner. The associates are the junior level employees of the law firm. The non-equity partners are the senior level employees of the law firm. The average salary of the employees of a law firm represents the average salary of both the associates and the non-equity partners of the law firm. Therefore, JEOO is operationalized as the average employee salary index, which is the quotient of the average employee salary divided by the average attorney salary of the city where the largest office of the law firm is located. JEOO represents the salary multiple between the average employee salary of a law firm and the average attorney salary of the city where the largest office of the law firm locates.

Others inside (JEOI) refers to an employee's perception of his or her job equity comparing to the job equity of the peers within the organization (Robins, Judge, Millet, & Boyle, 2013). An employee often compares her or his income with the income of others in the same organization having similar education qualification, expertise and work schedule (Inuwa, 2017). *Self-outside* (JESO) refers to an employee's perception of his or her job equity comparing to the job equity of a previous job position at the organization or positions held outside the organization (Robins, Judge, Millet, & Boyle, 2013). An employee tends to develop strong commitment to the organization, when the output received from the organization exceeds his or her input to the organization; and employee tends to develop weak commitment to the organization, when the output received from the organization does not exceed his or her input to the organization (Cohen & Vigoda, 2000). Employees' perception of equity at an organization minimizes their turnover rate (Nguyen & Do, 2020). Most law firms constantly have personnel change during the year. *Self-inside* (JESI) refers to an employee's perception of his or her job equity comparing to the job equity of previous job position or positions held within the organization (Inuwa & Idris, 2017). This study only analyzes the data associated with JEOO, represented as the average employee salary compared to the average attorney salary of the city. The analysis of JEOI, JESO, and JESI is beyond the scope of this study.

In the context of a law firm, outcomes are the dollar amounts of average employee salaries, and inputs are the average working hours of the employees. Because all the employees of a law firm are full-time employees, their job satisfaction will be positively related to their salary. If employees perceive their salaries to be fair, they will be more motivated and such motivation will transform into positive work attitude and behavior. Thus the law firm will achieve higher financial performance (Kollmann et al., 2019). Hence we hypothesize:

H5A: The average employee salary is positively associated with the law firm's financial performance.

Law firm employees (i.e., associates and non-equity partners) are paid a salary and bonus based on their services billed to the clients. The financial performance of the firm is represented by the annual profit per equity partner. If higher salaries are paid to associates and non-equity partners for a set amount of billable hours, the balance profit left to be paid to equity partners of the law firm will be lesser. Thus, if a law firm over compensates its employees, the performance of the law firm will decrease. Hence as an alternative to H5A, we hypothesize:

H5B: The average employee salary has an inverse U-shaped relationship with the law firm's financial performance.

Client Satisfaction

Stakeholder Theory serves as the framework for examining the third research question, which concerns the relationship between the law firm's client satisfaction and the law firm's financial performance. Stakeholder Theory suggests that a firm's financial success heavily depends upon its stakeholders, who have the capability of affecting the firm's long-term strategic goals (Danso, Adomako, Amankwah-Amoah, Owusu-Agyei, & Konadu, 2019). According to Stakeholder Theory, in order to have a successful business operation, it is critical for the business leaders to consider the interests of all stakeholder groups (Zhu, Sun, & Leung, 2013). The responsibility of business leaders should extend to all different stakeholders, rather than only focusing on the maximization of shareholders' wealth (Zhu et al., 2013). From the stakeholders' perspective, ethical business leaders develop a shared sense of meaning and purpose with all the stakeholders (Zhu et al., 2013). Value does not simply mean the profit maximization of the firm, but includes the balanced needs of multiple stakeholder groups, including employees, customers, environmental constituents, and the broader community (de Luque, Washburn, Waldman, & House, 2008).

In the context of a law firm, it serves the interests of all stakeholders, including employees, equity partners, and clients, for the law firm to achieve financial success. The responsibility of the management committee of a law firm cannot be limited to maximizing the law firm's financial performance only, but the clients' satisfaction as well. From stakeholders' perspectives, the management committee of the law firm can achieve high client satisfaction, while achieving financial success for the law firm.

According to Graham & Robles (2019), an hourly fee arrangement of a law firm with its clients is associated with the moral hazard problem, because the hourly fee arrangement does not encourage the law firm to exert its best effort in maximizing the value to its clients (e.g., partners and associates may be motivated to maximize billable hours beyond those strictly necessary). With the concern of moral hazard, a law firm's hourly billing practice to its corporate clients might lead to overbilling, and in turn impact client satisfaction with the legal service. Because client satisfaction is positively related to the firm's financial performance (Osuagwu, 2019), the can have a negative impact on the firm's financial performance.

According to Stakeholder Theory, a successful law firm will be able to provide high compensation to its salaried employees and achieve a high level of client satisfaction, while achieving high firm financial performance. Hence, we hypothesize:

H6A: The average employee salary is positively associated with the client satisfaction.

If average employee salary is too high, clients will be overbilled, which impacts client satisfaction, and in turn, impacts firm financial performance. Thus, if a law firm over compensates its employees, the performance of the law firm will decrease. Hence as an alternative to H6A, we hypothesize:

H6B: The average employee salary has an inverse U-shaped relationship with client satisfaction.

H7: Client satisfaction is positively associated with the law firm's financial performance.

Because client satisfaction has been found to have a mediating effect on firm financial performance by various researchers (Aldeehani, 2018; Asnawi & Awang, 2018), this study also tests the possible mediation effect of client satisfaction on the relationship between the average employee salary and the law firm's financial performance. Hence, we hypothesize:

H8: Client satisfaction mediates the relationship between the average employee salary and the law firm's financial performance.

Chapter 3: Methodology

Data

To test the hypotheses, this study analyzed secondary data from the top 200 U.S. law firms by revenue in 2018 obtained from independent third parties. Demographic information about the management committee members was obtained by contacting the HR departments of the law firms. Average employee salary and financial performance of the firms was obtained from the ALM Intelligence database and paysa.com (a personalized career service for salary compensation and job matching of corporate employees). Client satisfaction with the firms was obtained from the BTI Consulting database, which included results from an annual survey of general counsels of over 2,000 public companies regarding their satisfaction with the legal services they received from outside law firms, which primarily were the top 200 law firms.

Operationalization of Variables

Demographic Composition of Management Committee. The demographic composition of the management committee, including racial and gender composition, professional networking, and professional experience, was obtained from the HR departments of the law firms.

The diversity of the management committee was operationalized by using Blau's Index, which is a diversity index that measures the probability of functional heterogeneity of two entities taken at random (van Zijl, Vermeeren, Koster, & Stein, 2019). Blau's Index has been used in literature to study the heterogeneity of top management teams (Kaiser & Müller, 2015). To measure heterogeneity we used Blau's Categorical Index (1977) formula (van Zijl, Vermeeren, Koster, & Stein, 2019):

$$\text{Blau's Categorical Index} = 1 - \sum p_i^2,$$

where p_i is the population percentage with a specific characteristic. The index is always a number between 0 and 1, where 0 corresponds to complete homogeneity and 1 to complete heterogeneity.

Racial Diversity. The management committee members were categorized into six groups, including non-Hispanic White, African American, Hispanic, Native Indian, Asian, and Pacific Islander. Racial diversity of the management committee was measured by the Blau's Racial Heterogeneity Index, which was operationalized as 1 minus the sum of the squares of the percentages of each racial group represented in the management committee.

Gender Diversity. We were prepared to include various gender category in addition to male and female. However, the management committee members were only categorized into male and female based on the information available from the HR departments. Gender diversity of the management committee was measured by the Blau's Gender Heterogeneity Index, which was operationalized as 1 minus the sum of the squares of the percentages of each gender group represented in the management committee.

Professional Networking. The size of the management committee's professional networking was measured by the average number of professional memberships of the members of the management committee.

Professional Experience. The professional experience of the management committee was be measured by the average years of professional legal practice of the members of the management committee.

Average Employee Salary. The average employee salary represents the average annual income of the associates and non-equity partners of the law firm. The average employee salary was obtained from the ALM Intelligence database. The average employee salary was operationalized as an index calculated by dividing the average employee salary with the average attorney salary of all the attorneys licensed to practice in the city where the largest office of the law firm was located. The use of the average employee salary index in the study compensates for salary differences of lawyers in different regions of the U.S.

Firm Financial Performance. The financial performance of the law firm is the annual profit per equity partner of the firm (Rule & Ambady, 2011). The annual profit per equity partner of the top 200 U.S. law firms was obtained from the ALM Intelligence database. The firm's financial performance was operationalized as an index calculated by dividing the annual profit per equity partner with the average attorney salary of all the attorneys licensed to practice in the city where the largest office of the law firm was located.

Client Satisfaction. The client satisfaction for each of the top 200 U.S. law firms was obtained from the BTI Consulting annual survey database. The client satisfaction score ranged from 0 through 20, with 0 being least satisfied and 20 being most satisfied.

Data Analysis

Data was analyzed using IBM SPSS Statistics Version 25. The demographic composition of the management committee, the average employee salary, and the client satisfaction with the law firm were the independent variables. The law firm's financial performance was the dependent variable. The control variables included the age of the law firm, the number of offices of the firm, and the location of the largest office of the firm.

We used hierarchical linear regression analysis to examine the relationship between (1) demographic composition of the management committee and the law firm's financial performance, (2) the average employee salary and the law firm's financial performance, (3) the average employee salary and the law firm's client satisfaction, (4) client satisfaction and the law firm's financial performance, and (5) the mediation of average employee salary and the law firm's financial performance by client satisfaction.

Hierarchical regression is a way to show whether the independent variables of interest explain a statistically significant amount of variance in the dependent variable after accounting for control variables (Meyers, Gamst, & Guarino, 2016). This study utilized hierarchical regression in SPSS to examine the relationship between a group of independent variables (Racial Heterogeneity Index, Gender Heterogeneity Index, Professional Networking, Professional Experience, Client Satisfaction, and Average Employee Salary), and the dependent variable (Firm Profit Index) while accounting for the effects of the control variables (Firm Age, Office Region, and Number of Offices). The control variables were entered into block 1 of the regression, and the predictor variables (operationalized as described in the measures section) were entered into block 2. We also generated scatter plots with the data which enabled us to determine whether these relationships were positive, negative, or curvilinear. The following hypotheses were tested.

Hypotheses 1-4. Hypotheses 1-4 concerned the relationships between the demographic composition of the management committee and the law firm's financial performance.

Hypothesis 5A. Hypothesis 5A concerned the relationship between the average employee salary and the law firm's financial performance.

Hypothesis 5B. Hypothesis 5B proposed that a curvilinear (inverted U) relationship would be found between the average employee salary and the law firm's financial performance. First, we generated a scatter plot to visualize the relationship. To statistically test the relationship, linear regression was conducted. The control variables were entered in block 1, the average employee salary was entered in block 2, and the square of the average employee salary was entered in block 3. If the beta coefficient for X is significant and positive, and for X^2 (i.e., average employee salary squared) is significant and negative, it will indicate an inverse U-shaped relationship between the average employee salary and the law firm's financial performance.

Hypothesis 6A. Hypotheses 6A concerned the relationship between the average employee salary and the client satisfaction.

Hypothesis 6B. Hypothesis 6B proposed that a curvilinear relationship (inverted U) would be found between the average employee salary and the client satisfaction. First, we generated a scatter plot to visualize the relationship. To statistically test the relationship, linear regression was conducted. The control variables were entered in block 1, the average employee salary was entered in block 2, and the square of the average employee salary was entered in block 3. If the beta coefficient for X is significant and positive, and for X^2 (i.e., average employee salary squared) is significant and negative, it will indicate an inverse U-shaped relationship between the average employee salary and the client satisfaction.

Hypothesis 7. Hypothesis 7 examined the relationship between the client satisfaction and the law firm's financial performance.

Hypotheses 8. Hypotheses 8 examined whether the relationship between the average employee salary and the law firm's financial performance was mediated by the client satisfaction. This hypothesis will be tested using linear regression analysis.

We tested the mediating effect of client satisfaction on average employee salary and the law firm's financial performance by using Hayes Process Macro for SPSS model 4. If the indirect effect estimate between the average employee salary and the law firm's financial performance is found to be significant, we can conclude that the relationship between the average employee salary and the law firm financial performance is mediated by the client satisfaction. If both the indirect effect estimate and the direct effect estimate are significant, we can conclude that the relationship between the average employee salary and the law firm's financial performance is partially mediated by the client satisfaction. If the indirect effect estimate between the average employee salary and the law firm's financial performance is insignificant, we can conclude that the relationship between average employee salary and the law firm's financial performance is not mediated by the client satisfaction.

Collinearity diagnostics. Collinearity diagnostics is a technique for examining the overlapping relationship between and among various independent variables in predicting the dependent variable (Meyers, Gamst, & Guarino, 2016). If the tolerance of the collinearity diagnostics is above 0.4, there exists low degree of overlapping between and among various independent variables, which indicates no collinearity problem (Meyers, Gamst, & Guarino, 2016). If the tolerance of the collinearity diagnostics is below 0.4, there exists high degree of overlapping between and among various independent variables, which indicates a collinearity problem (Meyers, Gamst, & Guarino, 2016). This study examined the tolerance of all independent variables, including Blau's Racial Heterogeneity Index, Blau's Gender Heterogeneity, Professional Networking, Professional Experiences, Client Satisfaction, and Average Employee Salary Index to determine the exclusion of those having collinearity problems. Multiple linear regressions were conducted again after the exclusion of independent variables with collinearity problem.

Implications

If H1 through H4 are supported, we will be able to provide guidance to large law firms in optimizing the demographic composition of their management committee to achieve high firm financial performance. If H5A and H6A are supported, we will be able to provide guidance to large law firms in optimizing their employee salary to achieve high firm financial performance and high client satisfaction. If H5B and H6B are supported, we will be able to provide guidance to large law firms in optimizing the employee salary to achieve an optimized combination of firm financial performance and client satisfaction through the adjustment of the employee salary of the law firm within an optimal zone, as illustrated in Figures 3. If H7 is supported, we will be able to provide guidance to large law firms in optimizing the client satisfaction to achieve high firm financial performance. If H8 is supported, we will be able to provide large law firms with a better understanding of the mediating effect of client satisfaction on the relationship between the employee salary and the law firm's financial performance.

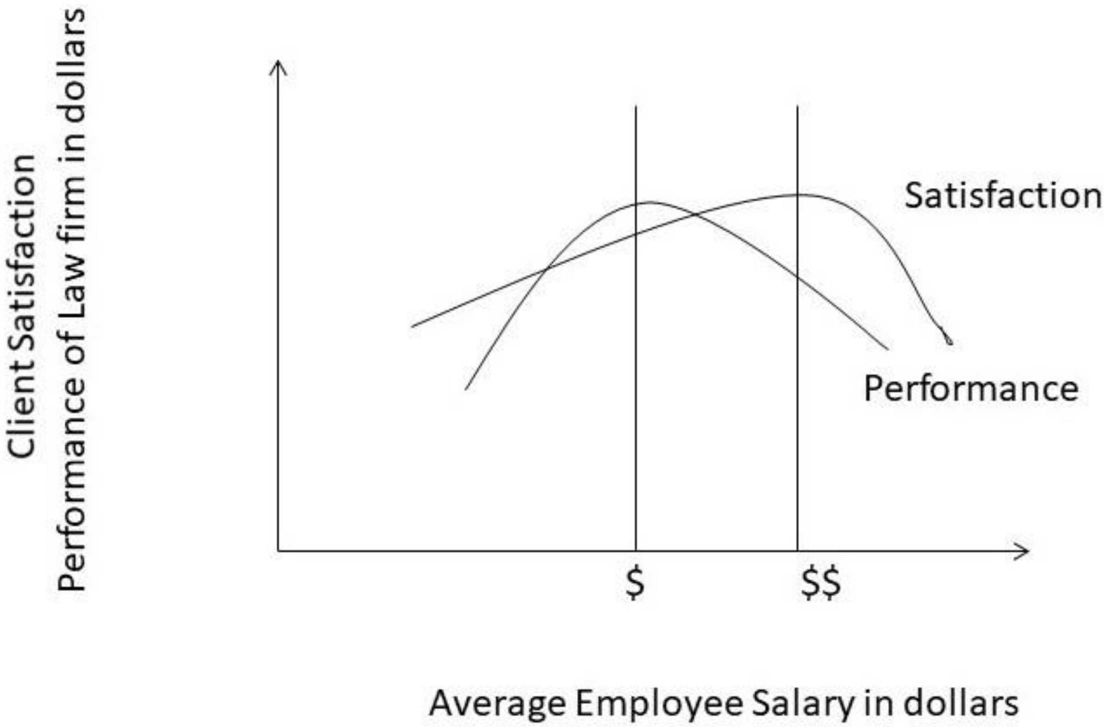

Figure 3. Proposed relationship between and among average employee salary, client satisfaction, and firm financial performance

Chapter 4: Results

Overview

This chapter presents the results of the multiple regression analyses, as well as the associate procedures. This study sought to evaluate the relationships between the demographic composition of the management committee, the average employee salary, the client satisfaction, and the financial performance in the context of the top 200 U.S. law firms by revenue of 2018.

We tested hypotheses that the demographic composition of the management committee, the average employee salary, and the client satisfaction are positively associated with the financial performance of the law firm. We also tested the hypotheses that the average employee salary has an inverse U-shaped relationship with the law firm's financial performance as well as with the client satisfaction. We further tested the hypothesis that the relationship between the average employee salary and the law firm's financial performance is mediated by the client satisfaction.

The independent variables in this study include Blau's Racial Heterogeneity Index, Blau's Gender Heterogeneity Index, Professional Networking, Professional Experiences, Client Satisfaction, and Average Employee Salary Index. The selection of these independent variables for this study follows from the literature review in Chapter Two, which demonstrates their association with the dependent variable of this study. The dependent variable is Firm Profit Index, which represents the law firm's financial performance. Firm financial performance was selected as the dependent variable because of its importance to professional service firms. The control variables of this study include Firm Age, Office Region, and Number of Offices. The effect of the control variables was controlled in the regression analysis through the use of hierarchical regression in SPSS while examining the relationship between a group of independent variables and the dependent variable.

In order to have a clear understanding of the relationships between the study's variables, i.e., demographic composition of the management committee, average employee salary, client satisfaction, and the law firm's financial performance, this study proposed the following questions:

RQ1. Is there a relationship between the demographic composition (race, gender, size of professional network, and professional experience) of the management committee and the law firm's financial performance (Hypotheses 1 through 4)?

RQ2. Is there a relationship between the average employee salary (i.e., the average salary of associates and non-equity partners) and the law firm's financial performance (Hypotheses 5A and 5B)?

RQ3A. Is there a relationship between the average employee salary (i.e., the average salary of associates and non-equity partners) and the client satisfaction (Hypotheses 6A and 6B)?

RQ3B. Is there a relationship between the law firm's client satisfaction and the law firm's financial performance (Hypothesis 7)?

RQ3C. Is the relationship in RQ2 mediated by the law firm's client satisfaction (Hypotheses 8)?

Based on prior literature and the above research questions, we developed and tested the following eight hypotheses using the quantitative research method:

H1: The racial diversity of the management committee is positively associated with the law firm's financial performance.

H2: The gender diversity of the management committee is positively associated with the law firm's financial performance.

H3: The professional networking of the management committee is positively associated with the law firm's financial performance.

H4: The professional experience of the management committee is positively associated with the law firm's financial performance.

H5A: The average employee salary is positively associated with the law firm's financial performance.

H5B: The average employee salary has an inverse U-shaped relationship with the law firm's financial performance.

H6A: The average employee salary is positively associated with the client satisfaction.

H6B: The average employee salary has an inverse U-shaped relationship with client satisfaction.

H7: Client satisfaction is positively associated with law firm's financial performance.

H8: Client satisfaction mediates the relationship between the average employee salary and the law firm's financial performance.

Data

To test the hypotheses, this study analyzed secondary data obtained from independent third parties about the top 200 U.S. law firms by revenue in 2018.

Demographic information about the management committee members was obtained by contacting the HR departments of the law firms. Average employee salary and financial performance of the top 200 U.S. law firms was obtained from the ALM Intelligence database and paysa.com. Client satisfaction for the top 200 U.S. law firms was obtained from the BTI Consulting database, which provided results from an annual survey of general counsels of over 2,000 public companies regarding their satisfaction with legal services received from outside law firms.

Participants

We selected the top 200 U.S. law firms by revenue of 2018 as the sample for the quantitative analysis. From these 200 firms, we collected complete data from various sources for 122 firms. Z-scores can quantify the unusualness of an observation. Z-scores are the number of standard deviations above and below the mean that each value falls. We use Z-scores of +/-2.5 as cutoffs for outliers. Upon completion of the data screening for outliers, the final sample consisted of 110 law firms.

Of the 110 firms, the youngest firm is 9 years old, and the oldest firm is 227 years old. Figure 4 is the histogram of the Firm Age of the law firms.

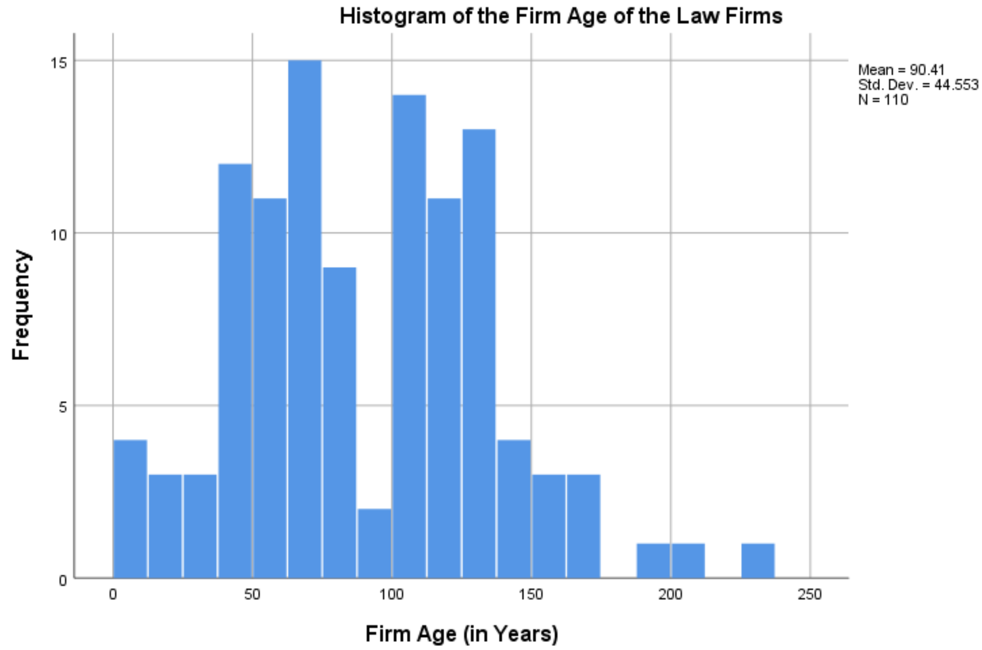

Figure 4. Firm age

The U.S. Census Bureau divides the United States into five regions, including Northeast (region 1), Southeast (region 2), South (region 3), West (region 4), and Midwest (region 5). Of the 110 firms, 33 law firms have their largest offices in region 1; 24 law firms have their largest offices in region 2; 10 law firms have their largest offices in region 3; 18 law firms have their largest offices in region 4, and 25 law firms have their largest offices in region 5. Figure 5 is the histogram of the number of law firms by region. We created dummy variables representing the various regions for the regression analysis. The Northeast was defined as the reference region in the regression analysis.

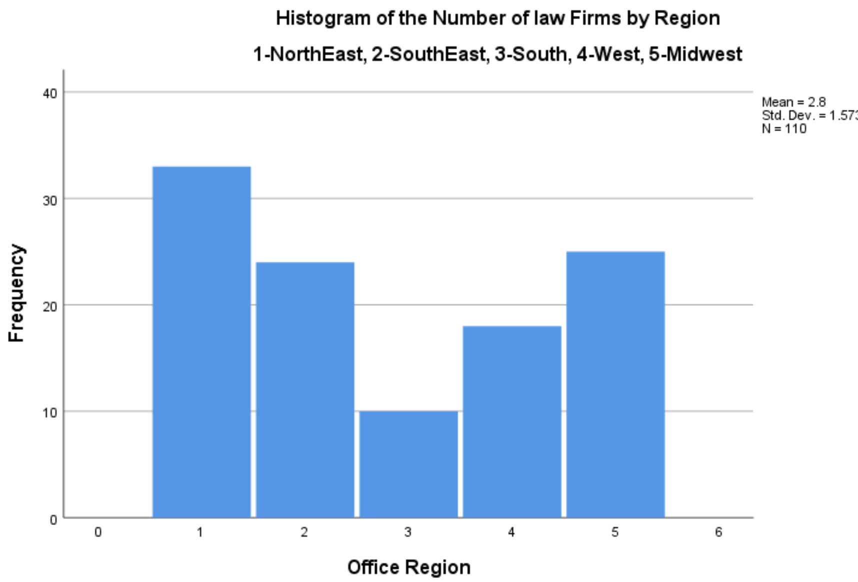

Figure 5. Region of the largest office

Of the one 110 law firms, the law firm with the least number of offices has only one office, and the law firm with the most number of offices has 54 offices. Figure 6 is the histogram of the number of offices of the law firms.

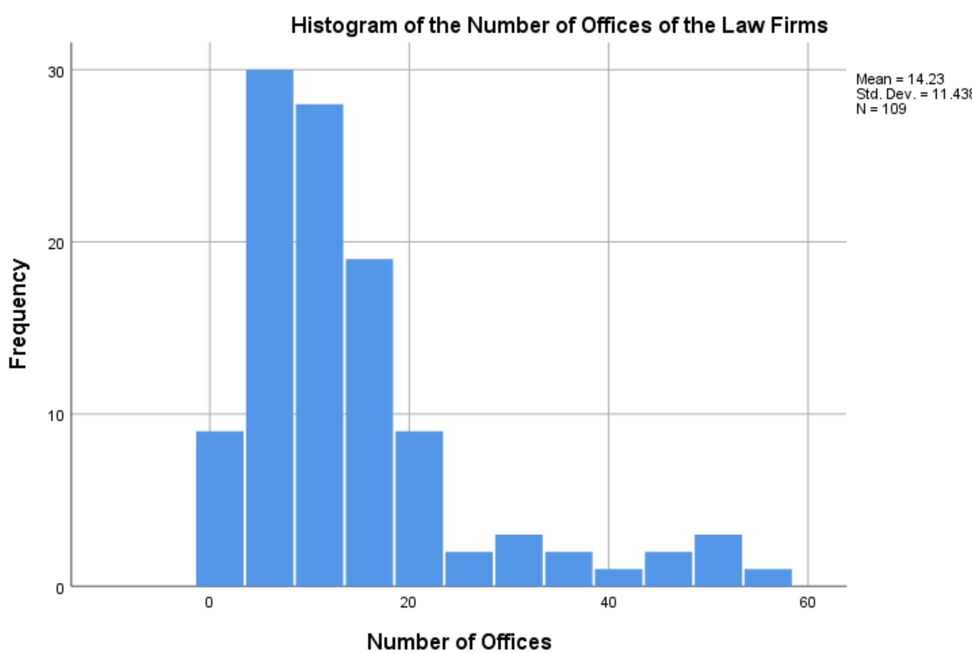

Figure 6. Number of offices

Of the 110 law firms, the law firm with the least number of attorneys has only 94 attorneys, and the law firm with the most number of attorneys has 3,376 attorneys. Figure 7 is the histogram of the number of attorneys of the law firms.

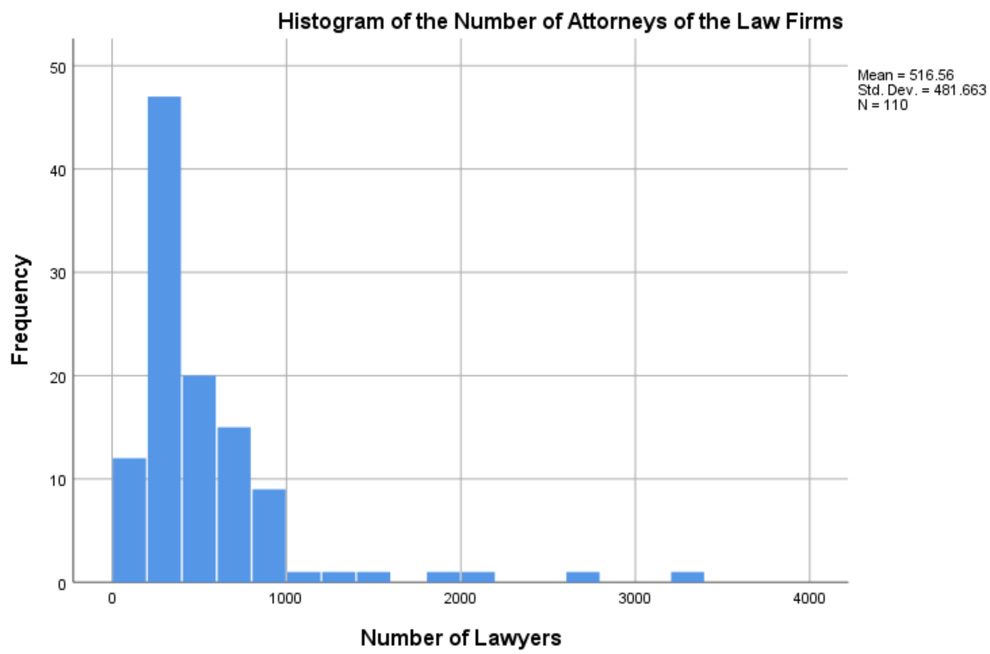

Figure 7. Number of Attorneys

Of the 110 law firms, the law firm with the least firm profit has average annual profit per equity partner of $347,000, and the law firm with the most firm profit has average annual profit per equity partner of $3,432,000. Figure 8 is the histogram of the firm profit, which represent the total profit of the firm divided by the number of its equity partners.

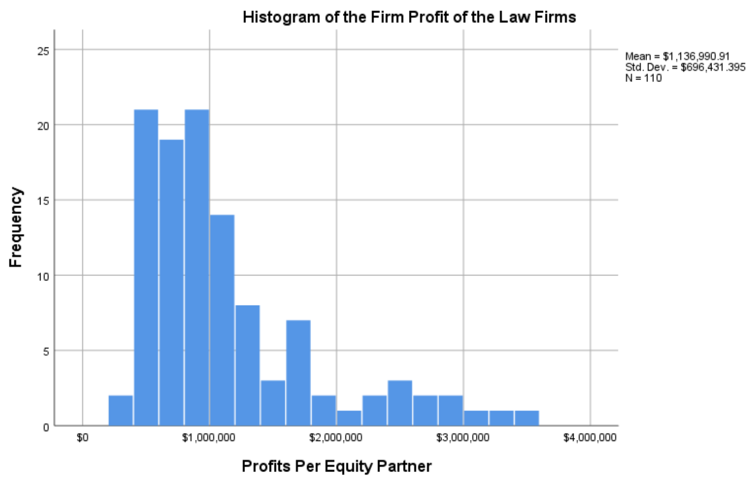

Figure 8. Firm profit

Of the 110 law firms, the least amount of average annual attorney salary of all the attorneys licensed to practice in the city where the largest office of the law firm is located is $60,400, and the highest average annual attorney salary is $107,000. Figure 9 is the histogram of the average attorney salary of the city where the largest office of the law firm is located.

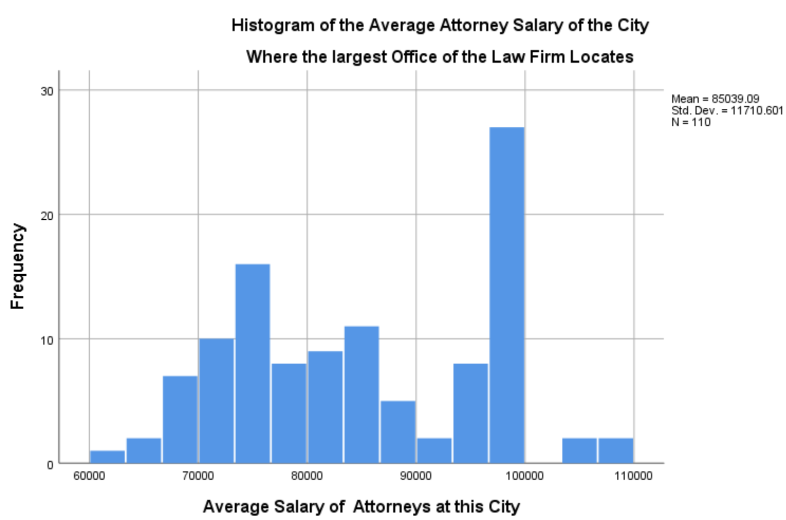

Figure 9. Average attorney salary at the city where the largest office is located

Of the 110 law firms, the lowest average annual employee salary paid is $162,488, and the highest average annual employee salary is $381,964. Figure 10 is the histogram of the average annual employee salary of the law firms.

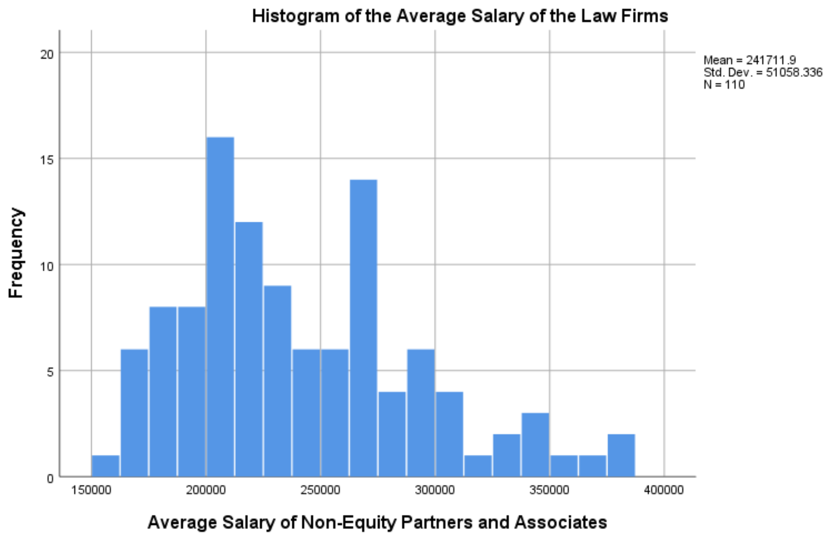

Figure 10. Average employee salary

Summary descriptive statistics for the independent variables and the dependent variables are provided in Table 1. Firm Profit Index, the dependent variable, has a minimum of 4.210, maximum of 36.038, mean of 12.955, and standard deviation of 6.848. Blau's Racial Heterogeneity Index, one of the independent variables, has a minimum of 0.000, a maximum of 0.5, a mean of 0.15, and a standard deviation of 0.159. Blau's Gender Heterogeneity Index, one of the independent variables, has a minimum of 0.000, a maximum of 0.58, a mean of 0.322, and a standard deviation of 0.147. Professional Membership, one of the independent variables, has a minimum of 1.143 a maximum of 9.000, a mean of 4.338, and a standard deviation of 1.797. Professional Experience, one of the independent variables, has a minimum of 20.000 a maximum of 38.750, a mean of 28.576, and a standard deviation of 4.131. Client Satisfaction, one of the independent variables, has a minimum of 0.000 a maximum of 15.000, a mean of 5.030, and a standard deviation of 3.593. Average Employee Salary Index, one of the independent variables, has a minimum of 1.660, a maximum of 4.310, a mean of 2.861, and a standard deviation of 0.544.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Firm Profit Index	110	4.210	36.038	12.955	6.848
Racial Heterogeneity	110	.000	.500	.150	.159
Gender Heterogeneity	110	.000	.580	.322	.147
Professional Experience	110	20.000	38.750	28.576	4.131
Professional Networking	110	1.143	9.000	4.338	1.797
Client Satisfaction	110	0	15	5.03	3.593
Average Employee Salary	110	1.660	4.310	2.861	.544

Answer to Research Question One (RQ1)

RQ1 of this study was: “Is there a relationship between the demographic composition (race, gender, size of professional network, and professional experience) of the management committee and the law firm’s financial performance?” In seeking the answer to this research question, this study proposed Hypotheses 1 through 4 as follows:

H1: The racial diversity of the management committee is positively associated with the law firm’s financial performance.

H2: The gender diversity of the management committee is positively associated with the law firm’s financial performance.

H3: The professional networking of the management committee is positively associated with the law firm’s financial performance.

H4: The professional experience of the management committee is positively associated with the law firm's financial performance.

Discussion of Hypothesis 1

We regressed Firm Profit Index on Blau's Racial Heterogeneity Index to determine whether Blau's Racial Heterogeneity Index was a significant predictor of Firm Profit Index. The relationship between Blau's Racial Heterogeneity Index and Firm Profit Index is statistically significant and positive (b = 12.650, β = .005, ΔR^2 = .071, p = .005). Based on the results of the statistical analysis on data associated with the sample of 110 law firms, we can conclude that the data support Hypothesis 1.

A scatter plot was generated with data about Blau's Racial Heterogeneity Index on the X-axis, and data of Firm Profit Index on Y-axis. Figure 11 is the scatter plot of Blau's Racial Heterogeneity Index and Firm Profit Index.

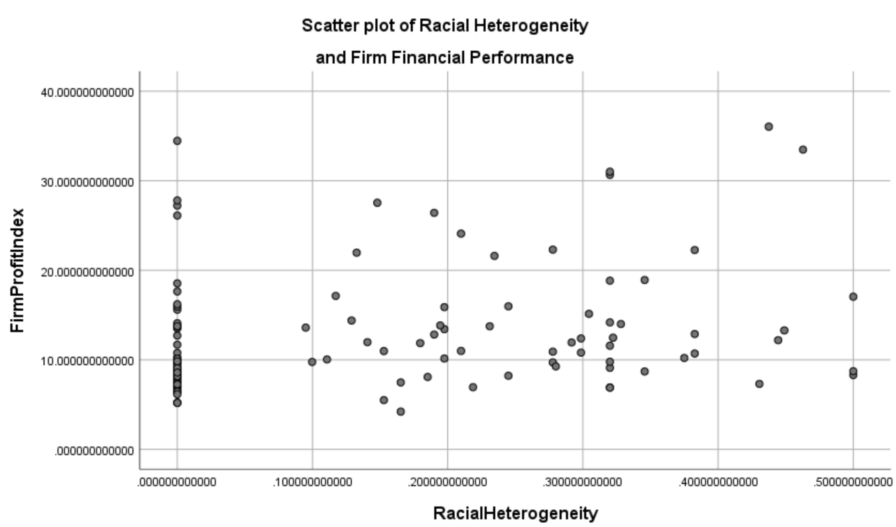

Figure 11. Scatter plot of racial heterogeneity and firm financial performance

Discussion of Hypothesis 2

We regressed Firm Profit Index on Blau's Gender Heterogeneity Index to determine whether Blau's Gender Heterogeneity Index was a significant predictor of

Firm Profit Index. The relationship between Blau's Gender Heterogeneity Index and Firm Profit Index is not statistically significant (b = 6.524, β = -.140, p = .161). Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we cannot conclude that data support Hypothesis 2.

A scatter plot was generated with data about Blau's Gender Heterogeneity Index on the X-axis, and data of Firm Profit Index on Y-axis. Figure 12 is the scatter plot of Blau's Gender Heterogeneity Index and Firm Profit Index.

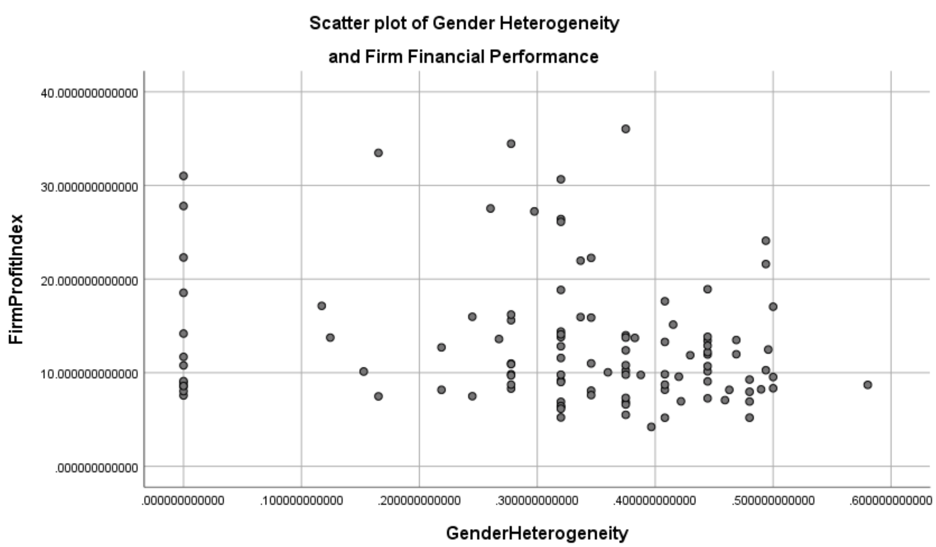

Figure 12. Scatter plot of gender heterogeneity and firm financial performance

Discussion of Hypothesis 3

We regressed Firm Profit Index on Professional Networking to determine whether Professional Networking was a significant predictor of Firm Profit Index. The relationship between Professional Networking and Firm Profit Index is statistically significant and negative (b = -.903, β = -.238, ΔR^2 = .050, p = .018). Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we can conclude that the data do not support Hypothesis 3, because the results of the linear regression demonstrate that professional networking of the management committee is negatively associated with the law firm's financial performance.

A scatter plot was generated with data about Professional Networking on the X-axis, and data of Firm Profit Index on Y-axis. Figure 13 is the scatter plot of Professional Networking and Firm Profit Index.

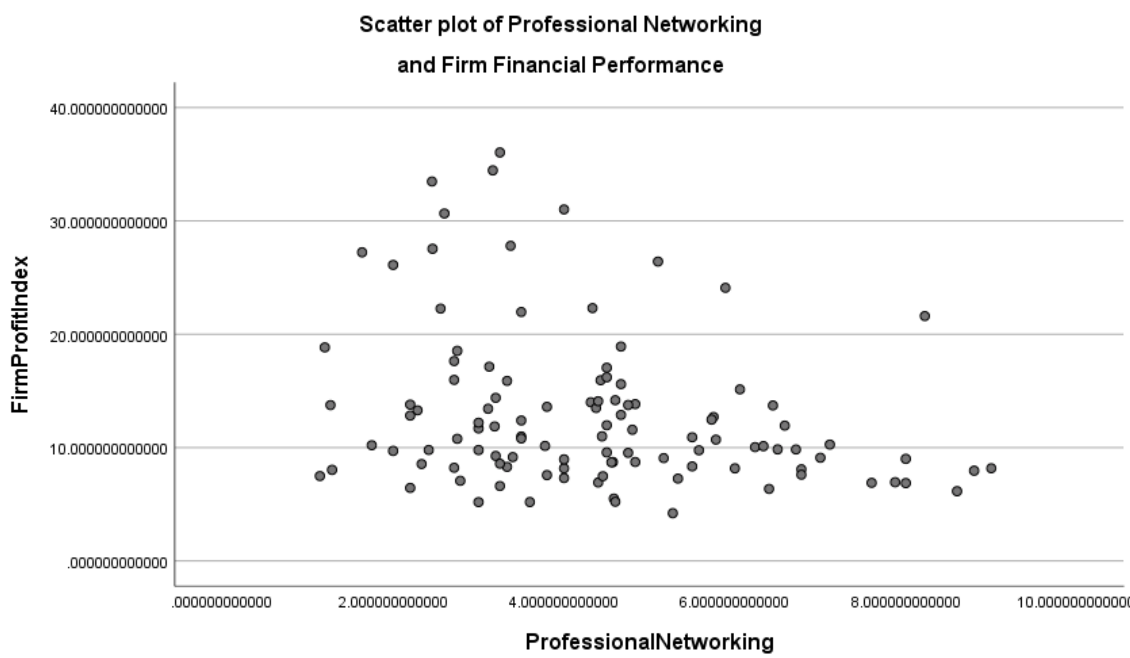

Figure 13. Scatter plot of professional networking and firm financial performance

Discussion of Hypothesis 4

We regressed Firm Profit Index on Professional Experience to determine whether Professional Experience was a significant predictor of Firm Profit Index. The relationship between Professional Experience and Firm Profit Index is not statistically significant (b = .031, β = .019, p = .853). Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we cannot conclude that the data support Hypothesis 4.

A scatter plot was generated with data about Professional Experience on the X-axis, and data of Firm Profit Index on Y-axis. Figure 14 is the scatter plot of Professional Experience and Firm Profit Index.

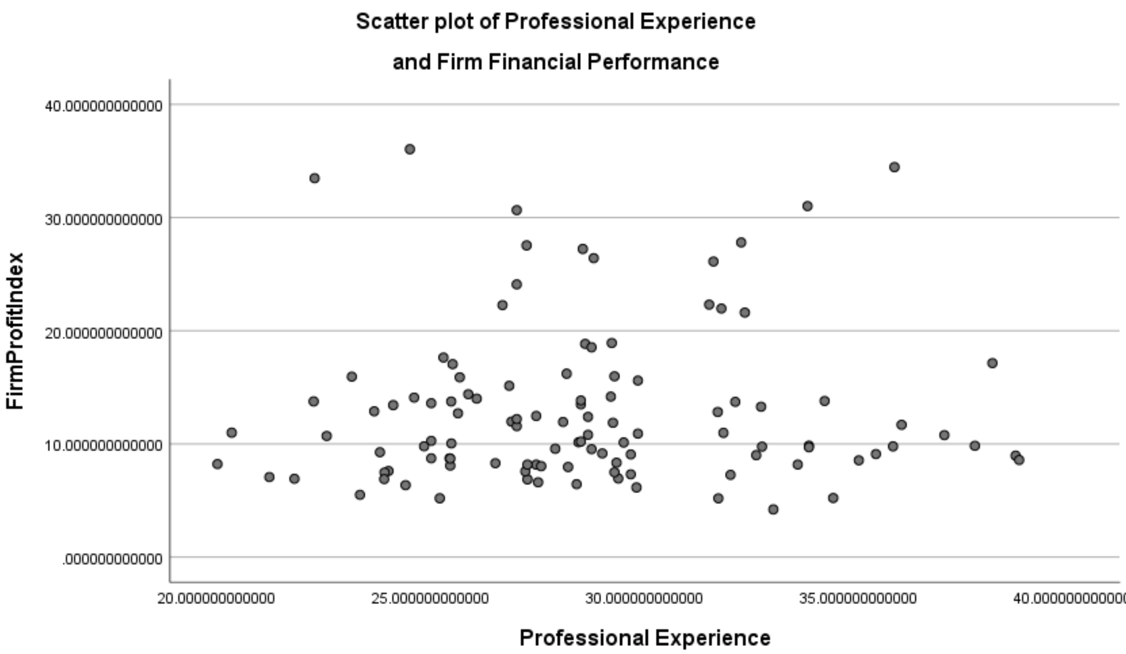

Figure 14. Scatter plot of professional experience and firm financial performance

Conclusion of Research Question One (RQ1)

Based on the study of the data associated with 110 law firms, we can conclude that there is a relationship between the demographic composition of the management committee and the law firm's financial performance. Based on the findings of this study, the racial heterogeneity of the management committee is positively associated with the law firm's financial performance, and the professional networking of the management committee is negatively associated with the law firm's financial performance.

Answer to Research Question Two (RQ2)

RQ2 of this study was: "Is there a relationship between the average employee salary (i.e., associates and non-equity partners) and the law firm's financial performance?" In seeking the answer to this research question, this study proposed Hypotheses 5A and 5B as follows:

H5A: The average employee salary is positively associated with the law firm financial performance.

H5B: The average employee salary has an inverse U-shaped relationship with the law firm financial performance.

Discussion of Hypothesis 5A

We regressed Firm Profit Index on Average Employee Salary Index to confirm whether Average Employee Salary Index was a significant predictor of Firm Profit Index. The relationship between Average Employee Salary Index and Firm Profit Index is statistically significant and positive ($b = 3.484$, $\beta = .278$, $\Delta R^2 = .069$, $p = .005$). Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we can conclude that data support Hypothesis 5A.

Discussion of Hypothesis 5B

A scatter plot was generated with data about the average employee salary on the X-axis, and data of the law firm's financial performance on Y-axis. The scatter plot enables us to determine that the relationship between the average employee salary and the law firm's financial performance is curvilinear. Figure 15 is the scatter plot of Average Employee Salary Index and Firm Profit Index.

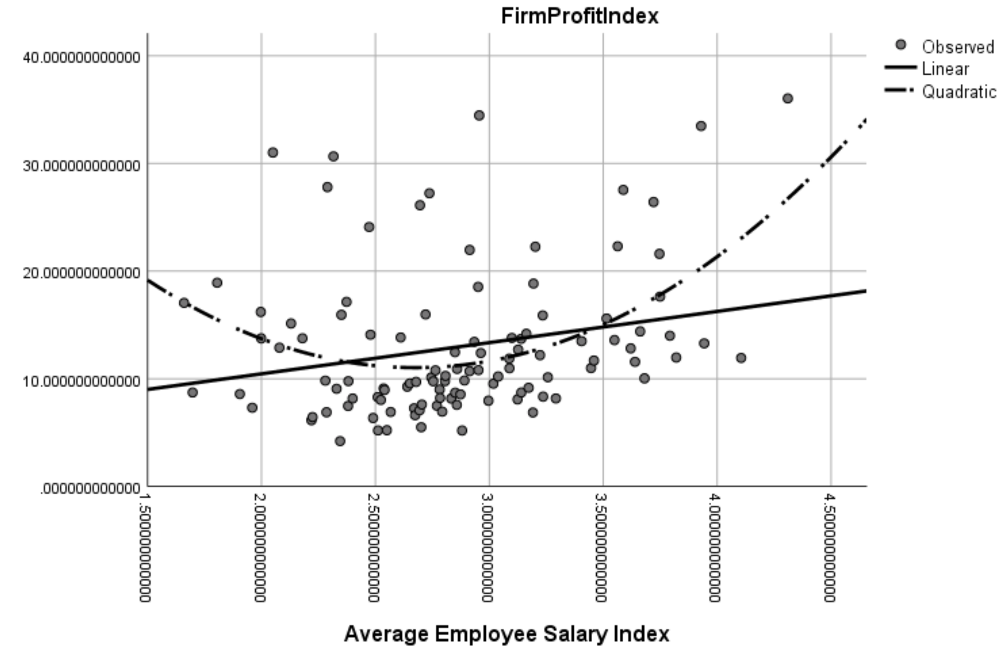

Figure 15. Scatter plot of average employee salary index and firm financial performance

We regressed Firm Profit Index on Average Employee Salary Index and Average Employee Salary Index Squared to confirm whether the relationship is curvilinear. The relationship between Average Employee Salary Index Squared and Firm Profit Index is statistically significant and positive (b = 5.710, β = 2.680, ΔR^2 = .098, p = .001). Because the beta coefficient of Average Employee Salary Index Squared is significant and positive, it represents a U-shaped relationship between the average employee salary and the law firm's financial performance. Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we can conclude that data support a U-shaped curvilinear relationship between Average Employee Salary Index and Firm Profit Index. However, they do not support Hypothesis 5B which had proposed an inverted U-shaped curvilinear relationship.

Conclusion of Research Question Two (RQ2)

Based on the study of the data associated with 110 law firms, we can conclude that there is a relationship between the average employee salary and the law firm's financial performance. Based on the findings of this study, the average employee salary is positively associated with the law firm's financial performance; and the average employee salary has a U-shaped relationship with the law firm's financial performance.

Answer to Research Question Three A (RQ3A)

RQ3A was: "Is there a relationship between the average employee salary (i.e., average salaries of associates and non-equity partners) and the client satisfaction?" In seeking the answer to this research question, this study proposed Hypotheses 6A and 6B as follows:

> **H6A:** The average employee salary is positively associated with the client satisfaction.
>
> **H6B:** The average employee salary has an inverse U-shaped relationship with client satisfaction.

Discussion of Hypothesis 6A

We regressed Client Satisfaction on Average Employee Salary Index to determine whether Average Employee Salary Index was a significant predictor of Client Satisfaction. The relationship between Average Employee Salary Index and Client Satisfaction is statistically significant and positive (b = 2.235, β = .341 ΔR^2 = .103, $p <$ .001). Based on the result of the statistical analysis of data associated with the sample of 110 law firms, we can conclude that the data support Hypothesis 6A.

Discussion of Hypothesis 6B

Figure 16 is the scatter plot of Average Employee Salary Index and Client Satisfaction. The scatter plot does not enable us to determine that the relationship between the average employee salary and the client satisfaction is curvilinear.

Figure 16. Scatter plot of average employee salary index and client satisfaction

We regressed Client Satisfaction on both Average Employee Salary Index and Average Employee Salary Index Squared to determine whether the relationship was curvilinear. The relationship between Average Employee Salary Index Squared and Client Satisfaction is not statistically significant (b = 0.328, β = .295, p = .679). Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we cannot conclude that the data support Hypothesis 6B.

Conclusion of Research Question Three A (RQ3A)

Based on the study of the data associated with 110 law firms, we can conclude that there is a relationship between the average employee salary and client satisfaction. Based on the findings of this study, the average employee salary is positively associated with the client satisfaction.

Answer to Research Question Three B (RQ3B)

RQ3B was: "Is there a relationship between a law firm's client satisfaction and the law firm's financial performance?" In seeking the answer to this research question, this study proposed Hypothesis 7 as follows:

> **H7:** Client satisfaction is positively associated with the law firm's financial performance.

Discussion of Hypothesis 7

We regressed Firm Profit Index on Client Satisfaction to determine whether Client Satisfaction was a significant predictor of Firm Profit Index. The relationship between Client Satisfaction and Firm Profit Index is statistically significant and positive (b = 0.626, β = .327, ΔR^2 = .085, p = .002). Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we can conclude that the data support Hypothesis 7.

A scatter plot was generated with data about Client Satisfaction on the X-axis, and data of Firm Profit Index on Y-axis. Figure 17 is the scatter plot of Client Satisfaction and Firm Profit Index.

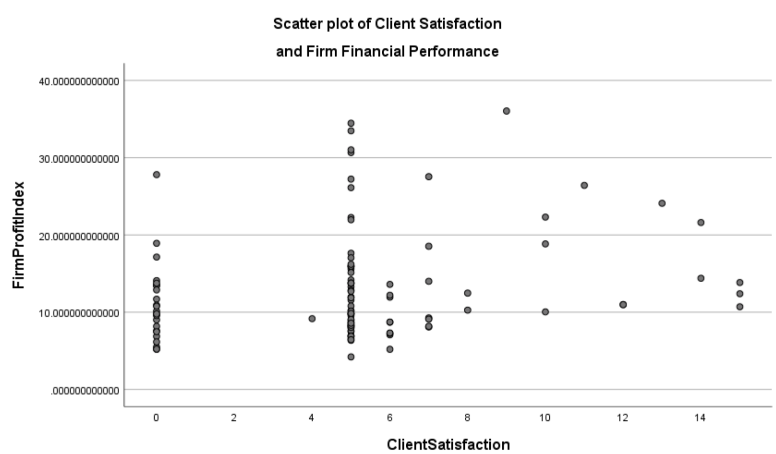

Figure 17. Scatter plot of client satisfaction and firm financial performance

Conclusion of Research Question Three B (RQ3B)

Based on the study of the data associated with 110 law firms, we can conclude that there is a relationship between the client satisfaction and the law firm's financial performance. Based on the findings of this study, the client satisfaction is positively associated with the law firm's financial performance.

Answer to Research Question Three C (RQ3C)

RQ3C was: "Is the relationship in RQ2 mediated by the law firm's client satisfaction?" In seeking the answer to this research question, this study formulates Hypothesis 8 as follows:

> **H8:** Client satisfaction mediates the relationship between the average employee salary and the law firm's financial performance.

Discussion of Hypothesis 8

This study uses Hayes Process Macro for SPSS model 4 to examine the relationship between Blau's Racial Heterogeneity Index and Firm Profit Index with Client Satisfaction as a mediator.

Client Satisfaction can be a possible mediator to the relationship between Average Employee Salary Index and Firm Profit Index, because the relationship between Average Employee Salary Index and Client Satisfaction is positive and statistically significant (b = 2.272, β = .576, p < .001), when Client Satisfaction is the outcome variable. The relationship between Average Employee Salary Index and Firm Profit Index is not statistically significant (p = .064), when Firm Profit Index is the outcome variable. The relationship between Client Satisfaction and Firm Profit Index is positive and statistically significant (b = 0.513, β = .206, p = .014), when Firm Profit Index is the outcome variable. Based on the results of the statistical analysis of data associated with the sample of 110 law firms, we can conclude that data support Hypothesis 8.

Conclusion of Research Question Three C (RQ3C)

Based on the study of the data associated with 110 law firms, we can conclude that the relationship between the average employee salary and the law firm's financial performance is mediated by the client satisfaction. Based on the findings of this study, client satisfaction fully mediates the relationship between the average employee salary and the law firm's financial performance.

Collinearity Diagnostics

Collinearity diagnostics is a technique in examining the overlapping relationship between and among various independent variables in predicting the dependent variable (Meyers, Gamst, & Guarino, 2016). This study examines the tolerance of all independent variables, including Blau's Racial Heterogeneity Index, Blau's Gender Heterogeneity, Professional Networking, Professional Experiences, Client Satisfaction, and Average Employee Salary Index to determine the exclusion of those having collinearity problems.

We regressed Firm Profit Index on all independent variables to determine whether all independent variables were significant predictors of Firm Profit Index. The tolerance for all the independent variables are greater than 0.40 under the full regression model. As the result, there exist no collinearity problems among the independent variables.

Under the full regression model, the relationship between Racial Heterogeneity and Firm Profit Index is statistically significant and positive (b = 11.740, β = .273, p = .007). Under the full regression model, the relationship between Gender Heterogeneity and Firm Profit Index is only marginally statistically significant and negative (b = -9.232,

β = -.199, p = .059). Under the full regression model, the relationship between Professional Networking and Firm Profit Index is not statistically significant (b = -.450, β = -.119, p = .220). Under the full regression model, the relationship between Professional Experience and Firm Profit Index is not statistically significant (b = .038, β = .023, p = .823). Under the full regression model, the relationship between Client Satisfaction and Firm Profit Index is statistically significant and positive (b = .500, β = .262, p = .014). Under the full regression model, the relationship between Average Employee Salary Index and Firm Profit Index is statistically significant and positive (b = 2.466, β = .197, p = .046).

About 23.4% of the variance in Firm Profit Index can be explained by all the independent variables while controlling the effect of control variables ($\Delta R^2 = .234$, $p < .001$).

Because the p values of both Professional Networking and Professional Experience are greater than 0.10, they do not have a statistically significant relationship with the law firm’s financial performance. As the result, we excluded both Professional Networking and Professional Experience from the next multiple linear regression analysis. We then regressed Firm Profit Index on the remaining independent variables, including Blau’s Racial Heterogeneity Index, Blau’s Gender Heterogeneity, Client Satisfaction, and Average Employee Salary Index, to determine whether all these independent variables were significant predictors of Firm Profit Index. The tolerance for all these independent variables are greater than 0.40. As the result, there exist no collinearity problems among the independent variables.

The relationship between Racial Heterogeneity and Firm Profit Index is statistically significant and positive (*b* = 12.808, β = .298, *p* = .002). The relationship between Gender Heterogeneity and Firm Profit Index is statistically significant and negative (*b* = 11.014, β = -.237, *p* = .010). The relationship between Client Satisfaction and Firm Profit Index is statistically significant and positive (*b* = .510, β = .267, *p* = .011). The relationship between Average Employee Salary Index and Firm Profit Index is statistically significant and positive (*b* = 2.564, β = .204, *p* = .037).

About 22.2% of the variance in Firm Profit Index can be explained by Blau's Racial Heterogeneity Index, Blau's Gender Heterogeneity, Client Satisfaction, and Average Employee Salary Index jointly while controlling the effect of control variables ($\Delta R^2 = .222$, $p < .001$).

Summary

A summary of findings of this study is listed below.

H1: The racial diversity of the management committee is positively associated with the law firm's financial performance (supported).

H2: The gender diversity of the management committee is positively associated with the law firm's financial performance (not supported).

H3: The professional networking of the management committee is positively associated with the law firm's financial performance (not supported).

H4: The professional experience of the management committee is positively associated with the law firm's financial performance (not supported).

H5A: The average employee salary is positively associated with the law firm's financial performance (supported).

H5B: The average employee salary has an inverse U-shaped relationship with the law firm's financial performance (not supported).

H6A: The average employee salary is positively associated with the client satisfaction (supported).

H6B: The average employee salary has an inverse U-shaped relationship with client satisfaction (not supported).

H7: Client satisfaction is positively associated with law firm's performance (supported).

H8: Client satisfaction mediates the relationship between the average employee salary and the law firm's financial performance (supported).

The results of individual linear regression analyses of this study provide support for Hypotheses 1, 5A, 6A, 7, and 8. This study also found the existence of a negative association between the professional networking of the management committee and the law firm's financial performance, as well as a U-shaped curvilinear relationship between the average employee salary and the law firm's financial performance. Under the multiple linear regression, the relationship between gender diversity of the management committee and the law firm's financial performance falls slightly short of statistical significance; while the relationship between the professional networking of the management committee and the law firm's financial performance becomes non-significant. Based on this study, we can conclude that (1) The racial diversity of the management committee is positively associated with the law firm's financial performance; (2) The professional networking of the management committee is negatively associated with the law firm's financial performance; (3) The average employee salary is positively associated with the law firm's financial performance; (4) The average employee salary has a U-shaped relationship with the law firm's financial performance; (5) The average employee salary is positively associated with client satisfaction; (6) Client satisfaction is positively associated with law firm's financial performance; and (7) Client satisfaction fully mediates the relationship between the average employee salary and the law firm's financial performance.

Chapter 5: Discussion

This study explores the relationship between several independent variables, including the demographic composition of the management committee, the average employee salary, client satisfaction, and the law firm’s financial performance.

Prior research has established positive associations of the demographic composition of the top management team, job equity perception, and client satisfaction, with the firm’s financial performance (Hambrick & Mason, 1984; Li & Hambrick, 2005; Marasinghe & Wijayaratne, 2018; Shammugam & Marimuthu, 2018); Soewin & Chinda, 2018; Sparlin, 2018), but none of these studies has examined the mediation effect of the client satisfaction on the relationship between the employee salary and the firm financial performance. Furthermore, previous research shows inconsistent findings about the relationship between the diversity of the top management team and the firm’s financial performance. Multiple studies have been conducted by various researchers to examine the relationship between the top management groups’ diversity and the firm financial performance with inconsistent findings. Some studies have concluded that the top management groups’ diversity is positively associated with the firm financial performance (Ahmadi, Nakaa, & Bouri, 2018; Bennouri, Chtioui, Nagati, & Nekhili, 2018; Conyon & He, 2017; Lee-Kuen, Sok-Gee, & Zainudin, 2017; Shukeri, Shin, & Shaari, 2012). However, other studies have had inconclusive findings or even concluded that the top management groups’ diversity is negatively associated with the firm financial performance (Abdullah & Ismail, 2017; Elsharkawy, Paterson, & Sherif, 2018; Hassan, Marimuth, Tariq, & Aqeel, 2017; Shehata, Salhin, & El-Helaly, 2017). Because of such inconsistent findings, this study sought clarity about the possible impacts of the demographic composition of the management committee, the average employee salary, and the client satisfaction on the firm financial performance.

Prior research has also demonstrated the positive association of client satisfaction with the maximization of the value of the firm (Aldeehani, 2018), the client loyalty towards the firm (Mubarik, Chandran, & Devadason, 2016), and the firm financial performance (Soewin & Chinda, 2018). Because of such findings, this study also explores the possible mediation effect of the client satisfaction onto the relationship between the employee salary and the firm financial performance.

The theoretical frameworks of Upper Echelons Theory, Adams Equity Theory and Stakeholder Theory help to inform this study. Upper Echelons Theory poses that the characteristics of the firm’s top management team can influence its business strategies as well as performance (Hambrick & Mason, 1984). Adams Equity Theory suggests that when employees believe that they have been treated fairly, they are more likely to be motivated and such motivation will be transformed into positive work behavior and attitude, which in turn impacts the financial performance of the firm (Adams, 1963, 1965). Stakeholder Theory suggests that a firm’s financial success heavily depends upon its stakeholders, who have the capability of affecting the firm’s long-term strategic goals (Danso et al., 2019).

The purpose of this study was to determine the relationship between the demographic composition of the management committee, the average employee salary, the client satisfaction, and the law firm’s financial performance. The three research questions of this study were:

RQ1. Is there a relationship between the demographic composition (race, gender, size of professional network, and professional experience) of the management committee and the law firm's financial performance (H1 – H4)?

RQ2. Is there a relationship between the average employee salary (i.e., salaries of associates and non-equity partners) and the law firm's financial performance (H5A, H5B)?

RQ3a. Is there a relationship between the average employee salary and the law firm's client satisfaction (H6A, H6B)?

RQ3b. Is there a relationship between the law firm's client satisfaction and the law firm's financial performance (H7)?

RQ3c. Is the relationship in RQ2 mediated by the law firm's client satisfaction (H8)?

To answer these research questions, this study adopted a quantitative research method to test the following 8 hypotheses:

H1: The racial diversity of the management committee is positively associated with the law firm's financial performance.

H2: The gender diversity of the management committee is positively associated with the law firm's financial performance.

H3: The professional networking of the management committee is positively associated with the law firm's financial performance.

H4: The professional experience of the management committee is positively associated with the law firm's financial performance.

H5A: The average employee salary is positively associated with the law firm's financial performance.

H5B: The average employee salary has an inverse U-shaped relationship with the law firm's financial performance.

H6A: The average employee salary is positively associated with the client satisfaction.

H6B: The average employee salary has an inverse U-shaped relationship with the client satisfaction.

H7: Client satisfaction is positively associated with law firm's financial performance.

H8: Client satisfaction mediates the relationship between the average employee salary and the law firm's financial performance.

The target population of this study was professional service firms in the United States. This study used law firms, a subcategory of professional service firms, as the research sample for the analysis. The unit of analysis was the law firm. The participants were the top 200 U.S. law firms by revenue in 2018. Data associated with the law firms in the sample were collected from various secondary sources. This study used Statistical Package for Social Sciences (SPSS) 25 to analyze and test the data. The results of the data analysis demonstrate the relationships between the independent variables and the dependent variables, while controlling the effect of control variables.

Findings

RQ1. Is there a relationship between the demographic composition (race, gender, size of professional network, and professional experience) of the management committee and the law firm's financial performance?

This research question was designed to investigate the correlation between the demographic composition of the management committee at a law firm and the law firm's financial performance. In order to find the answer to this question through quantitative research method, this study hypothesized that racial diversity, gender diversity, professional networking, and professional experience of the management committee are all positively associated with the law firm's financial performance.

Prior studies have found that the top management groups' diversity is positively associated with the firm financial performance (Ahmadi, Nakaa, & Bouri, 2018; Bennouri, Chtioui, Nagati, & Nekhili, 2018; Conyon & He, 2017; Lee-Kuen, Sok-Gee, & Zainudin, 2017; Shukeri, Shin, & Shaari, 2012). Therefore, this study tested the relationship between the demographic composition of the management committee of a law firm and the law firm's financial performance.

This study revealed that the racial diversity of the management committee is positively associated with the law firm's financial performance. The R^2 change equals to 0.071, which means about 7.1% of the variance in law firm's financial performance can be explained by the racial diversity of the management committee while controlling the effect of control variables. This study also revealed that the gender diversity of the management committee is negatively associated with the law firm's financial performance. The R^2 change equals to 0.018, which means about 1.8% of the variance in law firm's financial performance can be explained by the gender diversity of the management committee while controlling the effect of control variables. This study further reviewed that professional networking of the management committee is negatively associated with the law firm's financial performance. The R^2 change equals to 0.050, which means about 5.0% of the variance in law firm's financial performance can be explained by the professional networking of the management committee while controlling the effect of control variables.

The result of this study aligned with the findings from the previous research that the racial diversity of the top management team is positively associated with the firm financial performance. This study provided further evidence in supporting the racial diversity of the top management team, because of its positive association with the firm financial performance.

RQ2. Is there a relationship between the average employee salary (i.e., the average salary of associates and non-equity partners) and the law firm's financial performance?

This research question was designed to investigate the correlation between the average employee salary at a law firm and the law firm's financial performance. In order to find the answers to this question through quantitative research method, this study hypothesize that the average employee salary of a law firm is positively associated with the law firm's financial performance. Alternatively, this study hypothesize that the average employee salary have an inverse U-shaped relationship with the law firm's financial performance

Prior study found that the job equity perception was positively associated with the firm financial performance (Inuwa, 2017). An employee's perception of job equity at the workplace results higher employee performance at the job, which leads to higher financial performance of the organization (Usmani & Jamal, 2013). Therefore, this study tested the relationship between JEOO, one component of the job equity perception, of the employees at a law firm and the law firm's financial performance.

This study revealed that the average employee salary of a law firm is positively associated with the law firm's financial performance. The R^2 change equals to 0.069, which means about 6.9% of the variance in the law firm's financial performance can be explained by the average employee salary of the law firm while controlling the effect of control variables. This study also revealed that the average employee salary of a law firm has an U-shaped relationship with the law firm's financial performance.

The result of this study aligned with the findings of prior research that the job equity perception at an organization is positively associated with the firm financial performance. Specifically, this study found that JEOO, measured by the average employee salary is positively associated with the law firm's financial performance. This study provided further evidence in supporting the need of nurturing the job equity perception of the employees at an organization, because of its positive association with the firm financial performance.

RQ3A. Is there a relationship between the average employee salary (i.e., the average salary of associates and non-equity partners) and client satisfaction?

This research question was designed to investigate the correlation between the average employee salary at a law firm and the client satisfaction of the law firm. In order to find the answers to this question through quantitative research method, this study hypothesize that the average employee salary of a law firm is positively associated with the law firm's financial performance. Alternatively, this study hypothesized that the average employee salary have an inverse U-shaped relationship with the law firm's financial performance.

Prior studies have found that employee salary to be positively associated with both the employee satisfaction and client satisfaction (Kabore, Ouedraogo, Niang, Seck, Diarra, Ouedraogo, Bationo, & Ouedraogo, 2016; Nwaogu, Akinola, Akinlolu, Oaikhena, 2016). Therefore, this study tested the relationship between the average employee salary and the client satisfaction.

This study revealed that the average employee salary of a law firm is positively associated with the client satisfaction. The R^2 change equals to 0.103, which means about 10.3% of the variance in Client Satisfaction can be explained by Average Employee Salary while controlling the effect of control variables.

The results of this study aligned with prior findings that the salary of the employees at an organization is positively associated with the client satisfaction. Additionally, this study found that only JEOO, one specific component of the job equity perception, of the employees at a law firm is positively associated with client satisfaction. This study provided further evidence in supporting the need of nurturing the job equity perception of the employees at an organization, because of its association with the client satisfaction.

RQ3B. Is there a relationship between the law firm's client satisfaction and the law firm's financial performance?

This research question was designed to investigate the correlation between client satisfaction of a law firm and the law firm's financial performance. In order to find the answer to this question through quantitative research method, this study hypothesized that client satisfaction of a law firm is positively associated with the law firm's financial performance.

Prior studies have found that the client satisfaction is positively associated with the firm financial performance (Aldeehani, 2018). Prior studies have also found that client satisfaction is positively associated with the client's loyalty towards the firm (Mubarik, Chandran, & Devadason, 2016), and the firm financial performance (Soewin & Chinda, 2018). Therefore, this study tested the relationship between client satisfaction of a law firm and the law firm's financial performance.

This research revealed that client satisfaction of a law firm is positively associated with the law firm's financial performance. The R^2 change equals to 0.085, which means about 8.5% of the variance in Firm Profit Index can be explained by Client Satisfaction while controlling the effect of control variables.

The results of this study aligned with the findings from the previous research that client satisfaction is positively associated with the firm financial performance. This study provided further evidence in supporting the development of the client satisfaction, because of its positive association with the firm financial performance.

RQ3C. Is the relationship in RQ2 mediated by the law firm's client satisfaction?

This research question was designed to investigate the mediation effect of the client satisfaction of a law firm onto the relationship between the average employee salary and the law firm's financial performance. In order to find the answer to this question through quantitative research method, this study hypothesized that the relationship between the average employee salary at a law firm and the law firm's financial performance is mediated by client satisfaction of the law firm.

This research revealed that client satisfaction fully mediates the relationship between the average employee salary and the law firm's financial performance. The result of this study aligned with the findings from previous research that client satisfaction has a mediation effect on the firm financial performance. This study provided further evidence in supporting the development of the client satisfaction, because of its mediation effect on the firm financial performance.

Implications for Research

Prior research has indicated that lawyers' leadership characteristics are associated with their financial success (Davis, 1994), and that there is an association between executive characteristics and the firm's financial performance (Peterson et al., 2012). This study built upon the findings of Davis (1994) and Peterson, Galvin, and Lange (2012), and took a step further to conduct a quantitative analysis of the demographic composition of the management committee. This study found that the racial diversity of the management committee is positively associated with the law firm's financial performance, and the gender diversity of the management committee is negative associated with the law firm's financial performance. The findings of this study not only provided further empirical support to the association between the demographic composition of the management committee and the law firm's financial performance, but also a better understanding of such relationship with each individual characteristic, respectively.

Job equity perception has been found by previous studies to be both positively and significantly related to employee performance at the workplace (Inuwa & Idris, 2017). Employee performance at the workplace is a significant and critical component of firm performance (Inuwa & Idris, 2017). This study built upon the findings of Inuwa & Idris (2017), and took a step further to conduct a quantitative analysis on JEOO, one component of the job equity perception. This study found that the job equity perception others outside, measured by the average employee salary index, have statistically significant positive association and a U-shaped relationship with the firm financial performance, as well as positive association with the client satisfaction. The findings of this study not only provided further empirical support to the positive association between the job equity perception and the firm financial performance, but also a better understanding of the mechanism of one component of the job equity perception in association with the firm financial performance, as well as the interaction with the client satisfaction.

Implications for Practice

Top management teams make strategic decisions based on their interpretation of situations, which in turn is a function of their background characteristics, such as experiences, personality and personal values (Lopatta et al., 2019). The job equity perception of the employees of the organization is positively associated with the firm financial performance (Inuwa & Muhammad, 2016). Client satisfaction has also been linked to firm financial performance (Gatuyu & Kinyua, 2020). The results of this study align with such findings from prior research. This study provided the professional service firms in general, and law firms in specific, with valuable information in understanding the different impacts on the firm financial performance of the racial diversity of the management committee, the gender diversity of the management committee, the average employee salary and the client satisfaction of the firm.

This study found that the job equity perception of others outside, measured by the average employee salary index, is positively associated and in a U-shaped relationship with the law firm's financial performance. This study also found that the job equity perception of others outside is positively associated with the client satisfaction. This study indicates that an organization might be able to adjust the salary of their employees in order to achieve an optimized level of the firm financial performance and the client satisfaction intended by the organization. The leadership of the organizations should take into the consideration of the effect of the job equity perception of others outside on the firm financial performance and the client satisfaction while managing the salary level of the employees in achieving an optimized level of the firm financial performance and the client satisfaction.

The implication of this study is that the racial diversity and the gender diversity of the management committee interact differently with the firm financial performance. Knowing that organizations manage the diversity to add value to their organizations for higher firm financial performance (Luu, Rowley, & Vo, 2018), the leadership of the organizations should adopt different diversity strategy for the racial diversity and the gender diversity of the top management teams in achieving high firm financial performance.

Limitations

This study has its limitations. It is based on data about the top 200 U.S. law firms by revenue of 2018. Most of the law firms on the list have multiple offices in various cities across the United States with different costs of living. Even though the average employee salary is measured firm wise, the average employee salary index is measured as the quotient of the average employee salary over the average attorney salary of the city, where the largest office of the law firm is located. This index however may not be an ideal measure and can be improved. Furthermore, although law firms are an important constituent of professional service firms, the empirical findings of this study might not be generalized to all other professional service firms. The nature of the data associated with the top 200 U.S. law firms by revenue of 2018 further limits the findings of this study to the United States. Lastly, this study only focused on the analysis of four demographic characteristics of the management committee, and their impact on the firm financial performance, whereas several other characteristics could have been considered.

Future Directions

This study conducted quantitative research analysis on the data associated with the top 200 U.S. law firms by revenue of 2018. The sample included 110 law firms. While the study was based on the analysis of the law firms among the top 200 U.S. law firms by revenue of 2018, the results may not apply to all the law firms of different sizes, or other kinds of professional service firms in general. Future researchers might consider the inclusion of more law firms, such as top five hundred U.S. law firms by revenue, or law firms on the top 200 U.S. law firms by size for years other than 2018. Future researchers might also want to conduct quantitative analysis on other kinds of professional service firms, such as accounting firms, architect firms, and consulting firms. Future researchers might further want to conduct time series analysis to determine how the relationships and interactions between and among the demographic composition of the management committee, the average employee salary, the employee salary distance, the client satisfaction, and the firm financial performance evolving over certain period of time.

This study conducted quantitative research analysis on the data associated with only four characteristics of the demographic composition of the management committee, including the racial diversity, the gender diversity, the professional networking, and the professional experience. Future researchers might want to include more demographic characteristics of the management committee, such as age, functional background, tenure, and educational background, into the research design.

This study investigated the relationship between the job equity perception and the firm financial performance. This study only conducted quantitative research analysis on the data associated with job equity perception others outside (JEOO), measured by the average employee salary index, and its relationship with the firm financial performance, as well as the client satisfaction. Future researchers might want to investigate the relationship between the job equity perception others inside (JEOI), the job equity perception self-outside (JESO) and the job equity perception self-inside (JESI), the other three components of the job equity perception of the Adams Equity Theory, and the firm financial performance. Future researchers might also want to investigate the mediation effect of client satisfaction onto the relationship between the demographic composition of the management committee and the firm financial performance, as well as the relationship between other job equity components and the firm financial performance.

General Conclusions

The results of this study support the association between a group of independent variables, including the racial diversity of the management committee, the gender diversity of the management committee, the average employee salary, and the client satisfaction, and the dependent variable of the firm financial performance. The results of this study also demonstrate a positive and U-shaped relationship between the average employee salary and the firm financial performance. This study was important because it not only provided support that the racial diversity of the management committee, the average employee salary, and the client satisfaction were positively associated with the firm financial performance, but also found a negative association between the gender diversity of the management committee and the firm financial performance.

Organizations should continue to implement strategies to improve and optimize the top management team's diversity, the job equity perception of the employees, and the client satisfaction to achieve higher firm financial performance. A better understanding of the relationships between these variables will help organizations select appropriate strategies for realizing these objectives. We hope this dissertation sheds some light towards such understanding.

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