

The Strategic Value of Customers in Professional Service Firms

*- A proposed framework for a
comprehensive client value
assessment*

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Author:
Simon Witt

Cand.Merc – Finance and Strategic Management

Advisor:
Peter Schrøder
External advisor

Copenhagen Business School

Executive summary

Throughout this paper, I have sought to establish a framework that will allow Professional Service Firms to comprehensively assess the total *strategic* value of clients and projects, i.e. characteristics that provide not only a financial advantage but also help the firm to sustainable long-term success.

Professional Service Firms are faced with several strategic challenges, some employee-oriented (internal) and some market-oriented (external). As such, Professional Service Firms are faced with not only a considerable dependency on their employees, but also low entry barriers, the need to mitigate ex-ante buyer uncertainty and increasing competition in the market. Due to a direct, two-way relationship between employee motivation and firm performance, succumbing to either of these challenges can result in a downwards-spiraling effect, where decreasing margins lead to lower employee motivation, which in turn leads to inferior service quality, which then results in lower prices and margins.

In order to address the employee dependency through increased motivation and retention, as well as building capabilities, is it important that Professional Service Firms focus on projects that are challenging and innovative. This will satisfy the restless and ambitious nature of professionals and, in case of innovative solutions, also further more efficient deliveries of future similar projects. Whereas improved motivation and retention creates increased performance, quantifying the value hereof is not possible at this point. The value of an innovative solution can however be quantified through an assessment of savings on future similar projects.

To address the market-related challenges, a firm should focus on clients and projects that represent reference and advocacy potential, i.e. clients/projects that can provide not only additional business through indirect sales activities, but also positively shape the firm’s reputation, so as to counter the low entry barriers and enable differentiation, which will shield it from the increasing price competition. While the value of the additional business can be quantified, the value of increased reputation – while considerable from a strategic perspective – is not quantifiable at this point.

Overall, the framework for assessing the total value of a client builds on traditional profitability frameworks, and consists of a quantitative and qualitative component:



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Introduction

Calculating what a company earns on its various customers has been an academic discipline for approximately 40 years (Gleaves, et al., 2008), resulting in various concepts all revolving around the profitability of the customer base. The most commonly used labels are Customer Profitability, Customer Equity and Customer Lifetime Value and they all share the common trait that they aim to arrive at an aggregate number that includes all current and/or future profits of a single customer or (part of) the customer portfolio (Gleaves, et al., 2008).

These analysis often arrive at eye opening results, such as the case used by Kaplan & Cooper (Kaplan, et al., 1998), in which a large proportion of a company's customers turned out to be unprofitable. In fact, an often quoted "rule" of in this context is the Pareto Principle, which argues that on average, 80% of profits will be generated by 20% of customers (Lipovetsky, 2009). This means that conversely, the remaining 80% of customers will only be generating a slight profit, break even or even be unprofitable altogether!

As mind boggling as such results can be, they do not tell the whole story. They might give a fair estimate of the expected future cash flow pertaining to a customer, a segment or the entire customer portfolio, but they ignore the potentially significant value created indirectly and more importantly, intangibly. Even though a customer might be slightly unprofitable, it might be worth retaining said customer if they provide an opportunity for customer-driven innovation or if they will provide a valuable reference due to a recognized and respected name – the mentioned intangible values might even outweigh the financial deficit. Conversely, a profitable customer might be (slightly) less attractive if one takes into account that this customer feels poorly treated and thus advises potential clients to avoid your company – in this case, lost sales might be higher than the profit of the customer in question.

There has been some discussion regarding what to include in profitability analysis (Bauer, et al., 2005) and some academics have suggested to include what has been referred to as the "soft" factors of customer value (e.g.(Stahl, et al., 2003)). Even though this has been attempted a few times (e.g. (Ryals, 2008)), the academic discussion generally comes to a halt at the point of whether or not to include these factors, let alone what factors to include (Gleaves, et al., 2008). This has resulted in a growing academic demand for research that quantifies or at least systematically looks at what these "soft" factors are and how they can be linked to business performance (Gleaves, et al., 2008).

Reading through the above paragraphs, it becomes clear that there is an expressed need in academic circles to address the intangible or indirect values pertaining to customer relationships. But it is not only the great minds of academia that long for a more systematic approach to the intangible or *strategic* aspects of customer relationships - the ability to identify and nourish attractive relationships can have a major influence on the long term success of a company.

Professional Service Firms such as consulting firms, law firms and accounting firms are perhaps more than any other industry dependent on their customer relationships – in fact, they do by their very nature only exist *in* the relationship. That is, the services rendered by a Professional Service Firm are not tangible products that can be produced at time A (the role of the company) and purchased later at time B (the role of the customer). Instead, the product of the Professional Service Firm is e.g. a piece of judicial advice or a strategic recommendation, both of which are results of and dependent on the relationship between the firm and the customer. Due to this interactive nature of the Professional Service Firm, along with other characteristics that will be discussed throughout the course of this paper, these types of companies will live or die with the types of clients that they are able to get and the relationships that they are able to build and sustain with them - in other words, the “*customers are becoming a key competitive advantage*” (Bagdoniene, et al., 2007).

Despite this obvious need to know which customers to target (and how), investigations concerning the value of customers for Professional Service Firms are NOT numerous (Gebert, et al., 2003), which is mainly due to a lack of framework that enables integration of the relevant factors (Bagdoniene, et al., 2007).

As such, both the academic world as well as the industry would seem to be able to benefit greatly from a framework allowing for a focused and proactive approach to selecting the right clients and projects and determine a more comprehensive measure for the value – both financial and strategic – that they represent for the Professional Service Firm.

1 Problem identification

1.1 Thesis aim

Knowing which clients and projects to focus resources on is key to success in the professional services industry but at the same time, it is perhaps one of the hardest things to systematically and explicitly frame. The aim of this paper is to create such a framework by identifying the various characteristics relevant when looking at client value in the context of Professional Service Firms and determining the value created more comprehensively. My aspiration is thus to produce a paper that will provide an interesting read for the academic while being of practical value to the professional – a handbook, as it were, on assessing the value of a client of a Professional Service Firm.

More specifically, such a framework will be an attempt to expand the current models for calculating the financial value of customers. This is done by assessing the more intangible value created by clients and projects, so as to create a more comprehensive framework for assessing the value represented by clients and/or projects. Where possible, the factors that are identified from a strategic perspective will be sought quantified. Factors that are deemed too intangible to quantify will be presented in a *score card* in addition to the quantifiable measures. In other words, the aim of this thesis is to create a framework for qualifying the value of a customer, consisting of both a financial and a strategic component.

1.2 Research questions

Based on the above thesis aim, the research question of this thesis is as follows:

Apart from directly measureable profits generated over the course of the relationship, how can clients and projects otherwise be of value to Professional Service Firms and how can this value be assessed?

In order to answer this question, the following subquestions must be answered:

- a) What are the characteristics of a Professional Service Firm and the challenges it is faced with?
- b) How can the value of a customer currently be estimated?
- c) How do characteristics of clients and projects affect a Professional Service Firm internally?
- d) How do characteristics of clients and projects affect a Professional Service Firm externally?
- e) To what extent can the identified factors be quantified?

In order to be able to answer these questions, it is necessary to establish the relevant theoretical basis for the discussion. This will be done by first discussing the nature of a Professional Service Firm and what unique characteristics set it apart from other types of businesses. Following this, I will discuss the strategic landscape of Professional Service firms in order to underline the importance of the subject of this thesis. The theoretical foundation is concluded by discussing current models for calculating customer value and the shortcomings of these in the context of this paper.

Based on this overall theoretical foundation and aided by the discussion of relevant theory throughout the paper, I will draft a list of factors that the theory suggests to be important. These factors will then be analyzed empirically through a survey conducted among a number of Professional Service Firms in order to assess the relative importance of the identified factors. A partially quantitative framework will then be built based on the theoretical and empirical evaluation of the relevant factors.

1.3 Delimitations

The concepts of customers and clients will be used interchangeably in this paper, as will the concepts of professional and employee.

The aim of this paper is, as mentioned, to propose a framework to assess the total strategic value of clients in Professional Service Firms. As such, the main role of this thesis is to identify the factors that go into such a framework. With regards to quantifying these factors, this paper does not aim to invent ways to quantify factors that have not yet been academically treated in this context. In other words, factors that present the academic or empirical foundation for a quantification framework will be considered in a quantitative perspective, whereas the remaining factors will remain intangible throughout the thesis.

Based in the empirical data collected for the purpose, the focus of this paper is Danish Professional Service Firms.

As it will become clear for the reader of this paper, *attracting* the right people is of the utmost importance to the success of a Professional Service Firm, alongside the challenge of motivating and retaining the people that the firm actually manages to attract. For this thesis, I have however chosen not to look specifically at the attraction-perspective, as I believe it will require a dedicated discussion, involving outside factors that do not play a role in motivation and retention. As such a discussion is not warranted within the scope of this paper, I have

chosen not to include it. From a resource-based perspective (see *1.4 Theoretical perspective and definitions*), I thus limit the discussion to the existing human asset base of a Professional Service Firm.

During a financial and economic crisis such as the one the world has experienced over the past few years, normal market dynamics are sometimes neutralized as the general psyche of the market participants change. As such, the arguments and theories put forward in this thesis might not be valid in the current market – price competition might for example be found to be more prevalent in such times, regardless of the individual firm’s ability to differentiate itself from the competition. A discussion on these effects and the way in which to deal with them will however require dedicated discussions and analysis on the dynamics of an economic crisis, which lies outside the scope of this paper.

While many concepts will be discussed throughout this paper in the context of Professional Service Firms, this does not by any means mean that these concepts are unique to Professional Service Firms. Many of the concepts discussed here will thus be relevant in other contexts just as parts of the proposed framework will be directly applicable to other industries or types of companies. What is however unique is the specific unification of concepts into a framework aimed specifically at Professional Service Firms.

Professional Service Firms are not a homogenous mass, but rather a group of unique firms that share a significant number of characteristics. Some of these differences will be highlighted during the theoretical discussion, as I believe this to be important for a more comprehensive understanding of the application of the framework in various types of firms. In order to keep the discussion focused on the main issues of the paper – and to avoid getting too fragmented empirical data – the empirical data collection (i.e. surveys and interviews) has however been conducted on an overall level.

1.4 Theoretical perspective and definitions

The purpose of the thesis is, as described under *Thesis aim*, to discuss the strategic value of customers in Professional Service Firms. Since this is a fairly unaddressed issue in academia, I have chosen an *exploratory* approach (Andersen, 2006), under which I will use the available theory to create a proposed framework which I will then attempt to support through quantitative and qualitative empirical data gathering. This approach also makes the approach more *pragmatic*, as it seeks to create a forward-looking perspective on the subject, based on theory and empirical data (Elkjær, et al., 2005). Furthermore, the use of empirical data and inter-

views will hopefully add a more *practical* dimension to the paper, making it more interesting reading for academics and professional service practitioners alike.

The issues addressed in this paper are primarily strategic, while recognizing and discussing the financial implications of the identified factors and challenges. In order to be able to identify many of the factors, it is however necessary to include theory pertaining to academic fields other than the two primary ones. As it will become clear for the reader later on in the thesis, the arguments for *why* certain client characteristics are of strategic and financial value from an employee perspective rest heavily on organizational and motivational theory, while the value of client characteristics from a market-oriented perspective can be explained using theory focusing on customer loyalty and purchasing behavior. As such, the reader should not confuse the theoretical fields represented throughout the thesis with the overall focus of the thesis, namely *strategic* value of customers of Professional Service Firms and the *financial* implications that pertain to the relevant factors.

In order to lay a proper foundation for the later theoretical discussion, I will in the following sections frame the discussion by defining the central concepts and perspectives of the paper.

1.1.1 A resource based perspective

The theoretical perspective chosen to address the subject of this thesis is the *resource based view* of the firm. According to this perspective, a company's competitive advantages are based on its resources, i.e. by either having *more* resources than the competition or by achieving better *utilization* of the asset base (Jalkala, et al., 2010). Through the resource based view, this thesis thus looks at the characteristics of customers and projects that will allow the company to expand its market-based assets or improve utilization of the existing employee- or market-based assets.

1.1.2 Behavioral assumptions

A considerable part of the discussion in this paper will revolve around such issues as motivation and employee retention. As such, it is important to specify the theoretical assumptions that these discussions are based on. The theoretical framework for the behavioral discussion is that of agency theory, i.e. the concept of delegation of authority involving asymmetric information and conflicting interests (Hendrikse, 2003). Agency theory is then in turn based on the assumptions of complete rationality and opportunism, meaning that all available information is considered when making decisions and that, when faced with a decision, the agent will al-

ways make the choice that comes closest to fulfilling his own personal interests (Hendrikse, 2003).

1.5 Source criticism

The fact that Nordeflycht (Nordenflycht, 2010) is one of the first researchers to directly touch upon the subject of explicit taxonomies for Professional Service Firms creates an issue, as no academic evaluations of this taxonomy have been conducted at this time, making it harder to assess the validity of Nordenflycht's taxonomy. The focus of this paper is however not the definition of Professional Service Firms nor the creation of a taxonomy and as such, I will not embark on a lengthy discussion on the subject.

The fairly new academic discipline that is Professional Service Firms also has general implications on the validity of the conducted discussion in this paper. As many subjects in this paper, e.g. the quantification of the identified factors, are only starting to emerge academically, not many sources exist to support the different points made. As such, some discussions in this paper will be somewhat one-sided, simply due to the fact that only one argument currently exists.

While this paper focuses on Danish Professional Service Firms, the majority of the sourced literature is of foreign origins. Cultural differences might therefore mean that these theories might not be directly applicable to a Danish context, as it has been done in this thesis.

As the conducted empirical data collection has not resulted in statistically significant results, it is dangerous to read too much into that part of the discussion. Statistically valid survey results might yield different results, even though the conducted validation interviews indicated that the results match the perceived reality of the interviewed professionals. Furthermore, the demographics of the employee-oriented survey are skewed towards Management and Engineering Consultants.

In general, the conducted interviews are subject to the interviewees' biased opinion and responses should thus be regarded with some measures of skepticism. Additionally, Rasmus Møller of COWI (Møller, 2010) was interviewed both on the employee and the market perspective, as he has extensive experience with hiring external professionals while working for a Professional Service Firm. Therefore, there is a possibility that his responses to the two different perspectives are somewhat affected by his knowledge of the other point of view.

2 General methodology

2.1 Purpose of thesis

As already established, this thesis aims to identify characteristics of clients and projects that can be of strategic value for Professional Service Firms as well as discuss the financial implications of the identified factors.

The research has been conducted in an *inductive* manner (Andersen, 2006), as the intention is to gather data from a sample group, based on which I will draw conclusions for the overall population. The use of both qualitative and quantitative data gathering is based on the attempt to create a framework around a subject that is essentially hard to quantify. That is, the qualitative data is used to qualify the theoretically founded framework, i.e. confirm that the proposed factors are indeed important in the context of Professional Service Firms.

While such a quantitative approach will qualify the proposed framework and point towards the relative *importance* of these parameters, the nature of the parameters is more qualitative, for which reason the interviews are meant to probe into *what* the different parameters mean for a Professional Service Firm. Also, since the results of the survey are not statistically significant due to insufficient responses, the interviews also serve the purpose of investigating to what extent the survey results match the perceived reality of the professionals. As the interviews are not to be considered an actual case study, they will not be analyzed explicitly as such but instead used throughout the paper to support theoretical arguments and bring a more practical angle to the discussion.

As the focus of the thesis is a number of different types of Professional Service Firms, the points discussed in this paper should not be viewed as conclusive in the same way it would have been possible had the thesis focused on one specific industry within the professional service sector. However, since this paper is exploring an issue not thoroughly discussed previously, I have deemed it more appropriate to start with this more holistic, aggregate level and then leave it to future research to dig further into the details of the specific industries.

2.2 Framework determinants

These factors determine the overall framework under which this paper has been written. In the following, the most important factors will be described so as to establish an understanding for the format and content of the thesis.

The production of this paper has been subject to a number of rules set forth by Copenhagen Business School, which have defined and limited the physical, structural and formal specifications of the paper. Furthermore, the cooperation agreed upon between the author and the academic advisor helped frame the overall focus of the thesis.

The approach to the writing of the paper, and more specifically the empirical data collection, has also been dictated by a wish to maintain a high degree of integrity in the process, i.e. ensuring anonymity in the survey and ensuring complete agreement with the interviewees in terms of quotation and level of confidentiality.

2.3 Process determinants

The factors discussed in this section have had an impact on specific processes during the writing of this thesis.

Overall, the production process has been determined by the nature of the problem being addressed in the thesis. The methodological choices made in addressing the overall problem have also determined choices made during the writing of this paper. Finally, the access to empirical data, i.e. the number of willing respondents, has determined to what extent and how the collected data could be applied. In the following, I will elaborate on the methodological approach to the empirical data collection.

2.3.1 Research design and data collection methods

To support the framework that is proposed based on available theory, I have gathered data of both qualitative and quantitative nature.

A critical assessment has been performed on both types of data before including them in the discussion of this thesis. This means that both the *validity* of the collected data – i.e. the degree to which the data collected is actually *relevant* to the subject in question – and the *reliability* of the gathered data – i.e. the degree to which the data actually represents and measures that which it was intended to measure and represent (Andersen, 2006) – has been considered throughout the process.

2.3.1.1 Quantitative data gathering

The purpose of the qualitative data collection was to look at the views of the professionals and their clients regarding the factors proposed to be of strategic value for the Professional Service Firm. As such, a survey seemed to be the appropriate measure of collecting such data

(see e.g. (Sapsford, et al., 1996)), as it allows for a quantifiable measure of relative importance among the difference factors.

According to Susan Thomas (Thomas, 2004), one should follow a specific process in order to achieve effective and successful data collection using surveys - this process is depicted in *Exhibit 1*. While the steps of the described process were generally followed, the chronological order of the process and the degree to which some of the steps was carried out varied somewhat from the proposed process, due to the specific nature of the data collection.

The initial planning of the survey process and the setting of the objectives was a part of the overall planning of the thesis process. The objectives that were arrived at as part of this process planning are discussed in detail in the empirical chapter of the thesis (see: *Chapter 7 Empirical data collection, analysis and interpretation*). In the same way, selection of the target audience was not explicitly addressed, as the target audience for the data gathering would essentially be the reader of the thesis. Likewise, the sample populations for the surveys were essentially already defined, through the theoretical definition of Professional Service Firms chosen for this paper. As such, the desired sample population for the employee-focused survey consisted of employees of consulting, auditing, PR and law firms as well engineering consultants¹ while the desired sample population for the client-based survey was more general, aiming at all relevant employees of companies – both Professional Service Firms and others – that have done business with a Professional Service Firm.

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When gathering information about the degree to which a person finds something important, Susan Thomas states that rating scales are appropriate (Thomas, 2004) and more specifically suggests the commonly used *Likert-scale*, named after psychologist Rensis Likert, who developed the scale back in 1932 for the purpose of measuring attitudes (Thomas, 2004). The original scale was made up of 5 points, but later researchers have used everything from 4 to 11 points on their Likert-scales, even though more than 7 points is generally considered to be inefficient (Thomas, 2004). For the data gathering conducted in relation to this thesis, I have decided to use the standard 5-point Liker-scale.

The questionnaire was written so as to avoid double-barreled questions (Thomas, 2004), i.e. questions where the respondent is in actual fact answering more than one question, which complicates analysis of the responses due to difficulties of separating the different issues contained in the question. Furthermore, the questionnaire has been written with a focus on avoid-

¹ See section 3.1: What is a Professional Service Firm?

ing leading questions and questions that leave concepts or terms open to interpretation by the respondent (Thomas, 2004).

Upon writing the questionnaire, the survey was created using the free web-based survey-tool *Limesurvey* (www.limesurvey.org), a tool which I have extensive previous experience with through my job. Upon creating the survey, the questionnaire was tested for validation purposes by sending it to two independent professionals, namely Klaus Lund from Klaus Lund & Partners and Anders Kold from Koompany. Based on the feedback from the two, the questionnaire was revised slightly so as to fit it to the target audience of professionals.

As already mentioned, the initial sample population consisted of firms from all five professional service sectors included in the theoretical scope of this paper. However, the final sample actually achieved was strongly limited by the ability and willingness of these firms to participate in the survey. As such, out of a proposed list of approximately 50 participating firms, only around half (27) allowed me to send the survey to them, without any guarantee that this would result in any actual responses. In order to maximize the number of firms that would be willing to participate in the survey, which included questions that to a certain extent could indicate strategic choices and other sensitive information, I chose to make the survey anonymous. The cost of making the survey anonymous is that one loses the option of tracking exactly which companies actually participated and with how many employees.

The surveys were distributed by means of hyperlinks sent via email. For each company on the initial sample list, I personally contacted the relevant person in the company (preferably the HR-manager) and asked if their company would be willing to participate in the survey(s). If the company in question accepted, I would then proceed to send an already written invitation email, explaining the purpose of the survey as well as overall goal of the thesis. This email, sent to the contact person in each participating company, came attached with a similar invitational and explanatory email specific for each of the two surveys, containing a hyperlink for the relevant survey. These two invitational emails would then be sent by the contact person to relevant employees throughout the company, without any guarantee as to how many would actually fill out the survey. The result was thus that a considerable number of surveys were distributed but that – due to the previously mentioned anonymity built into the survey – it was not possible to establish afterwards exactly which companies had contributed. Through the demographic question included in the survey, it was however possible to determine the type of company that the respondent worked for.

2.3.1.2 Qualitative interviews

In order to validate the results of the quantitative surveys and to look into the underlying reasons for the various outcomes, it was decided to conduct more qualitative data collection, in the form of personal interviews. As the interviews would be closely related to the conducted surveys, it was decided to use the survey samples as sample population for the interviews as well. For this purpose, a page was built in at the end of the surveys, allowing the respondent to indicate a willingness to participate in a follow-up interview and – in case of a positive response – give name and number so as to allow for contact.

Due to the validation purposes of the interviews, the questionnaires for the interviews were essentially structured around the results of the surveys. The interview guidelines were thus partially standardized, revolving around a graphical presentation of the results of the different parts of the surveys. Identical questions were consequently asked at the beginning of each part of the interview, while a certain amount of flexibility was allowed in the follow-up questions, allowing the interview to unfold according to the individual interviewee. This flexibility was however constantly limited by the need to have the questions in the interview guideline answered to a satisfactory degree. This form of interviewing, known as *naturalistic interviewing*, often becomes less structured than the more stringent social scientific approach to interviewing (Sapsford, et al., 1996). The naturalistic approach instead aims for a more conversational type of interaction, rather than a one way questioning of the interviewee (Sapsford, et al., 1996).

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2.4 Thesis structure

Introduction

The thesis begins with an introduction, during which the reader is presented with the thoughts and ideas on which this paper is built as well as my personal motivation for writing this thesis.

Problem identification

The introduction is followed by a section focusing on the aim of the thesis as well as the overall problem addressed in the paper, where the reader can also find the actual problem identification. This section will clarify exactly what questions the paper aims to answer, also including sub questions. In order to specify exactly what issues will be taken under consideration throughout the thesis, the problem identification is immediately followed by a discussion on the delimitations of the thesis. To further prepare the reader and provide him/her with a detailed understanding of the choices and assumptions underlying the thesis, a theoretical framing of the paper is also included in this section. Finally, a critical assessment of the literature

used in the thesis is conducted. It should be noted here that source criticism will not be applied to all sources but only the ones which demand specific attention.

Methodology

The methodology section provides the reader with a more technical walk-through of the approaches used in writing this paper. This includes a description of the overall purpose of the thesis as well as a general description of the research design and data collection methods.

Theoretical section

This section will establish the theoretical pillars on which the remaining part of the thesis will rest. First and foremost, this means a theoretical discussion revolving around Professional Service Firms and the distinguishing features of these and the implications hereof. In this section, I will also engage in a discussion regarding the overall strategic reasoning of this thesis, using Michael Porter's Five Forces framework.

A review of the existing frameworks

This section will include a review of the current state of customer valuation frameworks and the shortcomings of these in the context of this paper.

Strategic value of clients – the employee perspective

To address the issues pertaining to the *internal* perspective, this section also includes a theoretical discussion of organizational and motivational theory, on the basis of which I will identify the factors that are crucial for achieving employee motivation and retention as well as capability building.

Strategic value of clients – the market perspective

To address the issues relevant to the *external* perspective, theory regarding customer satisfaction and loyalty will be discussed, allowing me to identify important characteristics of clients and projects that will provide a Professional Service Firm with strategic and financial advantages.

Empirical study

Upon identifying the factors from a theoretical perspective, I will seek to test the importance of the factors against the current patterns in the professional services industries. This section does not attempt to statistically prove the concepts discussed but rather to take the first step in empirically researching the perceived importance of the factors, the awareness of this importance and the degree to which Professional Service Firms actually act in accordance with this strategic focus. This section will include a description of the methods used in the data gather-

ing framework and a resume of the questionnaires. Finally, the results of the empirical study will be discussed.

Quantifying the factors and building the framework

Last step before actually constructing the proposed client valuation framework is to engage in a discussion as to possible quantifications of the identified factors. This will be done partially based on available theory and partially based on the conducted interviews. As this subject is only scarcely treated in academia, some factors will have the theoretical foundation for a valid discussion on quantification, while others will have no theoretical or empirical foundation, making it invalid to engage in a valuable discussion on the subject. As the aim of this thesis is not explicitly to quantify the factors but rather to identify them and construct a strategic framework around them, this discussion will only be conducted in the scope of the current theoretical and empirical resources.

Finally, this section will see the building of the actual framework, based on arguments and findings from all the previous sections. The factors that have been proven possible to quantify will be considered as a quantitative extension to the existing customer valuation frameworks previously discussed, while the more qualitative factors will be presented in a scorecard in addition to the quantitative model, so as to create a comprehensive framework, acknowledging both qualitative and quantitative factors when determining the value of a client or project.

Final discussion, conclusion and perspectives

This final section will discuss the strategic value of the applying the framework and present a conclusion on the entire thesis. This chapter will also include a short perspective on possibilities for future research as well as acknowledging certain shortcomings in the thesis and the underlying research.

An illustration of the thesis structure can be found in *Exhibit 2: Thesis structure*.

3 The theoretical foundation

In this chapter, I will seek to establish the theoretical foundation on which I will conduct the following discussions. I will begin by defining the concept of Professional Service Firms, followed by a discussion on the nature of these. A discussion of the strategic landscape of Professional Service Firms will follow, using a well-known strategic framework. The aim is to give the reader an understanding of the idiosyncrasies of Professional Service Firms and how these affect the strategic setting of these companies, all of which will serve to highlight the importance of customer-related factors.

3.1 What is a Professional Service Firm?

The pivotal point of this paper is the Professional Service Firm, which, for obvious reasons, makes the definition of this type of business paramount for a clear and concise presentation and understanding of the content of this thesis. The interesting thing is however that no such clear definition exists in the academic literature on the subject. Two of the central pieces on Professional Service Firms, i.e. *Aligning the Stars* (Lorsch, et al., 2002) and *Managing the Professional Service Firm* (Maister, 1993), only offer an indirect definition hereof by discussing the managerial implications of various characteristics of Professional Service Firms. But an explicit taxonomy for the identification of Professional Service Firms is not found in these books and the definitions that can be found are rarely consistent (Nordenflycht, 2010). According to Nordenflycht, the result of the ambiguity of the definitions is that it has prevented the accumulation of a broad body of research and instead fostered research mainly focused on law, accounting and consulting firms, which are usually categorized as Professional Service Firms despite the underlying definition. Due to the lack on academic work focused explicitly on theoretical definitions of Professional Service Firms, this section will mainly be based on Nordenflychts paper from 2010, which addresses precisely this lack of definition.

This lack of academic discussion however creates the issue of academic validity of the taxonomy, as no peer evaluations of Nordenflycht's framework have been put forward at this point. Acknowledging that this paper is dealing with an academic field that is still quite young, I have nevertheless decided to use Nordenflycht's taxonomy to frame the theoretical focus going forward, as it is currently the only available taxonomy in the academic literature. I will still incorporate into my discussion other parameters not included in the taxonomy so as not to limit my self by potential short-comings of this theoretical framework due to the lack of academic consensus.

To try and establish a consistent definition of Professional Service Firms, Nordenflycht (Nordenflycht, 2010) develops a taxonomy consisting of 3 parameters:

- 1) *Knowledge intensity*, i.e. the degree to which production is based on specialised knowledge,
- 2) *Low capital intensity*, i.e. the degree to which production is primarily produced by human assets
- 3) *A professionalized workforce*, which is characterized by a particular knowledge base, regulation and an industry ideology.

Instead of aiming for a rigid definition under which all characteristics have to be present, Nordenflycht proposes a gradual definition based on the *degrees* of the three characteristics. The argument for doing so is that a rigid “all-or-nothing” definition would exclude many industries commonly recognized as Professional Service Firms. An example, also discussed by Løwendahl (Løwendahl, 1997), is the lack of professionalization in the management consulting industry. As opposed to e.g. the accounting industry, management consulting firms do not base their work on an established body of knowledge nor is one required to obtain a license in order to operate as a management consultant. For this exact reason, Løwendahl argues that looking at whether or not a company is part of a profession is not relevant in identifying Professional Service Firms, and instead argues that a company should be characterized by the type of services it offers rather than the type of people delivering the services (Løwendahl, 1997). She does however acknowledge that the existence of a profession, or a lack thereof, results in particular managerial challenges, which I will be discussed further in section 3.3 *Differences between types of Professional Service Firms*.

For the purpose of determining the focus of this paper, I have chosen to apply Nordenflycht’s taxonomy, as I believe it is non-exclusive while still acknowledging the differences that do exist between different types of Professional Service Firms. The taxonomy sorts the various types of Professional Service Firms into four categories, based on their characteristics as described above. The categorization can be found in *Table 1: Nordenflycht’s Taxonomy for Professional Service Firms*.

Table 1: Nordeflycht’s Taxonomy for Professional Service Firms

Category (with examples)	Knowledge Intensity	Low Capital Intensity	Professionalized Workforce
Technology Developers E.g. Biotech, R&D labs	X		
Neo-PSF’s E.g. Consulting, Advertising	X	X	
Professional Campuses Hospitals	X		X
Classic PSF’s E.g. Law, Accounting, Architecture	X	X	X

Source: (Nordenflycht, 2010)

From the above taxonomy, I have chosen to look at only two out of the four specified categories, excluding what Nordeflycht refers to as *Professional Campuses* and *Technology Developers*. The reason for the exclusion of *Professional Campuses* is that in a Danish context, which is the primary focus of the paper, both private and public hospitals are heavily regulated and are therefore limited in their ability to actively target clients and manage client relationships. As to the exclusion of *Technology developers*, it is actually due to a firm dimension that Nordeflycht does not take into account as opposed to Løwendahl, i.e. the degree of interaction between the professional and the client. In this aspect, *Technology Developers* stand out in that the type of services offered can be delivered with limited interaction between professional and client. In contrast hereto, the services offered by firms in the remaining categories are all carried out in close interaction and cooperation with the client. The concepts of client interaction and relationships are somewhat central to the concept of customer value in Professional Service Firms, which is the reason why I have chosen not to look at *Technology Developers*. Going forward, references made to Professional Service Firms thus refer to the types of firms chosen for this paper.

The firms I have chosen for this paper are as follows:

- Law firms and Accounting firms will represent the *Classic* Professional Service Firms
- Management Consulting Firms, Engineering Consulting Firms and PR Firms will represent the *Neo-Classical* Professional Service Firms

Needless to say, as it should be clear from the above table, the different types of Professional Service Firms have different characteristics that set them apart. An obvious question would therefore be to what degree they are comparable and to what extend findings from one type of firm can be applied to other categories. This is according to Nordeflycht one of the main

drawbacks of the past research on Professional Service Firms: Due to the lack of taxonomy, research has generally treated all Professional Service Firms as one and generalized findings from research focused on one type of Professional Service Firm to apply to all Professional Service Firms (Nordenflycht, 2010).

Having chosen to look at many different types of Professional Service Firms is a deliberate choice and not one made out of ignorance of the before mentioned differences between the different firm types. I have chosen to do so in order to further a hopefully interesting discussion on the implications of these differences in the context of this paper. As much as possible, I will thus not generalize any finding from one firm category to another, but distinguish between general and type-specific findings.

3.2 A general discussion on Professional Service Firms

The individual characteristics discussed here are not necessarily unique to Professional Service Firms but the presence of all the characteristics simultaneously and the intensity of the factors has distinctive implications for Professional Service Firms (Løwendahl, 1997).

The factors that are discussed in this section can be found in summary in the table in *Exhibit 3: Differences between goods and services*.

3.2.1 Knowledge intensity

Despite the lack of a clear consensus as to the definition of a Professional Service Firm, it is commonly acknowledged that Professional Service Firms are *knowledge intensive* (e.g.: (Maister, 1993), (Gardner, et al., 2008)) meaning that the output is heavily reliant on the knowledge embedded in the employees of the company. This further creates direct link between the competence and motivational level of the employed professionals and the quality of services that the firm can offer (Maister, 1993).

The knowledge intensity of Professional Service Firms challenges traditional ways of looking at a firm and give reason to question to what extend the theory of the firm is really applicable to such firms (Teece, 2003). An example is Ronald Coase's idea of a firm as a nexus of contracts, according to which the employee makes a contract with the employer who then directs the employees work so as to optimize output (Hendrikse, 2003). Such a framework presupposes that the employer has better knowledge than the employee, allowing him to guide the employee to more effective ways than he would otherwise be capable of achieving. This assumption is however somewhat undermined when dealing with Professional Service Firms, as

it is doubtful whether the manager will indeed have superior knowledge over the professional as the professional is by definition an expert on his field (Teece, 2003). In fact, it could be argued that in a Professional Service Firm, more than any other type of firm, the employee possesses a high degree of *informational power*, i.e. knowledge so valuable to the success of the company that the holder of such knowledge will be able to leverage it in order to further his own interests (Jacobsen, et al., 2004).

In essence, the knowledge intensity of Professional Service Firms thus shifts the traditional balance of power in favor of the professionals, as they not only possess superior knowledge of the nature of the job but also have a direct influence on the quality of the delivered services. This shift of power is further strengthened by the *low capital intensity* of Professional Service Firms, which means that value creation essentially is based solely on the professionals, meaning that in Professional Service Firms, almost the entire asset base goes down the elevator every night (Nordenflycht, 2010). Furthermore, the low capital intensity means that professionals will not build any nonhuman capital specific skills tying them to the firm, thereby making switching costs low (Lorsch, et al., 2002) and bargaining position strong (Nordenflycht, 2010).

Lorsch & Tierney (Lorsch, et al., 2002) note that an implication of this knowledge intensity and dependence on human assets is that competing on costs is not a viable strategic option for Professional Service Firms. The reason for this is fairly straight forwards, since the knowledge intensity of these firms means that the largest cost category will inevitably be professional salaries. As such, competing on costs will directly affect the quality of the brainpower a firm can attract and retain, which will then again (all things equal) directly affect the quality of the services offered.

3.2.2 Intangible output

The knowledge intensity of the Professional Service Firms is closely related to another characteristic, namely the intangibility of the output. Knowledge intensity indicates that the production of a firm is mainly based on thought processes rather than physical production, which then by definition will result in intangible or *opaque* output formats (Nordenflycht, 2010). While this output characteristic has several strategic implications that will be discussed later, it is worth mentioning here that it generally means that professional services are basically *sold on a promise* (Bagdoniene, et al., 2007). That is to say, the intangibility of the output of Professional Service Firms means that it is almost impossible for a potential client to judge the

quality of the work *ex-ante* (Lorsch, et al., 2002), as physical proof of the output rarely exists. Consider a strategic implementation facilitated by a management consultant. This will have little value or meaning outside the specific context in which it was done just as the value created by a top quality audit can be hard to objectively assess by a third party. The intangibility of professional services also has deep roots in the relational nature of professional services, an issue that will be discussed in the following section.

3.2.3 Based on relationships

The ex-ante evaluation of the output from a Professional Service Firm becomes even harder because the output and the production process are not detached but instead deeply intertwined. In Professional Service Firms, the output is essentially created *during* the interaction with the client, which makes the before-mentioned promise which professional services are sold on, about not only the quality of the output but also the quality of the *relationship* that frames the service delivery (Lorsch, et al., 2002).

The cause for this mix of output and process is essentially that the nature of professional services makes it impossible for the professional to pre-produce the service for which he is being paid. The reason is that almost every service delivery revolves around a company or a challenge that is in some way unique to any other project ever undertaken by the Professional Service Firm. The point is that professional services are always to some extent *customized* to the specific issue at hand (Maister, 1993), which in turn means that the *production input* of professional services essentially is information residing with the client, like financial reports, process insights and so on. This means that only by *interacting* with the client can the professional deliver the promised service and more importantly: *The quality of the delivered service is proportional to the quality of the relationship!* The reason for this lies in the intuitive fact that the quality of any output depends on the quality of the required input. As the input in the case of Professional Service Firms is often sensitive information, the degree to which the client is willing to share this information with the Professional Service Firm and do so in a meaningful way, effectively depends on the level of *trust* between the individual consultant and the client.

As the above discussion indicates, the “product” of a Professional Service Firm consists of a process component and an actual output component, whereas the “price” of the engagement from the client’s perspective consists of the actual monetary cost of the service as well as the amount of effort that the client has to commit to the process. These components have been

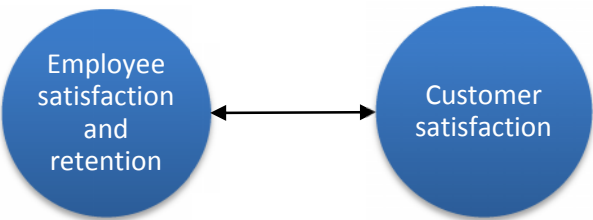
visualized by Heskett et al in what they refer to as the Customer Value Equation: (Heskett, et al., 1997):

$$Customer\ Value = \frac{Product + Process}{Price + Effort}$$

While this equation is true for most companies, the importance of the four components varies. When dealing with a Professional Service Firm, *Process* and *Effort* are more important than when dealing with a producer of physical goods, where the majority of the transaction revolves around *Product* and *Price*. Because the process is so central when dealing with a Professional Service Firm, and since a process is by nature elusive and hard to document *ex-ante* as well as *ex-post*, it is hard for a potential client of a Professional Service Firm to find any evidence of the service process quality that he is about to pay for. Combined with the fact that the product itself is intangible, a potential client will therefore have to look for any and all other indications that the Professional Service Firm can deliver the promised service and deliver it as promised.

The relational aspect of professional services would obviously indicate the importance of the relationship itself. But furthermore, the relational aspect of professional services naturally means that professionals and their clients are more intertwined than in other industries. In their book *The Service Profit Chain*, Heskett et al (Heskett, et al., 1997) argue that employee satisfaction and customer satisfaction are two highly correlated factors in service industries, and argument which is echoed by Lorsch & Tierney, who state that “you can’t have stars without satisfied customers” (Lorsch, et al., 2002). It would thus seem that the creation of meaning and purpose of work for the individual professional is closely linked to customer satisfaction. This makes sense, as the relational nature of professional services allows the professional to experience the effect of his services first hand.

Figure 1: Link between employee and customer satisfaction



Source: Inspired by (Heskett, et al., 1997)

3.3 Differences between types of Professional Service Firms

While the previously discussed characteristics are generally shared by all Professional Service Firms, the different types of firms do also differ in nature; differences that have implications in the context of this thesis. As I discussed during the theoretical definition of Professional Service Firms (see 3.1: *What is a Professional Service Firm*), differences between Professional Service Firms have not received much attention in the academic literature (Nordenflycht, 2010), even though some obvious differences do exist, as I will discuss in the following. I have chosen to discuss the factors that are of direct relevance to the focus of the thesis, meaning that this section should not be viewed as a complete list of differences between various types of Professional Service Firms.

3.3.1 Varying degrees of professionalization

While all Professional Service Firms produce output that is to some degree intangible, the degree to which this intangibility affects the firm's competitive position in the market differs among the various sectors of the professional services industry. The differences stem from a basic difference in what Nordenflycht (Nordenflycht, 2010) refers to as the degree of *professionalization* of a professional service sector. The term professionalization essentially covers the degree to which a vocation is founded on a specified body of knowledge and an explicit code of ethics such as in the case of auditors, who are often members of a professional organization providing them with an official auditing license (Løwendahl, 1997). At the other end of the spectrum of professionalization, we find professions such as management consultants, where no established body of knowledge exists and no license is required to practice professional management consulting. As it was discussed during the theoretical definition of Professional Service Firms (see: 3.1: *What is a Professional Service Firm*), law and accounting firms are generally considered to be professionalized, while management consulting, engineering consulting and PR firms generally are considered not to be professionalized, due to the lack of the above mentioned characteristics.

The existence or lack of professionalization of a professional service vocation has important implications in terms of the individual firm's stance in the marketplace. The existence of a recognized profession essentially provides the professional and his/her firm with a seal of approval, guaranteeing a certain level of competence and ethical behavior (Løwendahl, 1997). Despite the intangible output of these firms, a prospective client will thus be able to assume a certain level of quality based on the membership of the professional organization. Conversely, firms that cannot present the quality seal provided by an official professional license will face

the challenge of providing ex-ante proof of the quality of their services otherwise. The ways in which to do this will be discussed in-depth in section 6: *Strategic value of customers – the market perspective*

3.3.2 Intangibility of output

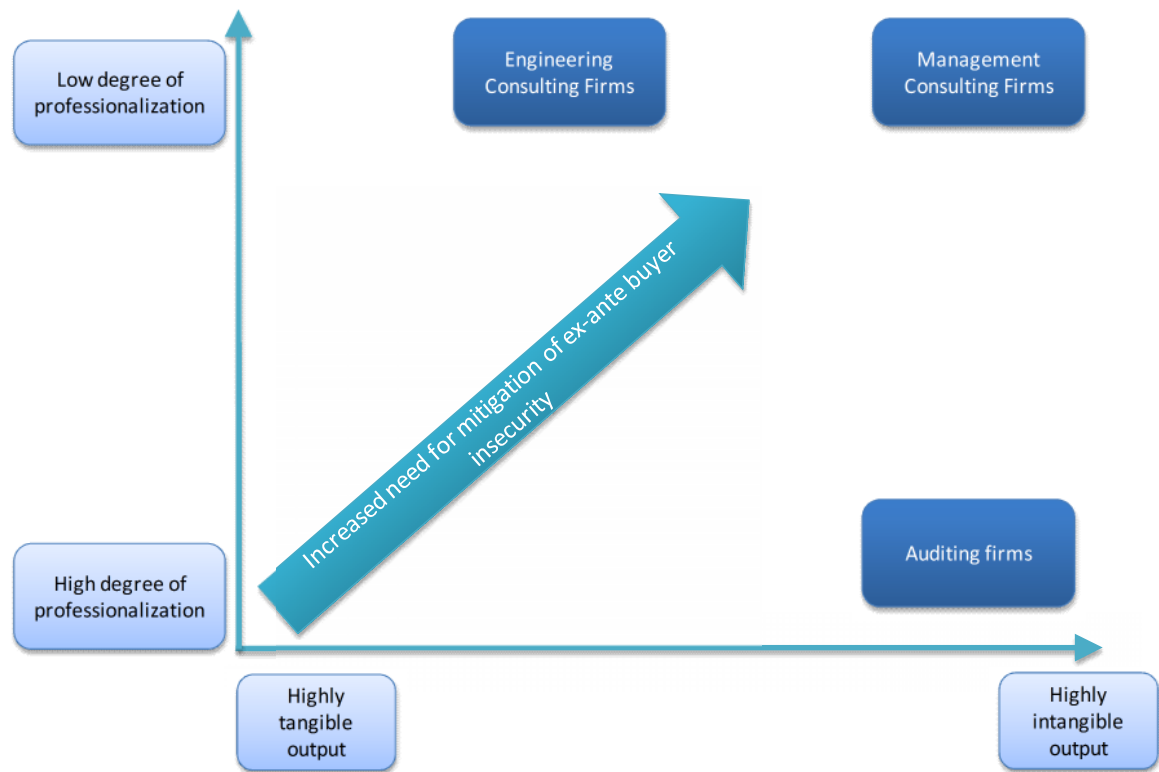
Building on the arguments presented in the preceding paragraph, the level of intangibility of the output of a Professional Service Firm also has considerable impact on the importance of customers. Essentially, the problem of output intangibility is mitigated by e.g. membership of a professional organization, inasmuch as output intangibility is actually an issue. In other words, the more tangible the output of a Professional Service Firm is, the less critical it is for the firm to provide ex-ante proof of quality through other, more indirect ways.

One could in fact place the Professional Service Firms on a continuum, ranging from *Highly Tangible Output* to *Highly Intangible Output*. As this discussion is conducted in the context of Professional Service Firms, it is however important to point out that the concept of tangibility is highly relative in this context. As such, talking about tangibility does not imply the existence of a physical product for a prospective buyer to evaluate for quality assurance purposes. Rather, tangibility in this context refers to any kind of tangible evidence left behind to document the delivery of the professional service. An example would be the Engineering Consultant, whose work will result in the construction of e.g. a bridge or a road, just like a P.R. firm will potentially be able to document communication strategies during publicly known incidents. At the other end of the spectrum, we find Auditing and Law firms, whose services often have little or no explicit impact, as they are of a more regulatory nature.

If one combines such a continuum with the degree to which a firm is professionalized, it results in a framework for determining a firm's need for mitigating ex-ante client uncertainty. Such a figure is exemplified below in *Figure 2: Framework for determining need for mitigating ex-ante client uncertainty*.

While it is outside the scope of this paper to engage in a detailed discussion regarding the position of the different Professional Service Firms in the framework, the point here is that whenever a firm is placed in the coordinate system, it has implications as to how dire the need for ex-ante mitigation of uncertainty is. For the purpose of exemplification, I have however attempted to position some of the firms in the framework. Based on the specific nature of the services rendered by a particular Professional Service Firm, the position of that firm along the continuum could however very well change.

Figure 2: Framework for determining need for mitigating ex-ante client uncertainty



Source: Author’s own creation

3.4 Why is a focus on customer value of strategic importance

While the preceding section has framed the general concept of Professional Service Firms and the overall characteristics of these, the following section will put these characteristics into a more strategic framework, so as to identify the strategic challenges faced by Professional Service Firms.

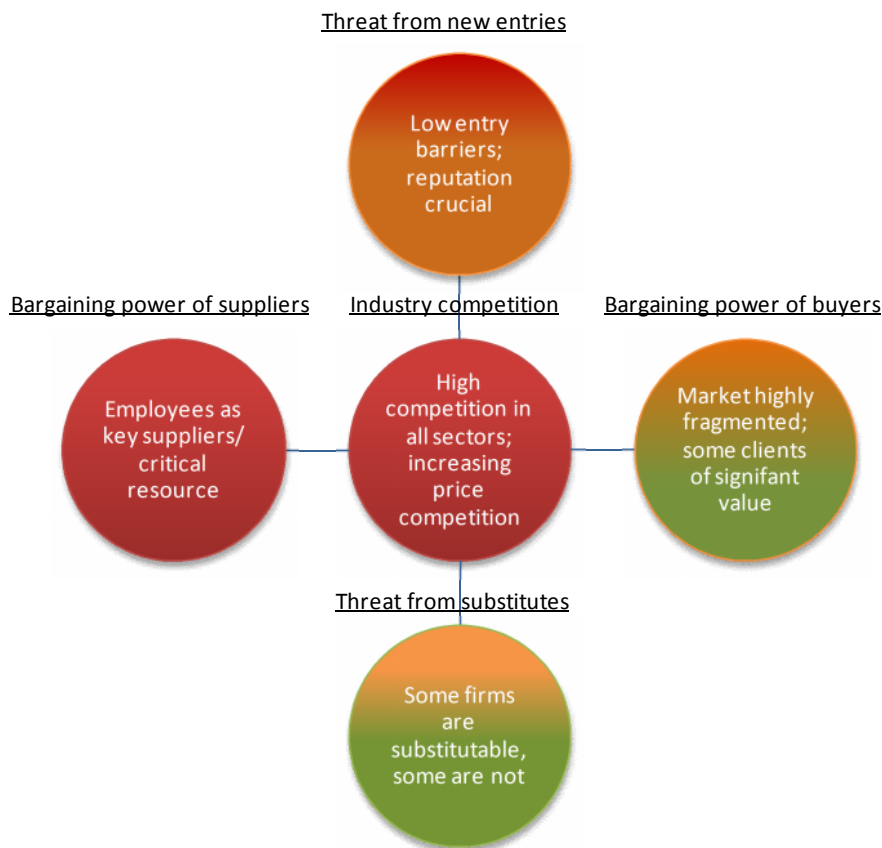
3.4.1 The strategic landscape of Professional Service Firms

By using the classic framework for industry analysis presented by Michael Porter, known as Porter’s Five Forces (Porter, 2008), I will now analyze the strategic landscape of professional services. This framework evaluates a given industry based on five parameters, each focusing on different challenges that can potentially face a firm in any given industry. Porter’s Five Forces are: *Threat from substitutes*, *Bargaining power of customers*, *Bargaining power of suppliers*, *Threat from new entries* and *Industry competition*. For further information on Porter’s framework, please see (Porter, 2008).

In the following illustration, parameters colored red indicate a severe challenge to the individual company, which needs to be in focus. Parameters colored in orange indicate a slight challenge that is however not a direct threat to the continued success of the company. Finally,

parameters colored in green indicate factors favorable to the success of the individual company. If a parameter is split between two colors, it indicates a level of challenge which is best placed in between two of the three categories.

Figure 3: Strategic analysis of the professional services industry



Source: Framework based on (Porter, 2008)

- **Threat from new entries** – The low capital intensity of professional services means that the barriers to entry in the professional service industry are practically non-existent (Lorsch, et al., 2002). However, while entry barriers might be theoretically low, the intangibility of the output of Professional Service Firms mitigates some of that threat through the need for addressing the ex-ante uncertainty pertaining to professional service. As this is often done through evaluating a firm’s past service deliveries, i.e. professional track-record, references etc, a new entrant in the professional services industry will naturally lack all of these ex-ante remedies against output uncertainty, thus giving the newcomer a competitive disadvantage vis-à-vis established market players. This disadvantage will however not be as significant in professionalized services, provided that the new entrant is part of the professionalized body. In such a case, the need for providing the indirect ex-ante proof of quality will to some

extent be met by his membership, as discussed in section 3.3.1 *Varying degrees of professionalization*. The threat of new entrants can therefore be considered acknowledgeable without being as severe as other parameters.

- **Bargaining power of suppliers** – The knowledge-intensity and general nature of Professional Service Firms means that the only real input for the value creation in Professional Service Firms is the professionals that perform the services. As such, looking at what Porter refers to as the bargaining power of suppliers essentially becomes a matter of the distribution of power between the Professional Service Firms and the professionals that they aim to attract, motivate and retain (Lorsch, et al., 2002). As discussed previously, the bargaining power of the employees is significant as they essentially constitute the entire asset base of the company, possessing a high degree of informational power. This is combined with the low switching costs due to the low capital intensity, which essentially enables the professional to change employer with almost no loss of capabilities. This challenge might in fact be the most serious one facing the individual Professional Service Firm, as the attraction, motivation and retention of highly skilled employees in essence determines the quality of services that the firm can provide.
- **Bargaining power of buyers** – In general, the market for professional services is made up of numerous potential clients (just think about how many companies exist that need auditing, legal advice or PR assistance), each of which does not represent a significant part of the total market value. As such, the individual customer does not possess much bargaining power when dealing with a Professional Service Firm, as the firm will have the option of targeting several other companies instead of spending too much time dealing with a difficult client. There is however a special group of clients that represent more potential value, both in terms of revenue generation and more intangible, strategic value for the Professional Service Firm. These clients, like the C20-companies in Denmark or the Fortune 500 companies in the US, all represent significant revenue, prestige and complexity of projects that make them especially interesting as clients, giving them more power when dealing with the Professional Service Firm.

An exception to the above discussion on the power of buyers is some firms of the type represented by Engineering Consulting Firms. Some such firms traditionally work on massive construction projects, sometimes (but not always) commissioned by governments or other large institutions. As such, a single project can represent a significant

portion of revenue, thus reversing the balance of power between firm and client. This difference is also evident from the fact that many larger projects in the engineering consulting industry are commissioned through bid rounds, which has potential suppliers accommodating their offerings to the specifications of the client.

On average, the bargaining power of suppliers can be considered existing while not dire. A certain class of potential clients – which in the case of Engineering Consulting Firms represent the majority of the market – have more power over the firm than the rest of the market, whereas the remaining clientele represent such a small part of the overall market that they do not hold any significant power in negotiating with a service provider.

- **Threat from substitutes** – Looking at the group of Professional Service Firms defined for the purpose of this thesis, the degree to which they are able to be substituted varies quite a bit. That is however if one expands the concept of product/service substitution to include the option of simply NOT purchasing the offering at all. In this case, the five different types of firms can be grouped into two categories; one group where the services offered cannot be deselected by the customer and one where the client has the option of simply not purchasing the service to begin with. If one looks for example at accounting firms, the core services that they offer are essentially required by law for most firms and clients do therefore not have the option of choosing not to have their firm audited. The same goes for law firms, where the services offered are often vital in situations in which they would be required, e.g. a corporate lawsuit or counseling on legal issues related to a potential merger/acquisition. Finally, in the group of non-substitutable services, we find the engineering consultants, whose services are highly specialized and can be neither substituted nor deselected. Just imagine a government planning to build a airport without the professional guidance of engineering consultants. The firms in this category thus face little to no threat from substitution or rather *deselection*.

In the other category, we find firms that are somewhat more exposed to the threat of substitution or deselection. These firms provide services that theoretically can be deselected by a potential client and either managed in-house or all together not proceeded with. These types of services include management consulting, where the offered services – while sometimes paramount to the ongoing success of a company – often technically could be conducted by members of the client's own staff, even though this might lead to an inferior outcome. In this same category, we find PR firms, offering

services that are not as such *required* by the firm and which can therefore be deselected by the client if so desired.

Table 2: Threat from service deselection

Substitutable	Non-substitutable
Management Consulting	Accounting
PR	Law
	Engineering Consulting

Source: Author’s own creation

We are thus dealing with two slightly different strategic challenges: One where the services offered are mandatory for the client company, and where competition becomes a matter of winning market shares from competitors based on various differentiating factors. The other is faced with the challenge of even convincing the client that the particular service is even an attractive offering compared to simply not purchasing any services all together.

- **Competition in the industry** – Professional Service Firm have long enjoyed a high degree of differentiation in the various sectors of the industry. In effect, a specific firm has had few direct competitors as each firm has managed to carve its own niche in the market (Løwendahl, 1997). Recently, the differentiation among Professional Service Firms has however started to diminish, thereby gradually forcing firms to increasingly focus on price as a key competitive parameter. This is for example the case among Danish law firms, where price competition has been prevalent lately (Børsen.dk, 2010) just like international consulting firms have seen an increase in clients’ focus on price and value for money (Sobel, 2006). If this development continues, it will become increasingly critical for the *financial* success of any Professional Service Firm that an explicit strategic focus is formulated, so as to enable the individual firm to rise above the increasing price competition and differentiate itself, thereby maintaining the high-income business that will allow it to attract top talent to further sustain future success.

In conclusion, the conducted strategic analysis of the professional services industry shows that Professional Service Firms are faced with a number of challenges that can have implications both financially and strategically. Most critical are the challenges arising from the input dependency that Professional Service Firms face, i.e. the fact that the quality of the services

rendered is directly affected by the professionals working at the firm and how well the firm manages to motivate and retain them.

Also, the competition in the professional services sectors has increased recently, moving towards a higher degree of price competition, which directly affects not only the bottom line of the Professional Service Firm, but also its ability to offer competitive remuneration schemes in order to motivate and retain the best minds in the business which again directly affects the output quality of the services rendered.

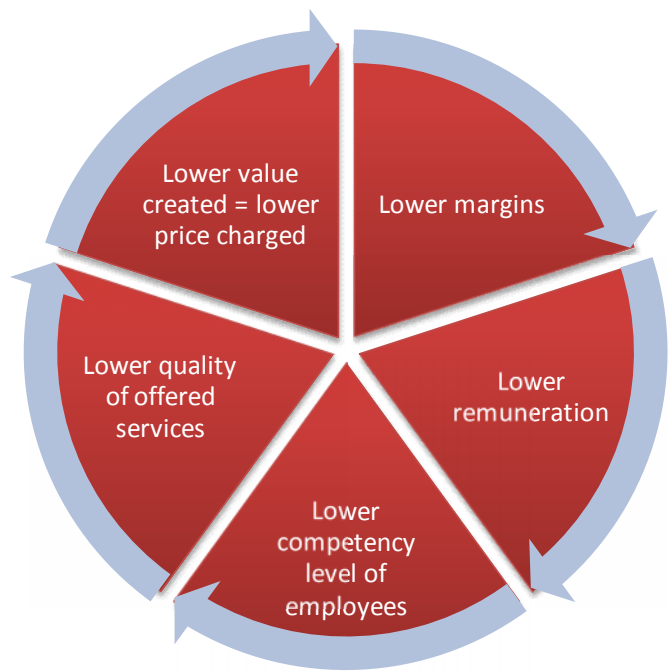
This relationship between employee competencies, output quality and market success can ultimately result in what I will refer to as the death spiral of price competition in professional services (*Figure 4: The death spiral of price competition in professional services*), which builds on Maister's motivational spiral (Maister, 1993). The spiral dictates that less competent employees will lead to lower output quality which again leads to lower margins and remuneration schemes that will result in inferior employee performance due to difficulties motivating and retaining high performing professionals. It thus follows that decreased margins can potentially result in a self-enforcing negative change for the individual firm. This challenge arises both from the general bargaining power of the employees, due to their importance, and a high degree of competition in the industry, which can lead to price competition if the individual firm does not manage to differentiate itself, in order to mitigate the risk of price pressure. It is therefore crucial for a Professional Service Firm to strive to rise above price competition so as to be able to continuously demand premium rates and attract premium minds to produce premium services.

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Additionally, Professional Service Firms face the challenge of new entrants due to the low capital intensity of the trade. However, the intangible nature of the output, which forces prospective clients to look for more indirect ex-ante proofs of quality, also means that the lack of a proven professional record that inevitably comes with being a new entrant makes it difficult for newcomers to win projects and thereby threaten the incumbent firms. Conversely, this also highlights how important it is for the established firms to maintain their leading positions by building a strong client/project portfolio that enables them to prove past performance to potential clients while providing competitive advantages by building strong relationships with their clients.

Overall, the identified challenges can be grouped in an employee perspective and a market perspective, tying it to the internal and external aspects defined in the problem identification.

Figure 4: The death spiral of price competition in professional services



Source: Inspired by (Maister, 1993)

3.4.2 A need for an explicit strategic focus

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As services cannot be pre-produced and stored, *human asset utilization* is somewhat difficult to keep at a constant level in Professional Service Firms (Løwendahl, 1997). The focus on asset utilization level, often managed in Professional Service Firms by the number of *billable hours* relative to total number of hours available, means that customer selection in Professional Service Firms often ends up being *reactive* (Maister, 1993), as proactive selling activities often take up more time than simply reacting to outside impulses, thus taking less time away from billable hours. In other words, it seems that there exists a focus on short-term optimization of asset utilization (e.g. through focus on rate of billability), which due the resulting reactive approach to customer selection might happen at the expense of long-term strategic goals of the firm.

Løwendahl (Løwendahl, 1997) also states that strategic management of Professional Service Firms was long neglected due to the inherent nature of these types of firms. The customization that is so central to professional services means that the concept of an explicit strategic plan has been viewed as detrimental to this requirement for flexibility. Furthermore, the individual professions as well as Professional Service Firms in general often build on implicit or explicit norms, demanding that the professional always puts client service before profit. As such, viewing the firm as being essentially controlled by the ad-hoc demands of the clients

renders any ex-ante strategy redundant, as it will always take second priority to the individual client needs (Løwendahl, 1997).

The reason why such a lack of strategic planning has been possible for Professional Service Firms stems from the low degree of intra-industry competition that was previously present in the professional services industries. Løwendahl argues that Professional Service Firms have generally enjoyed a high degree of (perceived) differentiation, with each individual firm being specialized within its own little niche. This has meant that firms only to a limited extent competed on specific projects, thus reducing the need for an explicit strategic approach (Løwendahl, 1997). As it became clear from the strategic analysis conducted in the previous section, Professional Service Firms today face several strategic challenges, most importantly increased competition and input dependency, which calls for an explicit strategic focus.

Løwendahl argues that in order to achieve such a focus, it requires a *conscious* managerial effort (Løwendahl, 1997). However, due to the previously mentioned flexibility that is required of Professional Service Firms, such a managerial effort must essentially be *decentralized* to allow the individual office management to accommodate their actions to the idiosyncrasies of their specific clients. The problem that arises from this setup is however that it can be difficult for a regional manager to maintain a long-term strategic focus, as the every-day issues that face him are those of asset utilization (i.e. full-time employment of professionals) and the unpredictability of meeting client demands on a daily basis

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3.5 Chapter summary

In this chapter, the theoretical foundation has been laid for the remaining parts of the paper. Firstly, the Professional Service Firms chosen as the focus for this paper were defined as knowledge intensive and having low capital intensity, which results in a significant dependency on the employees and an according shift of power, granting the professionals of a firm considerable bargaining power. A third characteristic pertaining to the theoretical definition was the professionalization of the trade, meaning to what degree it is subject to an explicit ideology and is self-regulated, as is for example the case in accounting firms.

It was also established that Professional Service Firms produce highly intangible outputs, which results in difficulties providing ex-ante quality assurance to prospective buyers. However, the degree of intangibility varies between the different types of firms, thereby also affecting how critical the challenge of ex-ante client uncertainty will be. The need to provide

this quality assurance is also mitigated by the degree of professionalization, as a professional membership in itself carries a certain amount of quality guarantee.

Adding to the challenge of intangibility is also the fact that professional services are highly relational, which additionally creates a direct bond between employee and customer satisfaction.

Finally, a strategic analysis was conducted using Porter's Five Forces, so as to identify the strategic challenges facing a Professional Service Firm today. It was argued that the main strategic challenges for a Professional Service Firm lie in the input dependency, i.e. finding ways to motivate and retain top-tier professionals, and the increasing competition in the industry, which can result in a downwards spiraling causal relationship in which lower margins lead to lower employee performance which in turn leads to lower service quality and – all things equal – even lower margins. In addition to these challenges, it was also argued that while the threat from new entrants is technically low due to low capital intensity, it is countered by the need for ex-ante quality assurance, which means that new entrants with no track-record will have a disadvantage compared to well-established firms with large client/project portfolios.

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The identified challenges could conclusively be grouped in an employee and a market perspective.

In closing, it was discussed how, in the past, an explicit strategic approach has been neglected by Professional Service Firms due to a high degree of differentiation in the market, allowing the individual firm to take a more reactive and adaptive approach. As competition increases, differentiation decreases and margins are being squeezed, having an explicit strategic focus becomes crucial for the financial and strategic success of a Professional Service Firm.

4 A review of current customer valuation frameworks

In this chapter, I seek to establish an understanding of the current frameworks for quantifying the value of a customer and the shortcomings in the context of this thesis.

4.1 How is the value of a customer traditionally assessed and where are the shortcomings?

As touched upon in the framing of this paper, quantifying customer profitability has been a discipline for over 40 years (Gleaves, et al., 2008) and is therefore a well established academic subject. In this section I will explain the current state of customer profitability assessment, i.e. what techniques are commonly used, and what appears to be the shortcomings of these frameworks in the context of this paper.

4.1.1 Determining the value of a customer – the existing frameworks

The most commonly used profitability measures can essentially be sorted according to two parameters, namely their scope and timeframe, as illustrated in *Table 3: Different customer profitability frameworks*. As to the timeframe, the measures fall into two overall categories, namely the ones that focus on customer profitability for a single period and the ones that quantify customer profitability for all future periods (Gleaves, et al., 2008). The single period measures are fairly straight forward, as they will in effect sum up to that period's operating profit when adding together the value of all individual customers.

The individual customer profitability can be calculated in a number of ways but will often be calculated using Activity-Based Costing (Gleaves, et al., 2008), which all things equal provides a more true picture of profitability by assigning costs to where they are actually generated rather than through often arbitrary overhead allocations. This is done by analyzing resource consumption based on activities that are tied to company processes (Kaplan, et al., 2004). Through Activity-Based Costing, it will thus become clear to the analyst if a particular client is significantly more resource heavy, demanding more resources than what the generated revenue warrants. By highlighting the profitability of the individual customer relationship, this measure provides an opportunity to optimize both the individual customer account as well as the overall customer portfolio.

When quantifying the value of a customer for all future periods (Customer Lifetime Value), one looks to estimate the total cash flow generated throughout the entire client relationship (Ryals, 2008). This is done by estimating the customer's purchasing behavior throughout the

relationship and then calculating the profit generated during the various periods based on the historic profit margins obtained through the single period customer profitability calculations. However, one needs to be aware of any potential changes to the client relationship and change the profit estimates accordingly. For example, it might be appropriate to increase future profit estimates by lowering estimated future sales costs, if the historic customer profitability measure pertains to a newly established relationship, where a disproportional amount of time has been spent establishing the relationship, time that is not required going forward. In other words, acknowledging the life cycle of a relationship has implications of the calculation of future cash flows.

The calculated profit estimates are then discounted using the appropriate discounting rate to arrive at a net present value of the customer relationship. If the net present values of all the company’s customers are aggregated, it will result in what is known as a company’s Customer Equity.

Table 3: Different customer profitability frameworks

	Single period	All future periods
One customer	Customer profitability	Customer Lifetime Value
All customers	Operating profit	Customer Equity

Source: (Gleaves, et al., 2008)

4.1.2 Shortcomings of customer value measures

While the described frameworks comprehensively cover the conventional financial gains pertaining to a customer, it is often argued that they fail to grasp the full value of a customer relationship (Gleaves, et al., 2008). Factors such as positive influence on other customers (e.g. (Stahl, et al., 2003)) and the potential reputational value of a customer (Ryals, 2008) have been argued to be relevant in calculating the total value of customer relationships. When one ignores factors such as these, it can result in a less than complete picture of the profitability of the customer portfolio, which can in turn lead to inferior strategic dispositions in choosing which clients to focus additional resources on and which clients to spend fewer resources on.

Consider the following example: A company is looking to allocate organizational resources between two customer accounts, pertaining to Customer A and Customer B respectively. Based on conventional Customer Lifetime Value calculations, Customer B represents a net present value of DKK 3.200.000 while Customer A represents a net present value of DKK 2.900.000. Based on these figures, the company would draw the logic conclusion that Com-

pany B is more valuable and therefore allocate more resources to maintaining the relationship with that customer.

But what if this traditional measure did not include all the value drivers pertaining to the two clients? In that case, if one were to focus solely on conventional customer value measures, the results would only show a partial picture and thereby potentially lead to a decision to down-prioritize the most profitable relationship. In other words, conventional customer value frameworks risk undervaluing the customer relationship (Ryals, 2008).

The problem with the above point is the validity with which it is in fact possible to assess the value of e.g. these indirect values. The problem of proving a direct link between revenue streams and indirect value drivers such as referrals can be difficult if not impossible (Ryals, 2008) and for this reason, these indirect value parameters have yet to meet the measuring standards of the management accountants responsible for the quantitative calculations of customer value (Gleaves, et al., 2008). Only recently has an academic discussion been initiated, taking a critical approach to which factors to include in the calculations of customer value and how to quantify these measures. Due to the inherent qualitative nature of these factors and the initial stage at which the discussion is presently taking place, no consensus has yet been established so as to actually expand the concept of quantitative customer value (Gleaves, et al., 2008).

There is therefore significant room for improvement in using the concept of customer value in a strategic setting – especially when looking at Professional Service Firms. As it has already been established, these types of firms are inherently highly relational, making the indirect value drivers pertaining to customer relationships even more important, both financially and strategically. While the specific factors will be identified in the following sections, the point to be made here is thus that, while it has been established that there exists a strategic and financial imperative for Professional Service Firms to take a more strategic approach to the market, at their current state, customer value frameworks do not allow for a value assessment in accordance with this more strategic customer/project mindset.

5 Strategic value of customers – the employee perspective

In this part of the paper, I will discuss the various ways in which customer and project characteristics influence the long-term success of a Professional Service Firm through affecting employee motivation, retention and performance. I will begin with a generic discussion of relevant organizational and motivational theories. Based on this theoretical foundation, I will proceed to discuss how one can enhance professionals' performance through a strategic focus on customer and project characteristics. This perspective is based on the need of Professional Service Firms to address the strategic challenge of employee (supplier) dependency.

5.1 An organizational approach

Organizational theory has come a long way since its birth in the early 20th century industrialization, during which organizations were considered production functions and employees simply another input variable to be manipulated and optimized (Jacobsen, et al., 2004). Even so, organizational theory is still struggling with the concept of knowledge intensive firms such

The superior bargaining position that professionals have is interesting from an organizational perspective, as it makes coordination significantly more challenging. Cyert & March viewed the organization as a myriad of coalitions and interest groups all striving to further their own interests (Jacobsen, et al., 2004). According to them, the role of the firm is to contain conflicts and align individual interests so as to further cooperation. As difficult as this might normally be, the amount of power shifted to the professionals in Professional Service Firms makes it even harder. As Teece puts it, the coordination of numerous actors with potentially divergent interests becomes particularly interesting in companies like Professional Service Firms where the professionals almost can “*write their own check*” (Teece, 2003). The implication of this knowledge-driven imbalance of power is that the role of the firm becomes less that of *organizing* and more one of *motivating*. In the following sections, I will therefore address the issue of motivation in Professional Service Firms, first by presenting a body of generic motivational theory and secondly by applying the concept of motivation to Professional Service Firms.

5.2 Motivational theory

As the focus of this paper is the strategic value of customers, it is beyond the scope of this paper to look at e.g. monetary incentive schemes or partnership plans, but this does not mean that they do not play an important part in the attraction, motivation and retention of top performers in Professional Service Firms.

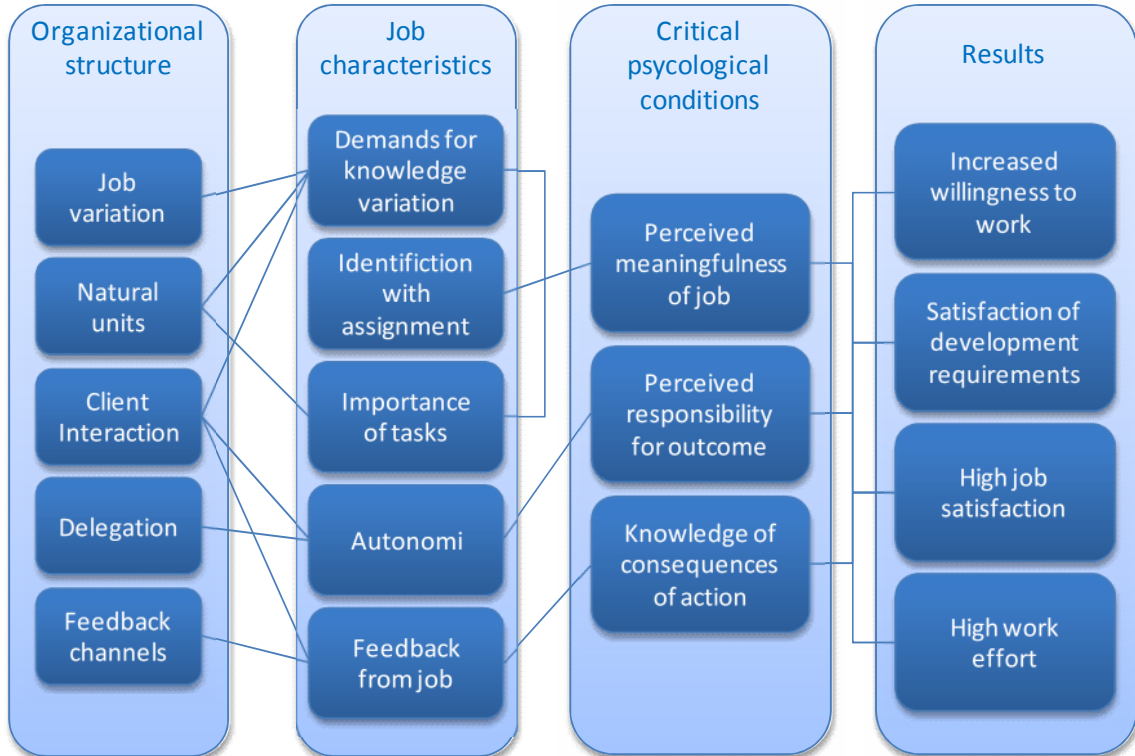
That being said, there are also strong theoretical arguments for why those types of motivational tools might not be the most important factors when aiming to motivate and retain professionals. These types of incentives are often referred to as *external* incentives, as they share the common denominator that they are granted by an external “force” such as an employer. While this is definitely important, research shows that these external motivational factors might not be as important as the *internal* incentives, i.e. the more emotionally driven motivational factors. An important theorist on this subject is Frederick Herzberg, who made a distinction between *hygiene factors* and *motivational factors* (Hein, 2009).

According to Herzberg, hygiene factors are the conditions that need to be present in order for the employee to not be unhappy in his job. In other words, hygiene factors do not make a positive difference by their presence but the lack of these factors will conversely make a negative difference in attracting, motivating and retaining employees. Among the factors that Herzberg considers in this category is salary, status and job security.

Contrary to the hygiene factors, motivational factors do not make a negative difference if they are not present but instead, they make a positive difference by their presence. Among the factors that are considered motivational by Herzberg is recognition, job content and personal performance. Herzberg’s argument is thus that the presence of hygiene factors is a prerequisite for the employee to even desire to work at a company whereas the motivational factors affect the employees’ desire to work harder and better. All this is summed up in *Exhibit 4: Herzberg's taxonomy for employee motivation*.

Another theory that also argues that the more qualitative aspects of a job matter in terms of motivation, is that developed by Richard Hackman and Greg Oldhan (Jacobsen, et al., 2004). Their theory links employee motivation to certain psychological conditions that are in turn linked to characteristics of the job which is then again linked to the underlying organizational structure.

Figure 5: Hackman & Oldhan's motivational model

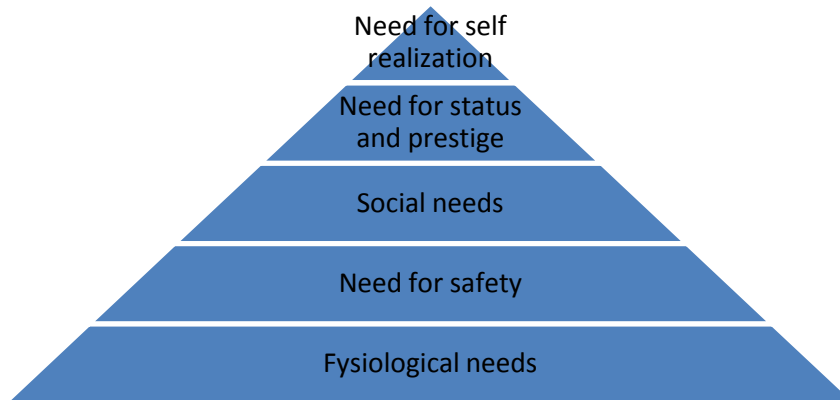


Source: (Jacobsen, et al., 2004)

As the figure shows, characteristics of the job such as the variation of the tasks, the knowledge required to perform them, the importance of the job and the autonomy that is granted to perform it, all play a central role in making the employee feel that the job he/she performs is meaningful. These factors also give the employee a sense of responsibility for the outcome and a feeling that the cause-effect relationship between the actions performed and the results achieved is clear. If these psychological factors are in place, Hackman and Oldhan argue that it will manifest itself in higher employee motivation and satisfaction (Jacobsen, et al., 2004).

Finally, Abraham Maslow has presented a very famous theory about the hierarchy of human needs, which also point towards the importance of the more quantitative aspects of a job. Maslow ordered the human need into hierarchical order, starting with the basic needs that every human being has in order to survive (thirst, hunger etc.) and ending up with the need for self realization, which is the ultimate need. The point of Maslow's hierarchical order is that the lower ranking needs will usually have to be satisfied before the need on a given level will be pursued. Maslow did however acknowledge that the exact order of the needs and the degree, to which lower ranking needs will be satisfied before higher ranking needs will be pursued, will vary from individual to individual (Hein, 2009).

Figure 6: Maslow's pyramid of needs



Source: (Jacobsen, et al., 2004)

Even though Maslow's theory was not designed to be applied in a business context, it has been widely used in just that. Assuming that most people are capable of satisfying the first three levels of needs, the implication of Maslow's pyramid would be that what employees are looking for in a job is *status and prestige*. Jakobsen & Thorsvik further point out that the concepts of *status* and *prestige* do not only cover external displays of these, but also an internal sense of accomplishment (Jacobsen, et al., 2004).

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5.2.1.1 Motivational theory in summary

Based on the discussed theories, I believe it is fair to assume that a major motivator in any type of firm is the job content, i.e. what kind of challenges and people an individual is faced with. In the following section, I will apply these findings in the context of Professional Service Firms in order to determine more specifically which aspects of the job would appear to be the most important sources of motivation and retention for a Professional Service Firm. In other words, what client and project characteristics should be sought out when strategically evaluating customers and projects?

5.3 Motivation in Professional Service Firms

As established, motivating and retaining top-tier professionals is crucial to the success of any Professional Service Firm. This can however be a challenging task, as most professionals are very demanding in what they expect out of a job.

Furthermore, the employee switching costs in Professional Service Firms are very low, as previously discussed. The answer to this problem is often the use of contracts or non-transferable benefits such as partnership or the promise of a such through reputation-building within the firm (Teece, 2003). While these measures might tie the professional to the firm,

other parameters need to be considered in order to motivate the professional to deliver high-quality services.

5.3.1 Motivating professionals

The challenges of motivating professionals are somewhat different than when looking to motivate other categories of employees. The reason for this is the fact that professionals are as people very conscientious and high-performing, something that is evident for example in Lorsch & Tierney's definition of professionals as *highly motivated, intelligent and ambitious people* (Lorsch, et al., 2002). Maister also notes that professionals are very dutiful, always working on the assigned problems, even when these are of no particular interest to them (Maister, 1993). Maister further notes that Professional Service Firms often focus on personal drive when recruiting new employees, which would imply that a certain base level of motivation and drive is present in all employees of Professional Service Firms. As such, the issue of motivation in Professional Service Firms becomes less about motivating the employee to work and more about motivating the employee to work at your company. According to Maister, the motivation of professionals is thus not about making them work but instead making them excited about working by creating *excitement* for the job (Maister, 1993).

5.3.1.1 Constant challenges

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One way to do so is by constantly challenging the professional, in order to create a feeling of personal development and variation that Hackman & Oldhan highlight in their motivational model.² Maister describes the typical professional as someone who easily gets bored and gets impatient and loses interest in something once he/she feels like that particular task has been mastered (Maister, 1993). In the same way, Lorsch & Tierney note that one of the central aspects that a professional looks for in a job is to learn through constantly challenging projects (Lorsch, et al., 2002).

Lorsch & Tierney's focus on the learning aspect of challenging assignments also highlights another important aspect, namely that of capability development. As mentioned earlier, a Professional Service Firm is among other things characterized by its low capital intensity and resulting high dependence on human assets. It therefore follows that aside from hiring new people, the only way for a Professional Service Firm to improve or extend its asset base in order to gain long-term competitive advantages, is to build on the knowledge base already

² See Figure 5: Hackman & Oldhan's motivational model

present³. In other words: Teach your employees new skills! As such, a challenging project can lead to firm innovation if it calls for a completely new solution to a known problem or a solution to an altogether new type of problem. When such a innovative solution is reached during the course of a project, Simmie & Strambach point out that the Professional Service Firm can attempt to generalize the solution and sell it in adapted form going forward (Simmie, et al., 2006).

I do however believe it to be important to distinguish between the concepts of challenging and innovative and note that a challenging project need not be innovative whereas an innovative project will almost always be challenging. As an example, imagine an accounting firm with vast experience in auditing small and medium sized companies in the energy sector. If the firm gets a new client, which is also in the energy sector but is significantly larger than the companies that the firm has previously audited, the project will most likely be challenging for the accountants. But while such a project will give the firm valuable experience in handling larger clients, it is hardly a project that can be characterized as innovative.

As Boone et al. point out, professionals do not learn the same way employees in most other industries learn. Whereas learning is traditionally created through repetition, the customized nature of professional services means that the learning process is rather tied to “insights gained from prior projects” (Boone, et al., 2008). They further found that the rate of a Professional Service Firm’s learning curve is directly proportional to the variety of projects that the firm has undertaken in the past. It thus follows that in order to further the learning, or capability development, of a Professional Service Firm, one must focus on the variety of projects undertaken. And since it can be argued that a lower degree of project variety leads to repetition, which then in turn leads to less challenging work for the professional, I will argue that the focus on variety in the project portfolio can be set equal to a focus on the challenging nature of the individual project.

5.3.1.2 Work to be proud of

Besides the desire to learn and evolve professionally, Lorsch & Tierney also claim that professionals look for their job to boost their careers (Lorsch, et al., 2002). As mentioned earlier, switching costs for employees are quite low and perhaps as a result, job hopping in Professional Service Firms is quite common (Teece, 2003).

³ Hiring new professionals is obviously an option but is outside the scope of this paper c.f. section 1.3 Delimitations

For the individual professional, the desired career path will determine what particular characteristics of a project or a client will be relevant in order to further his/her career. Therefore, engaging in an in-depth discussion, as to what client and project characteristics will be interesting in terms of motivating high-performing professionals, is futile, since these characteristics will vary based on the individuals career aspirations. I would however argue that there is one customer characteristic that could potentially be attractive to any professional regardless of career plans: to work with clients that are highly respected and well known, both in their industry and by Professional Service Firms catering to that industry.

Such well-renowned clients are valuable to any kind of firm, something that will be discussed more in-depth in section 6 *Strategic value of customers – the market perspective*. I would however argue that the intangibility of the services rendered by Professional Service Firms, which makes it hard to document quality and content when selling to new clients, also makes it hard for a potential new employer (i.e. “buyer” in the input market) to assess the work of a potential hire. But just as in the output market, a well-known client will create a certain reference framework within which the “buyer” can relate to the work performed by the potential employee.

This means that targeting prestigious clients will not only yield a strategic advantage in the *output* market (which will be discussed in detail in a later section) but also in terms of motivating professionals. The implied uncertainty as to the validity of this argument stems from the fact that, to my knowledge, no academic discussion on the subject has been conducted. As it might be apparent, this point is therefore solely based on logical reasoning based on the established characteristics of professionals. I will therefore look to support this assumption through my empirical research, which will be discussed in a later section.

5.4 Chapter conclusion

In this chapter, I have sought to identify the factors that from a theoretical point of view are of strategic and financial importance from the internal or *employee perspective*. Firstly, it was discussed how professionals are considered to be intellectually restless types, who constantly seek new challenges. As such, in order to motivate and retain these individuals, it is important to consistently challenge them through varying projects that will not allow the professionals to feel stagnant in their development.

Focusing on challenging projects is also important from a resource-based perspective, as the employees essentially represent the entire asset base of a Professional Service Firm. If a firm

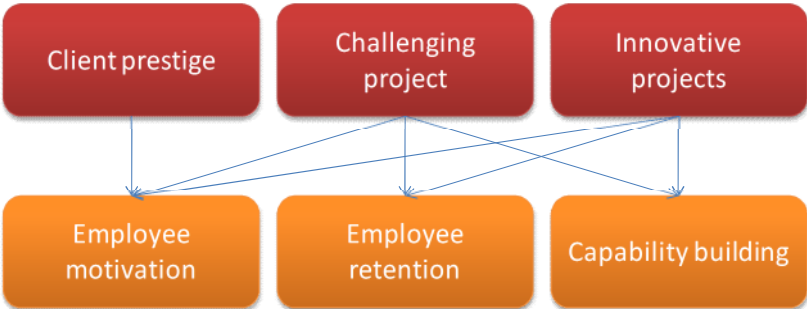
is looking to improve its asset base, this basically means (in the scope of this paper) furthering the acquisition of new skills for your current employees. Due to the reactive and flexible nature of professional services, it is however hard for professionals to learn by repetition, which is usually the case in learning theory pertaining to more traditional industrial businesses. Therefore, professionals learn at a speed and effectiveness directly proportionate to the number and diversity of assignments that they have undertaken in the past. As such, both from a motivational as well as a human asset management perspective, ensuring that professionals are constantly challenged is of the utmost importance.

It is however important to remember that a challenging project is not necessarily the same as an innovative project. The importance of innovative projects was discussed separately, as these have some subtle differences that were exemplified in the preceding section. While challenging projects can be within an established area of expertise, innovative projects will challenge the professional within a competency area which is entirely new to him/her. The difference between a project that is merely challenging and a project that is both innovative and challenging is that the latter will not only present a learning opportunity and motivate the professional but also enable the firm to gain access to completely new capabilities that might enable them to position themselves in a new market or more efficiently deliver similar projects in the future.

Furthermore, it was discussed how prestigious clients will improve employee motivation. This argument was essentially based on Lorsch & Tierney’s point (Lorsch, et al., 2002), that professionals often look for a job to potentially further their career in the future.

Overall, the client/project characteristics identified as being of value to the Professional Service Firm are summed up in *Figure 7: Strategic advantages of clients from the employee perspective*.

Figure 7: Strategic advantages of clients from the employee perspective



Source: Author’s own construction

6 Strategic value of customers – the market perspective

In this section of the paper, I will discuss factors related to the extrovert dealings of a Professional Service Firm, i.e. factors that can improve the company's competitive position in the marketplace. As discussed, this perspective is built on the need of Professional Service Firms to overcome the inherent intangibility of the offered services, increased price competition and low entry barriers.

6.1 Customer satisfaction and loyalty

Customer loyalty and satisfaction are not characteristics of the individual client/project as much as results of the actions of the Professional Service Firm. While this section therefore does not aim directly at the final framework, it does however have some important strategic implications in the context of this paper.

6.1.1 Generic theory on customer purchasing behavior

How a customer acts is mainly focused on *purchasing behavior*, i.e. to what extent a customer is likely to engage in *repeat purchasing* of a company's products or services. Repeat purchasing is characterized by the customer automatically choosing a particular company as vendor whenever faced with the choice, without the need for persuasion on the part of the company (Griffin, 1995). From the perspective of the company in question, this repeat purchasing behavior of a loyal customer has several positive implications, all of which create value for the company. First and foremost, the predisposition of the customer to choose the same company every time means that the company does not have to spend the same amount of resources during the sales process, which (depending on how costly the sales process is) can result in significant cost savings, increasing the profitability of the customer. Secondly, the loyal predisposition of the customer implies that he/she becomes less price sensitive, as the preference for a certain vendor means that a mere price difference is not enough to lure the customer to a competitor (Griffin, 1995). With lowered price sensitivity, the company even has the ability to charge a price premium for its products or services, which will then again increase company profits (Reichheld, et al., 1990). Finally, a customer that keeps coming back over time will allow the company to become increasingly efficient in servicing the customer, which will *ceteris paribus* reduce operating costs and thus increase customer profitability.

In the context of this paper, these factors are already covered in the sense that they will be included when calculating the lifetime value of a customer. As discussed in section 4.1.1:

Determining the value of a customer – the existing frameworks , both the decreasing sales costs, potential price premium and lower production costs are quantifiable measures that can be factored in when estimating the accumulated profits of the entire customer relationship. The behavioral aspects of customer loyalty do however provide an interesting jumping-off point for continuing the discussion in the context of Professional Service Firms!

6.1.2 Purchasing behavior in the context of professional services

While the financial implications of customer loyalty are included in the established measures of customer value and therefore not of further interest throughout this paper, the behavioral aspects of loyal purchasing behavior are of interest from a strategic perspective. However, the nature of the Professional Service Firm changes the importance of loyal customers as otherwise discussed above. As it has become evident from the previous discussion, purchasing behavior in the context of the “traditional” theory revolves around repeat purchasing, implying a repetition of an almost identical sales process, i.e. buying the same product or services time after time. When talking about professional services, it is however difficult to come to terms with a concept such as repeat purchase, since professional services are almost always customized, making every purchase unique (Løwendahl, 1997). It therefore makes more sense to talk about *retained clients* (Lorsch, et al., 2002) rather than repeat purchasers, when looking at Professional Service Firms.

So why is customer loyalty so important in Professional Service Firms? Several unique characteristics of the trade mean that focusing on creating stabile long-term customer relations of great importance for the individual firm.

Even though lower sales costs has been discussed and identified as part of the quantifiable measures included in the calculations of Customer Lifetime Value, it is still worth noticing the particular importance that these savings have in a professional service context. The reason is that the human assets dependency of Professional Service Firms means that time spent selling is time taken directly from hours that could have been billed to customers and therefore created additional revenue for the company (Lorsch, et al., 2002). Increased customer loyalty, which should then increase the predisposition of the customer to choose the Professional Service Firm in the future without further ado, will thus increase the number of hours available for billable activities, thereby increasing the revenue potential and *ceteris paribus* profits of the company.

Most important is however the ways in which customer loyalty and satisfaction can address the strategic challenges identified in section 3.4.1: *The strategic landscape of Professional Service Firms*.

Crosby (et al) notes that customers are likely to make long-term relational commitments “*in order to reduce... the uncertainty of future benefits*” (Crosby, et al., 1990), something that is highly relevant given the intangibility of professional services. They go on to stress the importance of *relationship quality* as a driver of customer loyalty, measuring the quality of a relationship as a combination of *satisfaction* and *trust* based on past interaction (Crosby, et al., 1990). Thus, if past projects have been delivered satisfactorily, it will all things equal result in improved relationship quality in the form of satisfaction with and trust in the competencies of the delivering professional(s), which will increase the likelihood of the customer seeking future engagements with the firm (Crosby, et al., 1990). As such, it would seem the intangibility of professional services makes past experience with a firm a very important determinant in any future choice of Professional Service Firm, making successful projects and close customer relationships of the utmost importance in mitigating quality unpredictability and providing sustainable competitive advantages, countering the low entry barriers of the trade.

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Finally, another way in which the retention of clients and the following improvement of the client-professional relationship create value is through a better understanding of the client business (Lorsch, et al., 2002). Through this better and more detailed insight into the client business, it becomes possible for the Professional Service Firm to deliver its services more efficient and with better results, reinforcing customer satisfaction and trust and thereby increasing customer loyalty, as discussed above. It thus becomes apparent that the quality of a relationship will be somewhat self-sustaining over time.

6.2 Customer advocacy and referencing

This section will discuss the potential value of a customer, not focusing on the behavior of the customer in relation to the Professional Service Firm itself, but instead of the customer’s role in the marketplace, as a direct as well as indirect sales asset.

6.2.1 Customer advocacy

An advantage typically associated with customer loyalty is the potential for positive *word of mouth* (Griffin, 1995). Word of mouth, also referred to as *customer referral* or *advocacy*, is the case in which a satisfied customer recommends a company to other potential customers

and through these recommendations creates additional business for the supplying company (Reichheld, et al., 1990)

The incentive for a customer to recommend a company is two-fold (Griffin, 1995), namely 1) to keep the recommended company in business, due to self-interests related to expected future dealing with the company, and 2) the possibility of gaining positive stature if the recommended company performs well for the referred client. When a customer refers a potential new customer to a company, it thus puts its own reputation on the line, betting that the company in question will live up to expectations when dealing with the referred customer. As such, the possible gains the referrer stands to gain if the recommended company lives up to expectations come with the risk of an equal loss of credibility if the recommended company falls short of expectations. It thus becomes imperative for creating customer advocates that the potential advocate feels somewhat certain that the company will provide the expected level of quality. The lack of trust in this regard is according to Griffin the main inhibitor of customer recommendations and conversely makes closeness and trust as prerequisites for customers being willing to recommend a company to a peer (Griffin, 1995). The importance of trust and the difficulty of establishing it (Walker, et al., 1998), means that customer advocacy according to Griffin (Griffin, 1995) is the ultimate stage of customer relationships, requiring a high degree of relationship quality c.f. the previous discussion on the subject. The fact that high quality customer relationships are of the utmost importance in creating customers that are willing to recommend your company to potential customers, is also pointed out by Halinen in Bagdoniere et al (Bagdoniene, et al., 2007), who states that “*only long-term relationships produce strategic advantages such as referrals...*”.

The value of customer referrals is generally that of creating new business opportunities, without any effort required by the company. In other words, a referring customer is to be considered largely responsible for a certain amount of revenue generation if the referral provided by the customer is assumed to be by and large responsible for one or more new customers hiring the company (Ryals, 2008). Furthermore, the profitability of these new customers, generated through referrals, would supposedly be higher than the average profitability of customers generated through normal sales activity. The explanation is that referrals establish new customer relationship while requiring significantly less selling time on the part of the company (Griffin, 1995). All things equal, the total profitability of a new customer generated through word-of-mouth will be higher than that of a customer generated with a higher sales effort from the company.

The value of client advocacy also lies in its contribution to building the firm's reputation by providing information on past deliveries (Rob, et al., 2005). As "*a good reputation is hard to replicate*" (Walsh, et al., 2007), advocacy thus helps the firm create a *sustainable competitive advantage*.

The very nature of customer referrals, i.e. creating new business and building reputation without the interference of the company, is also the very characteristic that make them so dangerous not to grasp completely. Jalkala & Salminen (Jalkala, et al., 2010) refer to word-of-mouth as an *informal type of market-level interaction*, which is essentially uncontrollable for the company. This uncontrollability can be devastating to a company's reputation in the marketplace if the word-of-mouth generated should happen to be negative. As Griffin puts it (Griffin, 1995): "*Negative comments can render worthless the most massive marketing blitzkrieg.*" It would thus seem that, as important as it is to create high quality relationships with existing, satisfied customers in order to create positive word-of-mouth about your company, it is just as important (if not more!) to make sure to mend any broken relationships, so as to prevent a disgruntled (ex)customer from spreading negative comments about your company.

6.2.2 The importance of customer advocacy in Professional Service Firms

As it has already been discussed several times throughout the course of this paper, professional services are inherently intangible. As it becomes hard for a potential customer to assess the output quality of a prospective professional service provider, other ways of sorting through the jungle of Professional Service Firms naturally become more prevalent. One result of this is that most professional work is generated by word-of-mouth (Lorsch, et al., 2002). So as important as customer referrals are to almost any business today, they are *especially* important in professional services (East, et al., 2005). Conversely, Professional Service Firms stand to lose significantly more if dissatisfied customers spread negative rumors about the service quality of a company to potential clients.

Achieving positive customer advocacy creates not only financial value generated by additional (and often more profitable) business, but also strategic value in that it helps counter the low entry barriers of the industry through shaping the overall reputation of the firm. This reputation also allows for differentiation to prevent price competition and the potential negative consequences hereof, as per *Figure 4: The death spiral of price competition in professional services*.

The fact that customer advocacy is hard to achieve and requires the highest levels of relationship quality is in some ways almost an advantage for Professional Service Firms. Since professional services are relational in their nature, creating a close bond with the customer and establishing trust between the parties is not a side bonus to an otherwise long and financially fruitful relationship, as it might be the case in industries of a more physical nature. In the professional services industry, a close bond and trust between the professional and the client is in fact a prerequisite for even doing business. Therefore, customer advocacy – good and bad – would be expected to be frequently observable as well as highly effective in a professional service context, making it all the more important to have an explicit focus on this when assessing the value of customers.

6.2.3 Customer referencing

Customer referencing is the ways in which companies communicate the nature of prior or current projects or clients to external parties (primarily potential customers), in order to gain some measure of legitimacy through these past undertakings (Scalet, 2002). Referencing is thereby similar to customer referrals in that it leverages existing customer relationship to improve firm performance. They are however fundamentally different in nature, with customer referrals being an uncontrollable pattern of behavior (as discussed above) while customer referencing covers company-initiated activities (Jalkala, et al., 2010). In other words, while a company cannot control how a customer acts or who the customer talks to and about what, it is completely within the company's control to which degree it explicitly presents e.g. a list of clients with a high degree of recognition or a written out story describing the successful delivery of a product or service.

The value created by customer references is as mentioned that the company gains legitimacy by proving through past deliveries that it is capable of future deliveries. In other words, providing customer references means providing evidence of past experience while concretizing and demonstrating solutions and competencies within a certain field (Jalkala, et al., 2010). Finally, reference will in the case of reputable customers be able to result in a status-transfer from the customer to the company (Jalkala, et al., 2010), thus positively affecting the company's reputation.

All these factors sum up to help reduce the ambiguity related to the total value of the offering (Anderson, et al., 2010). By providing this value evidence, references thereby reduce the per-

ceived risk and uncertainty that exist in the purchasing situation from the perspective of the potential buyer (Jalkala, et al., 2010).

6.2.4 Customer references in Professional Service Firms

The role of customer references in overcoming uncertainty and perceived risk in the purchasing process obviously becomes even more important when the market is characterized by a high degree of uncertainty (Jalkala, et al., 2010). As such, customer referencing would appear to be especially important in a professional services context where the output is inherently intangible, as already discussed extensively (see 3.2 *A general discussion on Professional Service Firms*). The ability of customer references to concretize not only past solutions but also the way in which these were delivered gains significant importance in Professional Service Firms, where a company differentiates itself as much in the delivery process as in the final service delivery. By providing proof of a professional *track record*, a Professional Service Firm can earn the trust of a prospective client in the competencies of the Professional Service Firm (Walker, et al., 1998), thereby addressing the fundamental obstacle of professional service selling, namely that professional services inherently are sold on a promise (Bagdoniene, et al., 2007).

6.3 Chapter summary

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This chapter has established the value represented by a client or a project from a market-oriented perspective as well as touching upon the value created by establishing satisfaction and loyalty in the client relationship.

While customer loyalty and satisfaction are not as such characteristics of the individual client/project as much as results of firm actions, they were included so as to stress the strategic value of achieving these. It was thus discussed how client satisfaction and loyalty, driven by past successful engagements, increases the client's predisposition to choose the Professional Service Firm for future services, which increases the firm's resistance to the low entry barriers previously identified. Furthermore, it was argued that successful relationships will be self-sustaining, as increased satisfaction will result in increased trust which in turn results in an increased ability of the Professional Service Firm to gain better knowledge about the client and thereby delivering more successful services.

The discussion on customer references and advocacy showed the value created by these in serving as a sort of indirect proof of the quality of past service deliveries, so as to mitigate the complications of output intangibility. Also, the discussion on customer advocacy once again

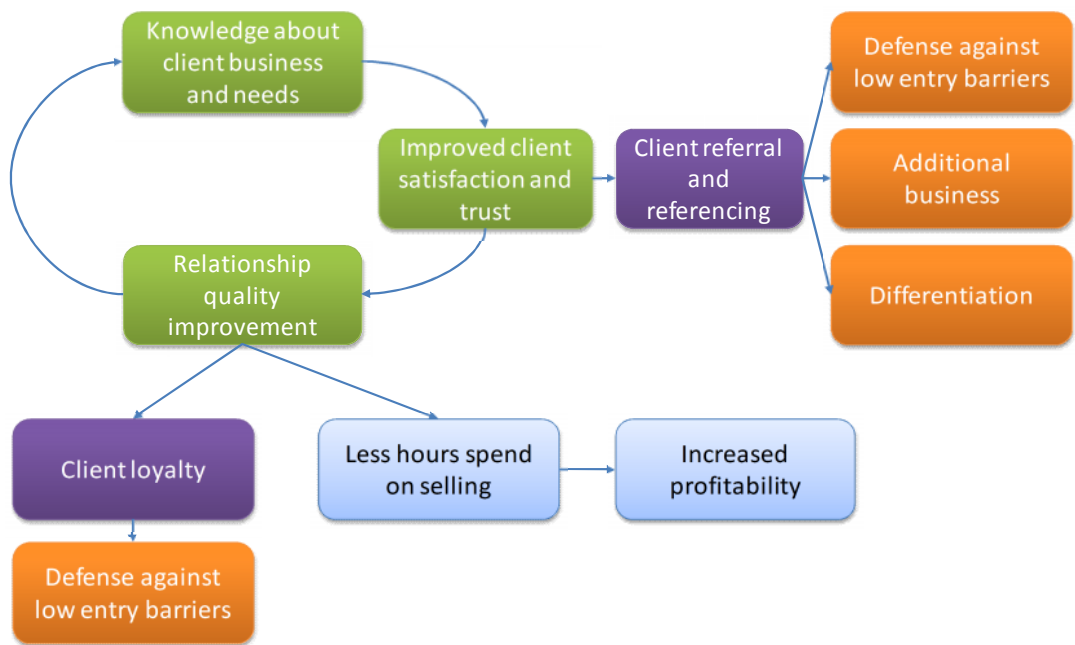
underlines the importance of relationships in professional services, as this behavior can only be achieved through a high degree of client satisfaction and trust.

The value created through both referrals and references is that of new sales or in other words, higher sales and increased company performance. Furthermore, the generation of business by leveraging existing customer relationship also means that the acquisitions costs for these new customers will be lower than otherwise, thus increasing the profitability of the new customers and – all things equal – increase overall firm performance. In addition hereto, customer advocacy (and to some extent references) affects the firm’s overall market reputation, which – in case of a positive effect – means that additional strategic value is created inasmuch as a positive reputation creates a competitive advantage against the low entry barriers of professional services and increases the basis for differentiation, thus preventing the risk of price competition.

A final note on customer referrals and references is the difference that exists in the controllability of the two phenomena. Whereas customer references are completely controlled by the Professional Service Firm, customer referrals are the result of client behavior and as such outside the control of the firm. Customer referrals can therefore both be valuable and dangerous, as positive as well as negative word-of-mouth can occur, depending on the particular client’s view on the Professional Service Firm.

The various points discussed in this chapter are summarized in the following figure:

Figure 8: Strategic advantages of clients from the market perspective



Source: Author’s own creation

7 Empirical data collection, analysis and interpretation

This chapter will present the empirical data gathered for the purpose of this thesis. The chapter will begin with a short description of the purpose of the empirical data gathering, followed by an explanation of the methods used throughout the data-gathering process. After this foundation has been established, I will proceed to guide the reader through the questionnaires while providing the reasoning behind the questions and the structure. Finally, I will analyze the results of the questionnaires, based on some measure of statistical analysis, and compare them to the theoretical discussions that preceded this chapter while implementing views and comments from the interviews in the discussion.

7.1 Purpose of the empirical data: Supporting the assumptions

The purpose of this empirical data gathering has been – as indicated in the above heading – to support the theoretical assumptions made so far and assess to what degree this theoretical framework is actually mirrored in the conceptual mindsets of Professional Service Firms today. In other words, to what degree are the related factors that I have so far identified as being of strategic value to Professional Service Firms, considered to be of importance by actual professionals and their clients? To achieve this, I have conducted both quantitative and qualitative empirical data gathering in the form of online surveys and personal interviews. In the following, I will describe the purpose of each of these.

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7.1.1 Quantitative data

As previously stated, the subject of this paper is to a certain extent roaming in previously unexplored territory. This quantitative empirical study is therefore not meant to be a statistically significant and valid support of the importance of the proposed factors, but instead meant to serve as a first attempt – a scratching of the surface, if you will – at determining the current patterns of practice and thinking of Professional Service Firms and their clients.

In order to achieve this, I have conducted two surveys – one aimed at clients of Professional Service Firms, and one aimed at employees of Professional Service Firms. The purpose of the former is to examine how the proposed market factors actually affect prospective clients' purchasing decision while the latter survey serves to examine both to what degree the proposed organizational factors actually matter to professionals but also to what degree they perceive the market factors to be influencing the purchasing decision.

The results will present an indicative ranking of the factors, as some factors will score higher on importance than other.

7.1.2 Qualitative data

Qualitative data for the thesis has been gathered in the form of personal interviews focusing both on the market factors and the employee factors. The interviews are not meant to serve as a case but merely as a validation of the quantitative results.

As such, the interviews will not be analyzed explicitly but instead be implemented when relevant throughout the remainder of this paper. When discussing the relative importance of the various factors, I will thus proceed to apply excerpts from the conducted interviews, so as to qualify and explain the results of these surveys.

Table 4: Interviewee overview

Name	Company	Company type	Position	Perspective
Anders Kold	Koompany	Management Consulting	Partner	Employee Perspective
Knud Høgh Knudsen	I2r	Engineering Consulting	Senior Engineer, Project Manager	Employee Perspective
Rasmus Møller	COWI	Engineering Consulting	Executive Assistant	Employee and Client Perspective

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7.2 Framework for gathering and analyzing data

In this section, I will take the reader through the questionnaires designed to gather data and the approach taken in analyzing this data. For a discussion on the methodological choices underlying this approach to data gathering and analysis, I refer the reader to the dedicated methodology section (Section 2: General methodology).

7.2.1 Building the survey frameworks

In this section, I will discuss the overall rationale for constructing the questionnaires in the manner chosen. For a full review of the question frameworks, I refer the reader to *Exhibit 6* and *Exhibit 7*. Generally, the applied frameworks were chosen so as to test the proposed factors against the practices carried out by professionals and clients alike.

The survey focusing on the client’s perspective was comprised of three different sections. The first section focused on the client’s purchasing decision, asking the respondent to rate the degree to which various factors affected their choice of Professional Service Firm. The purpose of this section was to assess to what degree the identified factors within the market perspective actually are of importance in the client decision process. Following, the respondent was asked to assess the likelihood of referrals as well as deterrence before finally answering a

question regarding the willingness to share valuable information depending on the quality of the professional-client relationship.

The survey focusing on the employees' perspective was slightly more extensive than the client survey, as it comprised both the employee focused factors as well as the market perspective. Firstly, the respondents were asked to answer questions mirroring the questions asked in the client survey regarding the purchasing decision. The aim of these questions was to establish to what degree the Professional Service Firms are in sync with the client in terms of what factors are most important for the decision process. Knowing which factors affect the clients decision is of significant importance in making strategic choices in terms of positioning and which projects and clients to focus resources on.

Secondly, the respondents were asked about which factors the Professional Service Firm looks at when assessing the attractiveness of a client. The factors that have been identified throughout this paper were grouped alongside other relevant factors, so as not to bias the results and make sure that the importance of the strategic factors was assessed *relative* to other factors that still play a role in the attractiveness of a client. The purpose of this section was to assess the degree to which the identified strategic factors are acknowledged by practitioners in Professional Service Firms today.

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Following these questions pertaining to the market perspective, the respondents were asked a series of questions regarding the employee perspective. For the factors identified during the discussion of the employee perspective (see: *5 Strategic value of customers – the employee perspective*), the respondents were asked to rate to what extent the factors affected

- Excitement in delivering the service
- Quality of the output
- Development of professional competencies
- Desire to remain at current firm

In addition to the identified factors, the respondent was also asked to rate the importance of the client-professional relationship with regards to the above parameters.

While *excitement in delivery* and *desire to remain at current firm* were intended as proxies for professional motivation⁴ and retention respectively, *development of professional capabilities* aimed at determining to what degree the various factors are of value from the asset-based

⁴ See section 5.3.1.1 for discussion on excitement as proxy for motivation

perspective of capability building. Finally, *quality of output* pertained to the discussion on how client satisfaction is closely linked to employee satisfaction in professional services as well as the importance of successful service deliveries in establishing client satisfaction and loyalty, which in turn is a prerequisite for advocacy and referencing..

For both surveys, the respondents were asked to answer the questions using the 5-point Likert scale, which looked as follows:

- 5 - To a very large extent
- 4 - To a large extent
- 3 - To some extent
- 2 - To a limited extent
- 1 - To a very limited extent

7.2.2 Building the interview framework

As the purpose of the interviews was to validate the survey results and probe into the underlying drivers of these results, the structure of the interviews was essentially built around the structure of the survey questionnaires. As such, the interviewees were presented with a graphical presentation of the survey results and asked if the results matched their perceived reality and how? For the question framework, I refer the reader to *Exhibit 9* and *Exhibit 10*.

7.2.3 Analyzing the results

While the purpose of the surveys was to test the identified factors against the current state of the professional services industry, extensive statistical analysis on the responses is not relevant in this context. The intention is to show absolute and relative importance, thus leaving detailed statistical analysis redundant. Furthermore, statistical analysis, such as student t-test or Z-test (Sapsford, et al., 1996), requires a minimum sample size which has not been possible to obtain during the data collection for this thesis. Assuming an infinite population of Professional Service Firms in Denmark alone, a 10% confidence interval would require a minimum sample size of 100 companies. Even if one assumed that only 100 Professional Service Firms existed in Denmark, the minimum sample size would be 51 companies (Israel, 2009). With a total response count of 37 for the employee survey and 10 for the client survey (see *Exhibit 5: Empirical data - demographic data*), the results therefore do not qualify for actual statistical analysis, even if this made sense in terms of desired use of the responses. The appropriate analysis of the results would therefore be based on *descriptive statistics*, i.e. mean and variance measures (Thomas, 2004). For all survey results, mean and standard deviations were

thus calculated using Microsoft Excel, and sorted according to mean values. This created a relative ranking of the factors based on the mean value of the importance of the individual factors. Due to the sample size, it is however important to note that the results will not be statistically significant and will instead serve as an indication of the importance of the various factors rather than a empirical proof of such.

7.3 Discussing the results

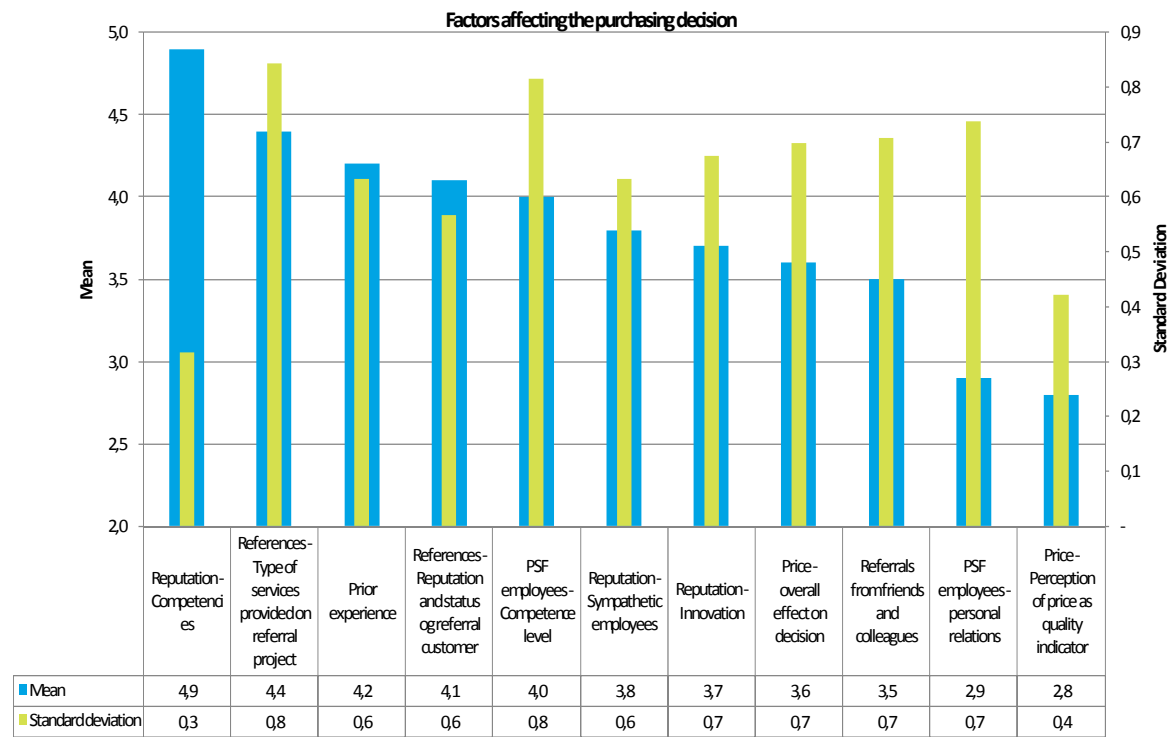
In this section, I will discuss the results of the two surveys. I will do so by presenting the reader to graphs and tables summing up the results of the different sections of the surveys. In discussing the results of the survey, I will include excerpts from the conducted interviews where relevant.

7.3.1 The client purchasing decision

As *Figure 9: Factors affecting the client purchasing decision* shows, the most important factor affecting a prospective client's choice of Professional Service Firm appears to be to what degree the firm is generally considered to be competent. This factor is not only the highest scoring but also the one with the lowest standard deviation, meaning that this result was the least disputed one. Second only to this factor is one of the parameters identified during the previous discussion, namely references and more specifically, the type of performed services pertaining to the reference projects. However, the variance of this question is the highest among this group. Overall, the three most important factors, (reputed competencies, references and prior experience) all mitigate the intangible nature of professional services inasmuch as these serve as proxies for the delivered service quality (Møller, 2010). That is, a firm's reputed competence level is presumably an aggregate measure in the market place of previous client experiences with the firm and will thus, for a prospective client, serve as a strong indicator of the delivered service quality. In the same manner, references are direct examples of previous service deliveries and thereby proof of past service quality. Finally, having past experience with a Professional Service Firm is naturally the best guarantee one can get of the quality of services.

In terms of strategic implications for the Professional Service Firms, the fact that the most important factors in the client decision process all relate to the firm’s past experience in some form, supports the strategic importance of choosing the right clients and projects. As both

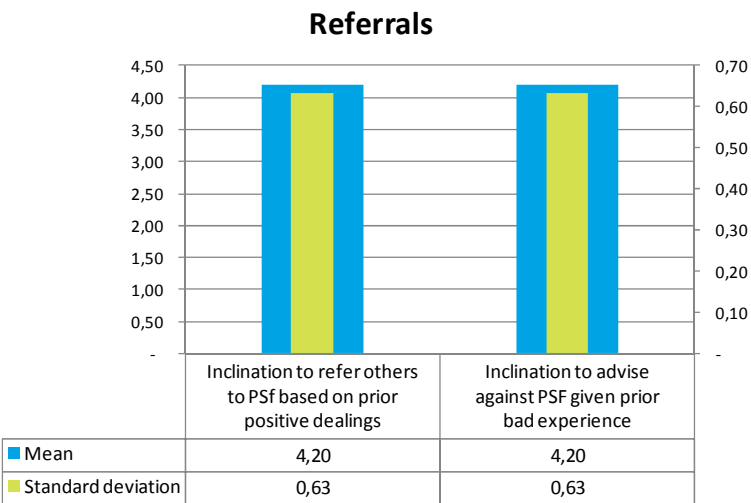
Figure 9: Factors affecting the client purchasing decision



Kold (Kold, 2010) and Knudsen (Knudsen, 2010) pointed out, the fact that so much of the client decision is based on a firm’s past experience, essentially means that the type of projects you have undertaken significantly affects the type of projects you are able to get in the future.

Surprisingly, referrals and especially personal relations seem to be relatively less important in affecting the client decision, albeit they both have fairly high standard deviations.

Figure 10: Empirical data - referral tendencies

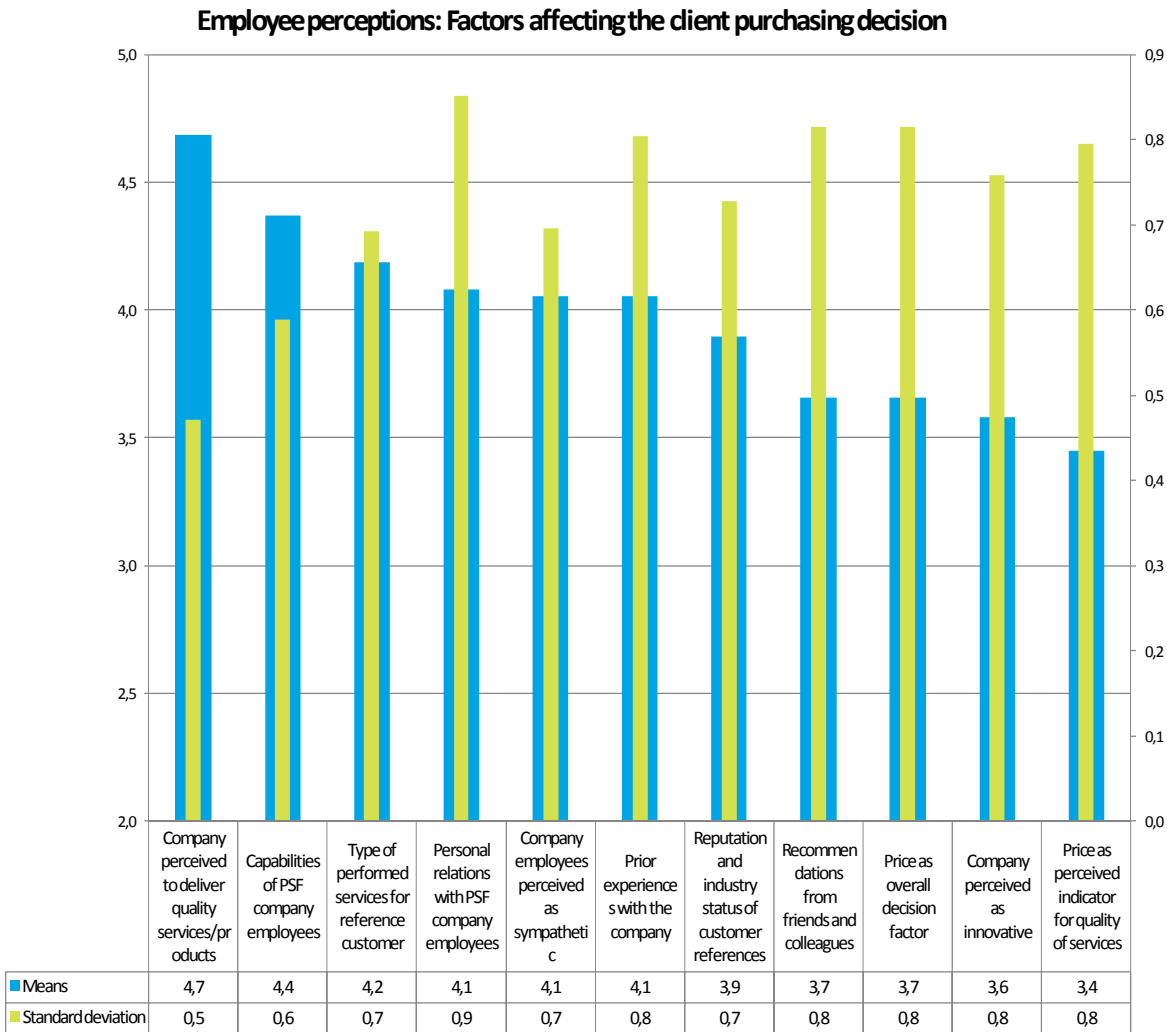


According to Rasmus Møller of COWI (Møller, 2010), the low relative importance of these factors, while initially surprising, actually fits well into the overall picture. While referrals are *sometimes* an important factor in the decision process (as indicated by the high standard devi-

ation), there is according to Møller a tendency among clients to believe that the particular situation that leads that client to seek the advice of a Professional Service Firm is unique to that client, thus rendering referrals somewhat useless, as they do not directly relate to the client’s own situation. This indicates that the main value of client advocacy lies in its ability to build overall firm reputations, which on the other hand is the most important factor in the client decision. In that sense, adding to the importance of referrals is the fact that clients seem to be highly prone to passing on experiences – good or bad – to friends and colleagues who might be considering doing business with the Professional Service Firm in question (see *Figure 10: Empirical data - referral tendencies*). Recognizing the potential value of a referral client is therefore of considerable importance for a Professional Service Firm.

As for the apparently low importance of the professional-client relationship, Møller argues that one needs to look at exactly what the value of the relationship is. He thus argues that the

Figure 11: : Factors affecting the client purchasing decision - the employee perspective



relationship itself is not important, but that the knowledge that the relationship offers the client is however of significant value. That is, through a close relationship with one or more professional(s), the client will be able to better assess the likelihood of a satisfactory outcome. Møller therefore points out that the low score of the relational aspect might be due to respondents' interpretation of the relationship as just that, while not considering the information value of such a relation.

Looking at *Figure 11: : Factors affecting the client purchasing decision - the employee perspective*, it appears that the professionals are in fact well aware of the factors that most affect the client's purchasing decision. This is seen by the fact that the relative ranking of the factors presented by the clients is essentially matched in the employee focused survey. However, Anders Kold of Koompany (Kold, 2010) argues that professionals often attempt to win a project to a matter of price – not because it is the most important aspect but because it is the easiest parameter to affect and relate to.

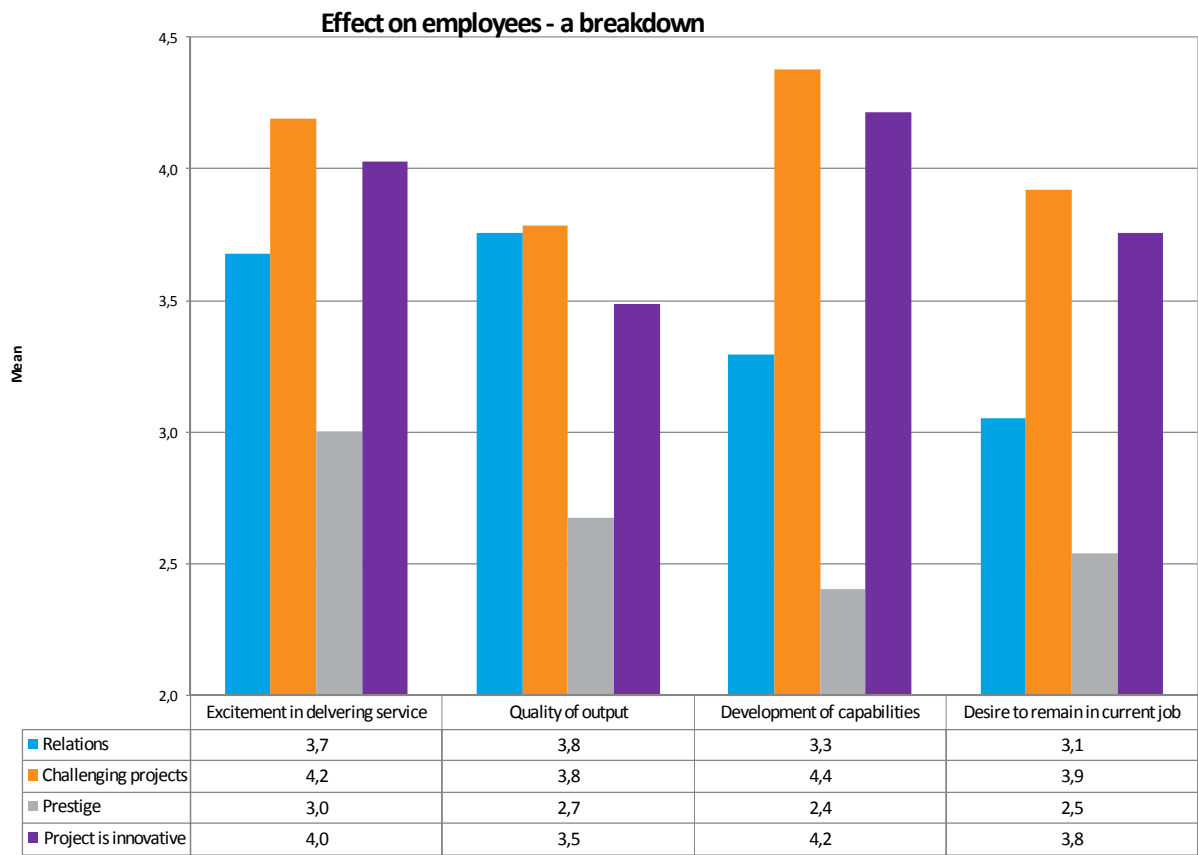
Overall, it appears that the factors identified through the theoretically founded discussion – i.e. references, referrals and prior experience - all play a role in the client decision process. Whereas references and prior experience both seem to be highly important, referrals appear to be somewhat more doubtful in their importance, presumably due to the unique nature of every project and thereby the difficulties in applying one client's experience with a Professional Service Firm to another client's situation. Through affecting the overall reputation of the firm, which is the most important factor in the client decision, referrals do however play an important role, albeit a bit more indirectly.

7.3.2 The employee perspective

Looking at how different client and project characteristics affect the professionals (*Figure 12: Factors affecting the employees*), it becomes clear that a main driver of motivation, retention and capability building is to professionally challenge the employees of Professional Service Firms. It does however appear that there exists confusion in terms of distinguishing the concepts of innovative and challenging projects, as these two appear to be displaying the same score patterns in the four categories, with innovative projects consistently scoring lower than purely challenging projects. The degree to which this could have been avoided by a different construction of the questionnaire is outside the scope of this paper, but it appears that there are grounds on which to conduct a discussion on a) the notion of distinguishing between chal-

lenging and innovative projects in the first place and 2) how to make explicit such a difference.

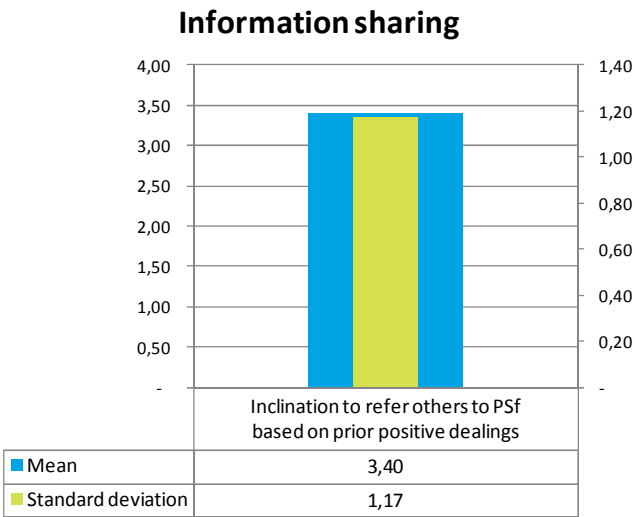
Figure 12: Factors affecting the employees



As expected from the theoretical discussion, the relational aspect seems to be most important in ensuring quality in the service delivery. As such, it supports the discussion conducted in section 6: *Strategic value of customers – the market perspective* in which it was argued that the quality of the client-professional relation-

ship is directly proportional to the ability of the professional to deliver a high quality service – a relationship illustrated in *Figure 8: Strategic advantages of clients from the market perspective*. It is however interesting to note that from the client-oriented survey, it appears that clients are only somewhat more inclined to share valuable information with professionals if they have a personal relation to them; as shown in *Figure 13: Empirical data - information*

Figure 13: Empirical data - information sharing



sharing. This indicates that the value of the client-professional relationship lies not as much in the client opening up to the professional as the relationship evolves, but more in the professional gaining a better understanding of the client.

The prestige of a client appears to be of limited effect on all four parameters in the survey. In fact, this factor is consistently rated as the least important one, except when looking at the excitement in delivering services. Even though the importance with regards to employee excitement/motivation is still only medium (3=“to some extent”), it is still worth noting that the prestige of a client does appear to have some influence on the job excitement of the professionals.

Overall, this section of the survey has indicated that the most important driver in all aspects of the employee perspective is challenging and, to a slightly lesser extent, innovative assignments. The importance of relationships and clearly defined success criteria appear to be empirically supported inasmuch as the focus is on employee excitement and the quality of delivered services. Especially clearly defined success criteria appear to be important in securing a high quality professional service level. Finally, it appears that neither the length of a project nor the prestige of a client noticeably influence the four employee factors.

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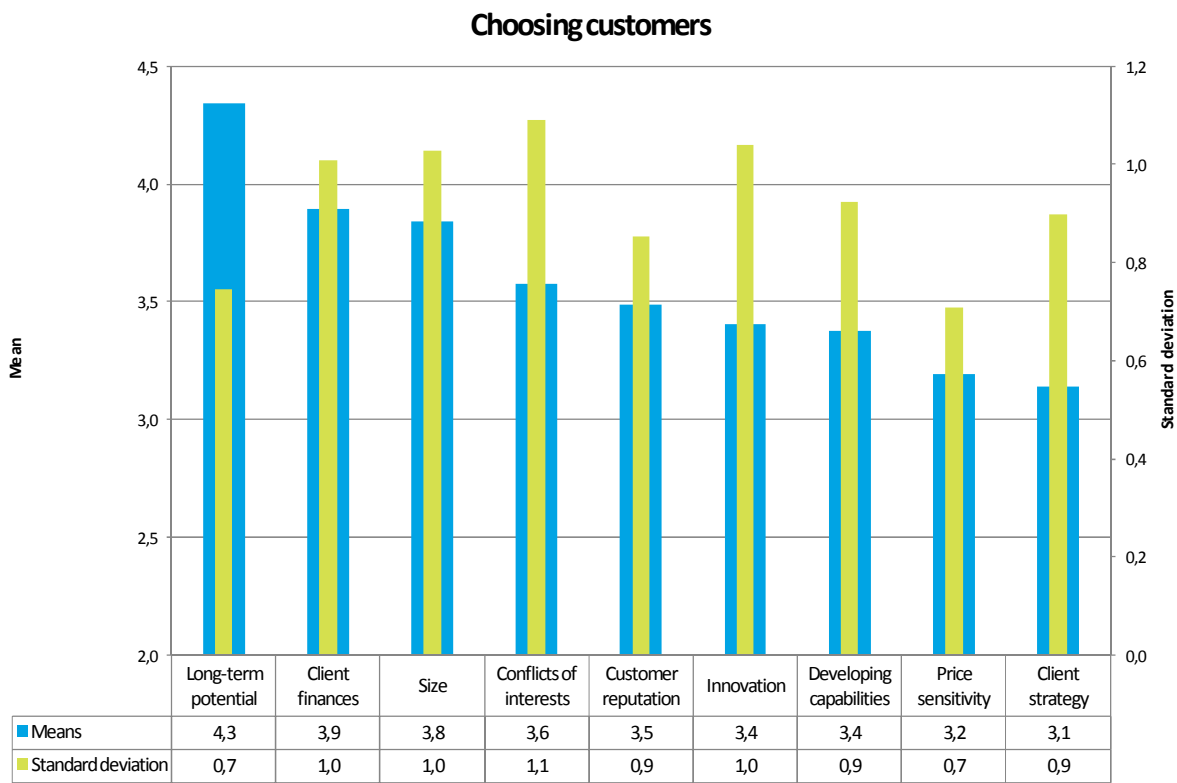
7.3.3 Choosing clients

When asking the professionals how they actually go about choosing between different clients and projects, it becomes clear that there is indeed a considerable gap between theoretical recommendations and real-world practices.

As *Figure 14: Choosing customers* shows, the parameters that seem to be top of mind for professionals are *long-term potential*, *client finances* and *size*. These factors, while unquestionably important for any Professional Service Firm, also show what both academics (Maister, 1993) and practitioners ((Kold, 2010) and (Møller, 2010)) refer to as the *reactive* nature of client selection in professional services. When looking at the attractiveness of a client, the long-term strategic factors such as *developing capabilities*, *innovation* and *customer reputation* appear to be considered less important than the three highest scoring factors. According to Kold (Kold, 2010), this is simply because it is easier to relate to (and assess) the long-term revenue potential and the short term payment potential represented by the client finances. Interestingly, *size* – which was included in the survey as a *control factor* – is argued by Møller (Møller, 2010) to be of some strategic importance, as a big client will often represent not only significant add-on selling potential but also obvious reference value.

Møller however notes that dealing with bigger clients also has its disadvantages, as it can sometimes mean that the client’s bargaining power increases significantly, thereby squeezing prices – as discussed during the strategic analysis of the professional service industry in section 3.4.1: *The strategic landscape of Professional Service Firms*.

Figure 14: Choosing customers



From this part of the survey, it becomes obvious that there is indeed a need for a framework explicitly presenting the strategic aspects of clients and projects.

7.4 Chapter summary

Upon conducting an indicative empirical testing of the identified factors, it is now possible to sum up the client and project characteristics that provide value to the Professional Service Firm – this summary is found illustrated in *Figure 15: Factors of strategic client value*.

All of the proposed factors seemed to be supported empirically, with the exception of prestigious clients’ effect on employee motivation and retention. Challenging and innovative projects, on the other hand, were supported in being of great value in terms both of motivation, retention and capability building.

The surveys also showed how the most important parameters in the client’s decision process all serve the purpose of providing ex-ante quality assurance and that the single most important factor is firm reputation, which indirectly underlines the importance of client advocacy.

Through the empirical research it was also underlined how important the relational aspect is for the success of client relationships, albeit not through increased information sharing but which presumably means that the value of a relationship is increased knowledge and understanding of the client.

Figure 15: Factors of strategic client value



8 Quantifying the factors and building the framework

In this section, I will one by one discuss the different values and the way in which they affect a firm's bottom line, i.e. their financial value. This discussion will be based on a combination of the previous theoretical discussions and the conducted interviews. For some factors, quantifying this value will be too arbitrary, as the nature of the factor is so qualitative that any attempt to quantify it will be futile. Furthermore, few of the factors have been discussed in the academic literature in a quantification context, so the theoretical base only allows for a quantification discussion on a couple of the factors. Finally, the framework is constructed.

8.1 The employee perspective

In this section, I will discuss the possible quantification frameworks pertaining to the factors identified under the employee perspective. These factors are generally related to two overall parameters, namely increasing employee motivation and retention and the asset-based perspective of building capabilities. This discussion will therefore focus on the overall financial impact of the effects of the factors as well as specific quantification frameworks that make sense to discuss explicitly with regards to certain factors.

Overall, the factors in the employee perspective all contribute (to some extent) to employee motivation and retention as well as building individual and firm capabilities. However, the degree to which each specific factor for each individual project/client contributes towards e.g. increased motivation is impossible to assess, making a quantification of any motivation, retention or capability building contribution pertaining to specific projects highly arbitrary. A project that is highly challenging will undoubtedly – based on the previous theoretical discussion as well as empirical study – increase employee motivation, retention and capabilities, but exactly how much so is hard to assess. A high quality relationship will further a higher quality output and higher employee motivation, but exactly how much employee motivation is derived from that particular project as opposed to all the factors that drive employee motivation (see section 5.2 *Motivational theory*) would again be a very arbitrary assessment. Essentially, motivation is an aggregate measure, making the various factors' individual contribution hard to determine, let alone the project specific contribution. It therefore makes more sense to briefly discuss the financial impact of overall increase in motivation, retention and capability building respectively, so as to give managers an idea of the potential financial benefits of focusing on the identified factors.

Increased employee job satisfaction, which in this context also covers motivation, has been shown to result in measureable direct-cost saving related to primarily increased employee performance (Mirvis, et al., 1976).

Even though Maister as well as Mirvis (et al) argue the case of a direct relationship between overall motivation and a company's economic success, determining exactly how much e.g. clearly defined success criteria increase motivation and thereby economic performance of the firm (through the relationship established in Maister's *Motivational Spiral*) would be arbitrary, at least based on the existing theoretical foundation. The factors affecting this parameter will thus *not* be sought quantified and will instead be included in the strategic scorecard included in the framework.

A direct link exists between employee retention, experience and output. This is often displayed in a concave performance function, as a maximum output level will eventually be achieved (Whitt, 2006). The relationship basically dictates that retained employees will have accumulated experience that enables them to solve problems more effectively and to a higher quality than less experienced employees. It thus follows that the value of employee retention is that of increased efficiency and quality in providing the services but also the saved cost of not having to replace the employee with a less experienced professional who will require training and adjustment (Tziner, et al., 1996).

As for capability building, the effects are perhaps even harder to quantify, as this parameter more counts towards ensuring the firm an overall sustainable strategic advantage in a long-term perspective. As such, predicting and assessing the exact value created by the capability-contribution of a single project or client is, just like the previously discussed parameters, highly arbitrary and to no extent supported in academic literature.

In fact, the only factor under the employee perspective that can be reasonably quantified is *innovation*. Kold (Kold, 2010) along with Møller (Møller, 2010) argue that the value of innovative solutions in the employee perspective lies in the extent to which such a solution can be applied to future similar problems, thereby decreasing the amount of time the professional will require to solve the issue. If a Professional Service Firm is looking at a project that is outside of the current skill set and will thus require an innovative solution, the firm might assess that this solution will be directly applicable (at least on a framework level) to similar projects in the future, which will save approximately 20 man hours per project. If this type of project is expected to be undertaken twice a year over the next three years and if the firm on

average calculates hourly costs at 500 DKK, then the value represented by this project being innovative is

$$500 \text{ DKK/hour} \times 20 \text{ hours} = 10,000 \text{ DKK per year}$$

The generic formula for the value of innovation in Professional Service Firms is therefore:

$$V_I = \sum_{i=0}^n \left(\frac{\text{Cost per hour} \times \text{hours saved per project} \times \text{expected number of project in year } n}{(1 + \text{Discount factor})^n} \right)$$

8.2 The market perspective

The factors pertaining to the market perspective, i.e. client references and referrals, are the only factors identified in this thesis that have in fact been discussed academically in terms of quantification. Ryals (Ryals, 2008) has taken a first step in determining the indirect value of a customer, focusing on the additional business that customers can generate through referencing and advocacy/referrals. Through consultations with academics and practitioners alike, she arrived at a probabilistic approach, where the rationale basically is, that the value created through these factors is an increased probability of gaining additional business and thereby profit. Ryals' framework then calculates the increase in probability achieved through customer X and then multiplies this with the estimated profit on the additional business, in order to arrive at a monetary value of the reference and advocacy activities. This value is then discounted at the appropriate discounting factor to arrive at a net present value. Ryals proposed valuation framework for reference and advocacy thus looks as follows:

$$V_{R\&A} = \sum_{i=0}^n \left(\frac{(\text{Prob. with Client X} - \text{Prob. without Client X}) \times \text{Profit of additional business}}{(1 + \text{Discount factor})^n} \right)$$

In addition to this quantifiable value provided by the generation of additional business, customer advocacy also offers a more strategic value through enhancing the firm's reputation in the marketplace. While this effect is far too broad to value, especially on a client/project-specific level, a strong reputation in the marketplace will, all things equal, enable the firm to rise above mere price competition and thereby maintain the premium margins that will allow it to achieve the opposite of the discussed *death spiral of price competition*, namely an upwards-spiraling cause-and-effect relationship between marketplace success and employee performance.

8.3 Building the framework

Based on the preceding discussion, it is now possible to construct a framework in which some factors are quantified as an extension to the traditional customer valuation framework, while some factors are considered from a more qualitative perspective in a scorecard. After constructing the framework, I will demonstrate the intended use through a fictional example.

I have argued that most of the identified factors are at the moment too arbitrary to be quantified, both based on the nature of the factors and the current advancement in academic literature on the subject. In fact, the only factors that have been identified as being quantifiable are the market factors of *reference value* and *referral value* and to some extent (inspired by the empirical data of this paper) the *value of innovation*. This leads to a framework in which these factors are assessed financially, while the remaining factors are considered strategically in a scorecard supporting the model. The framework therefore technically consists of two models: One that identifies the factors that a manager in a Professional Service Firm can consult in identifying the important characteristics of clients and projects (see *Figure 15: Factors of strategic client value*) and one that will actually allow for the assessment of total value represented by a client of project, based on the presence of the characteristics in the first framework.

The framework builds on the established Customer Lifetime Value measure, as it includes all traditional financial benefits pertaining to the client relationship⁵. Added to this traditional financial measure is then the value of the factors identified in this paper:

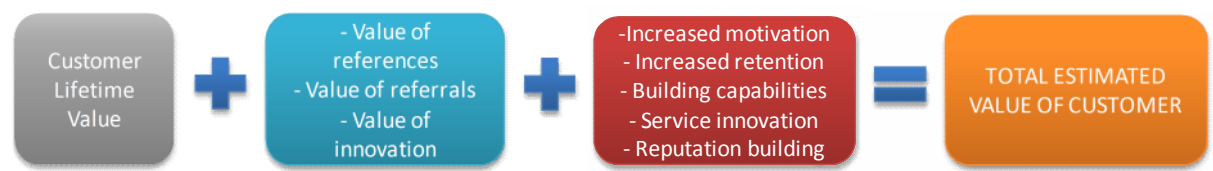
- The value of the additional business created through client references and advocacy. This value is estimated using a probabilistic approach as discussed in the preceding section
- The value created in case the project results in an innovative solution that will enable the firm to spend fewer hours on similar projects in the future. This value is estimated by multiplying the relevant hourly cost with the estimated number of hours saved.

Having estimated the total *financial* value of the client/project, the framework also call for an additional, *qualitative* assessment of any intangible value created, such as increased motivation resulting from a challenging project, the degree to which the project will expand em-

⁵ For details on the traditional customer valuation frameworks, see section 4.1.1: *Determining the value of a customer – the existing frameworks*

employee competencies (i.e. grow the human asset base of the firm) or help build the firm’s reputation through advocacy (i.e. grow the reputational asset base of the firm).

Figure 16: Strategic customer value - strategic valuation framework



Source: Author’s own creation

$$SCV = CLV + V_{R\&A} + V_I + \Delta(\text{motivation, retention, innovation and capability building})$$

As an example, consider the two clients from the example in chapter 4: *A review of current customer valuation frameworks* , where conventional customer valuation frameworks arrived at NPV’s of 2,800,000 DKK and 3,200,000 DKK for Client A and Client B respectively. This initially led the firm to allocate more resources to Client B.

Client A is however expected to represent considerable reference and referral potential, just like the specific project undertaken will challenge the professionals and likely require a highly innovative solution that can be applied in future projects. The additional business that is expected to be generated through the reference and referral value of the client/project has an estimated value of 2,000,000 DKK (profits) and currently carries a 30% likelihood of being realized whereas the client’s referral and especially reference value would increase that probability to 80%. The project solution is expected to save approximately 20 hours on similar future projects, which is expected to total 300 hours for the next 3 years. The average cost per hour for the firm is set at 400 DKK. Thus, the overall value of the client using the proposed framework would be as follows:

Total financial value of Client A = 2,800,000 DKK + 2,000,000 DKK x (0,8-0,3) + 300 hours x 400 DKK/hour = 3,920,000 DKK

Total strategic value of client/project: *The client represents an estimated DKK 3,920,000 in future profits, both in terms of directly generated profits and increased probability of additional business through reference and referral activities. The advocacy provided by the client is also expected to have a positive effect on the firm’s overall reputation, which will help sustain the current favorable position in the market. Furthermore, the project is expected to have significant positive effect on employee motivation by being highly challenging and on the*

edge of the current competencies of the involved professionals. This project will thus position the firm favorably, both in financial terms, in terms of market presence and in terms of employee motivation and retention.

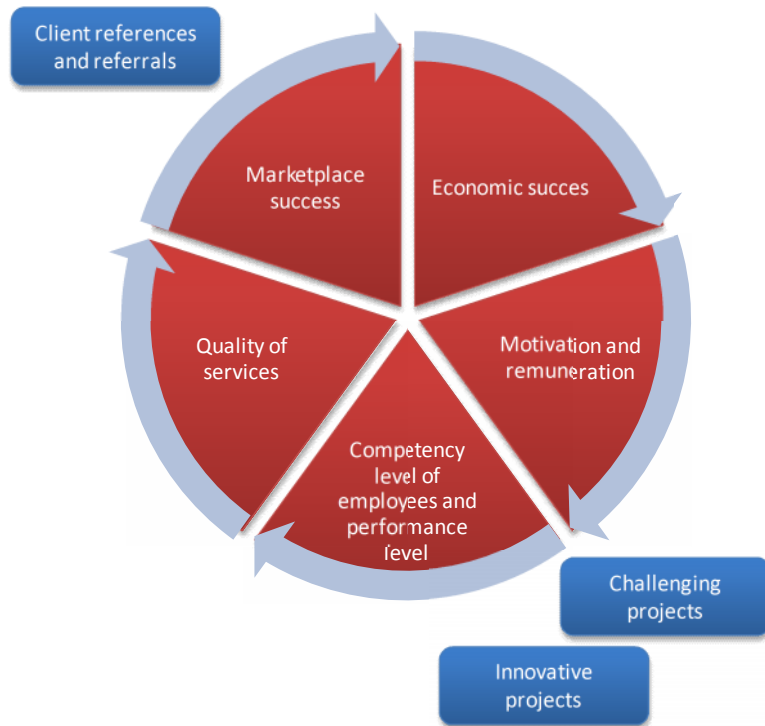
As this example shows, applying the proposed framework will result in a more comprehensive understanding of the value represented by different clients, which will lead to more informed strategic decisions.

9 Final discussion, conclusion and perspectives

9.1 Final discussion

The Professional Service Firm faces significant strategic challenges, both in terms of its input market (Maister, 1993), i.e. the high degree of human asset dependency, and in terms of the output market, i.e. overcoming the inherent intangibility of the services rendered, differentiating the firm in an increasingly competitive market while protecting the business from new entrants. If a firm fails to focus on one or more of these factors, it can have severe implications, both strategically and financially, as illustrated by *Figure 4: The death spiral of price competition in professional services*. By taking a strategic approach and focusing on the proposed factors for managing clients and projects, the firm will be able to balance the various factors so as to effectively maximize employee motivation and retention while strengthening the firm's market position through strategic client relationships. Finally, a strategic approach to client/project assessment will enable the firm to build its asset base (i.e. employee capabilities and firm reputation) to fit long-term strategic goals, such as gaining a footing in a growing niche market that requires skills currently outside the firm's capability set.

Figure 17: Strategic and financial impact of identified factors



As such, the proposed framework will not only allow the Professional Service Firm to more comprehensively assess the financial value contributed by a specific client or project, but also to assess to what degree the client/project contributes to the overall strategy of the firm in providing competitive advantages for long-term success. It thus becomes possible for the Professional Service Firm to actively address its strategic challenges, i.e. *employee (supplier) dependency, increased competition and low entry barriers*.

In addition, it must be noted that even the *strategic* factors in the model, e.g. increased employee motivation, have a direct (albeit difficult to measure as such) impact on the financial success of a Professional Service Firm; a relationship that has been shown through the spiral presented several places in this paper.

It is also important to note that the discussed differences between various types of Professional Service Firms have an impact on the model's components. More specifically, the degree of output intangibility and professionalization will affect the need for, and thus the value created by, the market factors, c.f. *Figure 2: Framework for determining need for mitigating ex-ante client uncertainty*. This does however not change the general structure of the framework, but merely the value that the different components contribute. Such an assessment will be a judgment call by the relevant managers, depending on the specific firm, client and other contextual factors. An accounting firm, being more professionalized than other types of Professional Service Firms, would for example ascribe less value to the reference and advocacy components of the model.

Such a strategic framework would appear to be of great value to Professional Service Firms. As discussed in section 3.4: *Why is a focus on customer value of strategic importance* Strategic, strategic management of Professional Service Firms must be decentralized due to the flexibility required in serving local client needs. It thus becomes a matter of *communicating* and *distributing* clearly formulated and prioritized goals based on an overall vision, all of which must be somewhat consensus-based (Løwendahl, 1997). In other words, managing a Professional Service Firms means making sure that all decision-makers know and respect the priorities set for the utilization and accumulation of strategic resources, given the goals and the strategic vision of the firm. In the context of this paper, it thus follows that giving decision-makers a framework for making client portfolio decisions is essential for effective strategic management of a Professional Service Firm.

9.2 Conclusion

Throughout this paper, I have sought to establish a framework that will allow Professional Service Firms to comprehensively assess the total *strategic* value of clients and projects, i.e. characteristics that provide not only a financial advantage but also help the firm to sustainable long-term success.

Professional Service Firms are knowledge-intensive firms with low capital intensity, which creates a considerable dependency on the employees of the firm, as they – through specialized

knowledge and application of said knowledge – have a direct impact on the performance and success of the firm.

Furthermore, Professional Service Firms produce highly intangible output (albeit to a varying degree) which creates challenges in the selling process, as it prevents prospective clients from assessing the quality of a firm's services prior to making the purchasing decision. The degree, to which this ex-ante uncertainty needs to be addressed by the firm, depends partially on the level of professionalization in the industry, i.e. to what degree the profession is guided by explicit norms and regulations instituted by an organ overseeing and licensing professionals in the industry (e.g. accounting firms). As membership of a professional organization in itself provides a certain amount of quality assurance, it lessens the need for providing other means of ex-ante proof of quality.

In addition to these that these characteristics, Professional Service Firms are highly dependent on the quality of the relationship, as the production of the service essentially takes place in cooperation with the client.

The main challenges facing Professional Service Firms today are supplier dependency (i.e. the professionals, as their knowledge is considered the only real input of production), increased competition - which squeezes margins - and the threat of new entrants due to low entry barriers. Due to the direct relationship between employee performance and firm performance, a so-called *death spiral of price competition* was presented, showing how price competition and lower margins, all things equal, will result in lower remuneration and thus employee performance. This will in turn lead to inferior service quality and thereby even lower margins – in other words, a downwards-spiraling development. To avoid such a spiraling effect, Professional Service Firms need to have an explicit strategic focus on addressing both the employee dependency and possibilities for differentiation, so as to avoid price competition and shield the firm off from the potential threat of new entrants. Overall, the strategic challenges can be grouped in an employee (internal) and a market (external) perspective.

Despite these considerable challenges, Professional Service Firms have long neglected such an explicit strategic focus, as it has been viewed as contradictory to the industry's need to be flexible, customize its services to the individual client and put the client before the pursuit for profits.

As for the current frameworks for customer valuation, these fail to include the more indirect sources of value creation. The current models, such as Customer Lifetime Value, only include cash flows directly relatable to the client relationship by assessing the revenue generated over a reasonable timeframe and then calculating the profit on this revenue and discounting the numbers to arrive at a Net Present Value of the client. Such a measure might neglect other value drivers pertaining to a client which could lead to inefficient strategic decision. The ways in which to expand this framework, and determining which factors to include, is however a subject that the academic literature has yet to establish a consensus on.

Due to the nature of professionals, being professionally restless types with a constant need to perform, a key component in maintaining motivation through excitement is to provide professionals with *challenging* and maybe even *innovative* projects. Aside from improving motivation, such challenging projects will also build the human asset base of the firm by developing the skill set of the professionals. In addition, it was proposed that more prestigious clients would further employee motivation, as professionals are often looking for a job to further their careers, in which case a recognizable client will create a reference point for a potential future employer.

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From a market perspective, the importance of customer loyalty was first established. While this is not an actual value characteristic represented by the client as much as a result of the action of the Professional Service Firm, its importance did however warrant a discussion. Due to the relational nature of professional services, successful client relationships were shown to be somewhat self-sustaining, which helps create a countermeasure to the low entry barriers of the industry. Furthermore, a strong client relationship built on satisfaction is the prerequisite for the behavioral factor of customer advocacy, i.e. satisfied clients who talk about the firm to other prospective customers. Such referral activity not only creates additional business but also helps shape the firm's reputation in the market, thus providing a differentiation factor that shields it against both price competition and new market entrants. It is however important to note customer advocacy is hard to control for the Professional Service Firm, making it a dangerous, two-edged sword as disgruntled clients can affect the firm's reputation negatively just as well as satisfied clients can have a positive effect on firm reputation. Significantly more controllable is the value of client references, which under the control of the firm creates additional business but does not have the same amount of reputational effect of the advocacy factor.

After identifying the relevant factors, these were tested in an empirical survey, where respondents were asked to rate the importance of the various factors, both from an employee and a client perspective. The collected data indicated that all proposed factors were indeed of importance, with the exception of the proposed link between client prestige and employee motivation, where the effect appeared to be weaker than anticipated. Also, the client-oriented survey indicated that referrals in themselves are not that important, which points to the value of these being more in that they help shape the general reputation of the firm, which on the other hand is the most important factor in the client decision process. Finally, the data indicated that Professional Service Firms take a reactive approach to client selection, focusing more on direct, quantifiable measures rather than the strategic factors identified in this paper.

The final step before constructing the framework was a discussion on the possibilities of quantification regarding the identified measures. The additional business created by referencing and advocacy along with the future resource savings enabled by innovative solutions was established as the only factors that could be quantified with some measure of validity. The remaining factors were conversely included in the framework on a strategic level.

The final framework is thus an extension of conventional profitability measures, adding both quantitative components and a scorecard to highlight the intangible, but yet strategically important, effects. The value of such a framework is thus that it allows the firm to proactively address the identified strategic challenges. This is done by accurately focusing resources on specific clients based on not only a more precise measure of the financial value provided but also a better understanding of the strategic value represented by these clients and projects.

9.3 Perspective

The proposed framework is meant to offer the Professional Service Firm insight as to the full value represented by a client. This is however not to say that I would expect a firm to solely take the suggested approach, as I understand the need for a certain amount of short-term utilization focus. It is thus a framework that can be used in practice as well as on a more conceptual level, so as to highlight the important characteristics. As this is a fairly young academic field, there are still many issues worth probing into:

The theoretical discussion conducted in the thesis is built on literature that is currently dominated by very one-sided arguments due to lack of theoretical discussion on the subject. As the theories on the subject evolve, some of the arguments put forward in this paper might be challenged, thus calling for a more critical look at the findings of this thesis.

The empirical data collected for the purpose was regrettably not of statistical significance, meaning that no definite conclusions could be drawn from it. If one was to undertake an empirical study that yielded stronger results, it could more conclusively show the nature of the various dynamics pertaining to the discussion.

Another subject briefly touched upon in this discussion has been the differences that exist between the various types of Professional Service Firms. Further research on this subject could greatly nuance the picture painted in this paper.

While the paper has focused heavily on the motivation and retention of professionals, it has not discussed how client and project characteristics affect the attraction of new professionals. While I would assume that it would be many of the same factors discussed throughout this paper, I would require a dedicated discussion on the subject, which would contribute to a more comprehensive perspective on the importance of clients and projects in Professional Service Firms.

Finally, the quantification of the identified factors was limited due to the lack of academic literature on the subject. It would therefore be valuable to look specifically on how to value the identified factors, so as to make the framework less diffuse and open to interpretation.

The proposed framework is thus an applicable tool that, by addressing some of the above limitations, could achieve a higher degree of nuance, so as to add value to the application in different types of Professional Service Firms.

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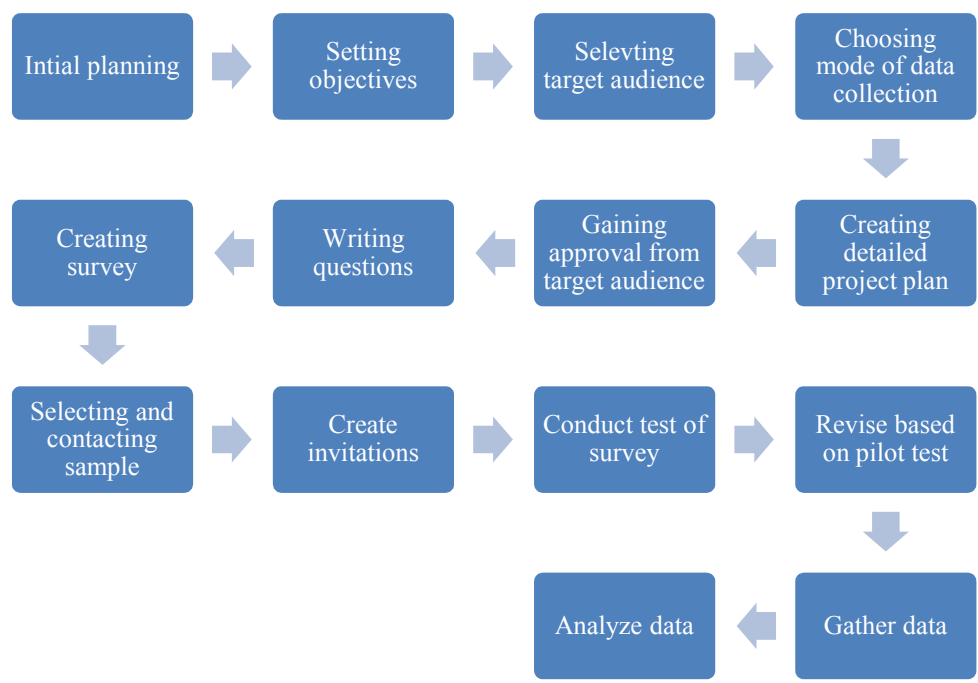
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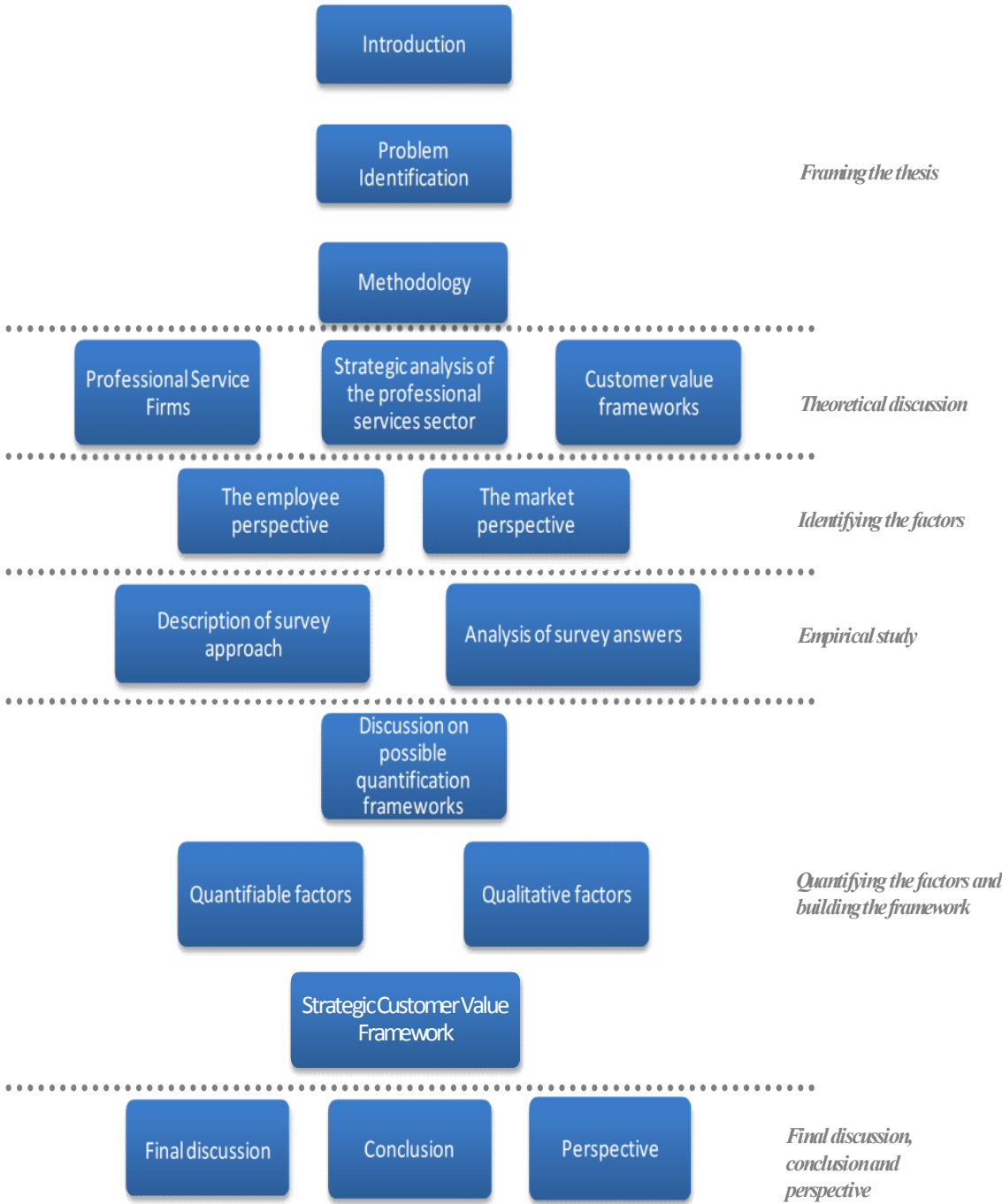
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Exhibit 1: Process for data collection through surveying



Source: Inspired by Susan Thomas (Thomas, 2004)

Exhibit 2: Thesis structure



Source: Author’s own construction

Exhibit 3: Differences between goods and services

	Goods	Services	Professional Services
Product	Physical goods	Intangible goods, customized	Intangible goods, customized
Consumption	Independent of production	Parallel to production	Parallel to production
Relation between producer and customer	Distance, impersonal, not direct	Close, direct and personal	Close, direct and personal
Primary production factor	Machines – capital intensive	Humans – labor intensive	Humans – labor intensive
Employees	Average motivation and performance	Average motivation and performance	Highly motivated and top performers

Source: Adjusted from (Jacobsen, et al., 2004)

84 Exhibit 4: Herzberg's taxonomy for employee motivation

	Hygiene factors	Motivational factors
Examples	Salary, Status, Job Security	Recognition, Job Content, Personal Performance
Positive impact if present	No	Yes
Negative impact if not present	Yes	No

Source: Inspired by (Jacobsen, et al., 2004)

Exhibit 5: Empirical data - demographic data

Survey demographics	Employee	Client
Management Consulting	14	-
PR	1	-
Law	1	-
Engineering Consultant	21	-
Total respondents	37	10

Exhibit 6: Client-oriented survey questionnaire

DEMOGRAPHICS	
What industry does your company primarily operate in?	Management Consulting, PR, Law, Auditing, Engineering Consulting, Other
Have you in your current or a past positiong been responsible for selecting a professional services provider?	Yes/No
DECISION PROCESS: When choosing a professional service firm, to what extent do the following factors play a role in your decision?	
General reputation of the company	
Company is generally perceived as being innovative	5-point Likert-type scale
Company is perceived as being professionally competent and/or offer high-quality products	5-point Likert-type scale
Company employees are generally perceived as being sympathetic/empathetic	5-point Likert-type scale
Referrals	
Referrals from friends and colleagues	5-point Likert-type scale
Company references	
How much do the reputation and status of the reference customer matter?	5-point Likert-type scale
How much does the type of delivered service matter?	5-point Likert-type scale
Prior experience	
If you have had a positive experience with a professional service firm in the past, how likely are you to use that firm again without exploring other options first?	5-point Likert-type scale
Employees	
How important are personal relations with firm employees	5-point Likert-type scale
How important are the percieved skill of the individual employees	5-point Likert-type scale

Price	
<i>To what degree do you percieve price to be an indicator of the quality of the services rendered?</i>	5-point Likert-type scale
<i>To what degree does price affect the final decision?</i>	5-point Likert-type scale
INFORMATION SHARING	
<i>To what extent does your personal relationship with the employees of the professional service firm affect your willigness to share sensitive information with them?</i>	5-point Likert-type scale
WORD OF MOUTH	
<i>If you have had a positive experience with a professional service firm, how likely are you then to refer others to that firm?</i>	5-point Likert-type scale
<i>If you have had a negative experience with a professional service firm, how likely are you then to deter others from doing business with that firm?</i>	5-point Likert-type scale
FOLLOW-UP CONTACT	
<i>Name</i>	
<i>Position</i>	
<i>Firm</i>	
<i>Phone number</i>	

Exhibit 7: Employee oriented survey questionnaire

DEMOGRAPHICS	
What industry does your company primarily operate in?	Management Consulting, PR, Law, Auditing, Engineering Consulting, Other
THE CLIENT DECISION PROCESS: <i>When a client is to choose a professional service provider within your industry, to what degree do you believe the following factors to be of importance?</i>	
General reputation of your company	
Company is generally perceived as being innovative	5-point Likert-type scale
Company is perceived as being professionally competent and/or offer high-quality products	5-point Likert-type scale
Company employees are perceived as being sympathetic/empathetic	5-point Likert-type scale
Referrals	
Referrals from friends and colleagues	5-point Likert-type scale
Company references	
How much do the reputation and status of the reference customer matter?	5-point Likert-type scale
How much does the type of delivered service matter?	5-point Likert-type scale
Prior experience	
If the client has had a positive experience with you firm in the past, how likely do you think that client is to use your firm again without exploring other options first?	5-point Likert-type scale
Employees	
How important are personal relations with firm employees	5-point Likert-type scale
How important are the perceived skill of the individual employees	5-point Likert-type scale

Price	
<i>To what degree do you believe the client views price as an indicator of the quality of the services rendered?</i>	5-point Likert-type scale
<i>To what degree do you think price affect the clients final decision?</i>	5-point Likert-type scale
CHOOSING CLIENTS: When your firm is deciding which client to target and how, to what extent are the following parameters factored in?	
<i>The reputation of the client</i>	5-point Likert-type scale
<i>Long-term potential</i>	5-point Likert-type scale
<i>Opportunity to develop competencies</i>	5-point Likert-type scale
<i>Opportunity for innovation</i>	5-point Likert-type scale
<i>Size of client</i>	5-point Likert-type scale
<i>Client's financial situation</i>	5-point Likert-type scale
<i>Client's percieved price sensitivity</i>	5-point Likert-type scale
<i>Client strategy</i>	5-point Likert-type scale
<i>Business related limitations (e.g. conflicts of interests)</i>	5-point Likert-type scale
CLIENT RELATIONS: To what extent does a close relationship with the client affect the following factors?	
<i>Satisfaction in delivering service</i>	5-point Likert-type scale
<i>Quality of output</i>	5-point Likert-type scale
<i>Development of professional competencies</i>	5-point Likert-type scale
<i>Desire to remain at current firm</i>	5-point Likert-type scale

CHALLENGING PROJECTS: <i>To what extent does a professionally challenging project affect the following factors?</i>	
<i>Satisfaction in delivering service</i>	5-point Likert-type scale
<i>Quality of output</i>	5-point Likert-type scale
<i>Development of professional competencies</i>	5-point Likert-type scale
<i>Desire to remain at current firm</i>	5-point Likert-type scale
CLIENT PRESTIGE: <i>To what extent does the client's status in the market place affect the following factors?</i>	
<i>Satisfaction in delivering service</i>	5-point Likert-type scale
<i>Quality of output</i>	5-point Likert-type scale
<i>Development of professional competencies</i>	5-point Likert-type scale
<i>Desire to remain at current firm</i>	5-point Likert-type scale
INNOVATION: <i>To what extent does an innovative project affect the following factors?</i>	
<i>Satisfaction in delivering service</i>	5-point Likert-type scale
<i>Quality of output</i>	5-point Likert-type scale
<i>Development of professional competencies</i>	5-point Likert-type scale
<i>Desire to remain at current firm</i>	5-point Likert-type scale
FOLLOW-UP CONTACT	
<i>Name</i>	
<i>Position</i>	
<i>Firm</i>	
<i>Phone number</i>	
<i>Email</i>	

Exhibit 8: Survey results - summary on employee factors

Effect on employees

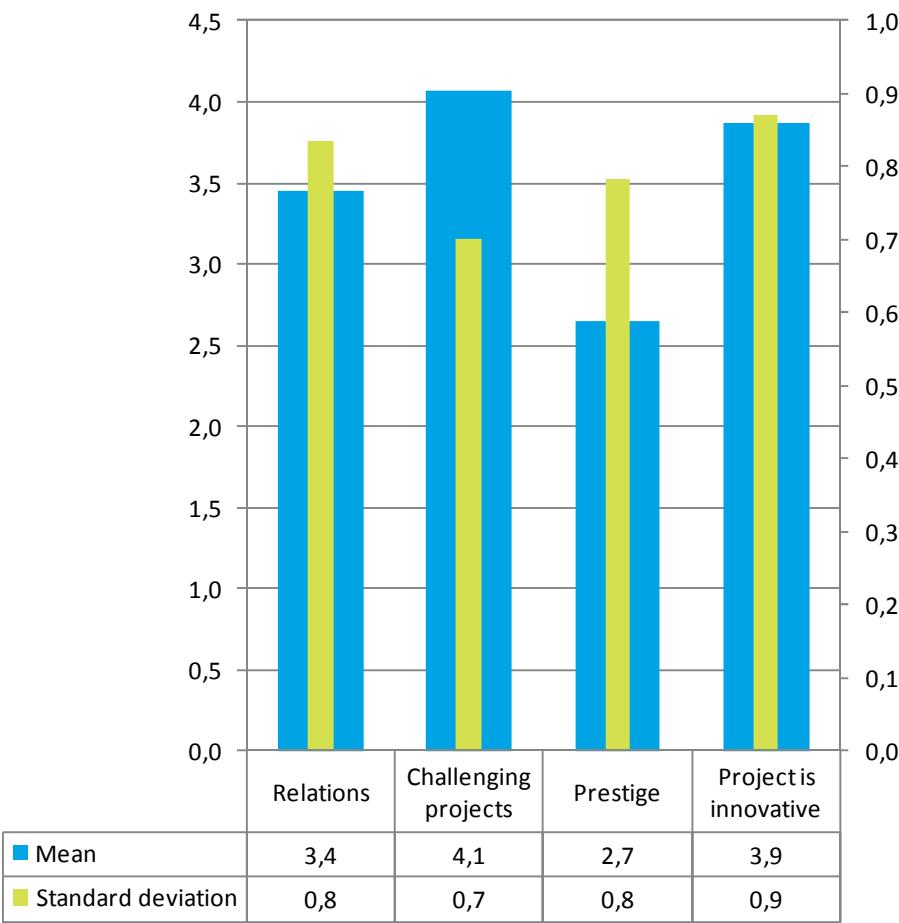


Exhibit 9: Question framework for client-oriented validation interview

The following graphical illustrations show the aggregate average scores resulting from the conducted survey. The scores are related to the 5-point Likert scale, which is structured as follows:

- 5 = To a very large extent
- 4 = To a large extent
- 3 = To some extent
- 2 = To a limited extent
- 1 = To a very limited extent

Factors affecting the purchasing decision

--- Insert graphical presentation of relevant results ---

- How do the results fit with your general perception of real world?
- How does an innovative firm reputation affect your decision?
- How do the professional capabilities affect your decision?
- How does the reputation of reference clients affect your decision?
- How does the type of reference projects affect your decision?
- How do referrals affect your decision?

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Referrals

--- Insert graphical presentation of relevant results ---

- How do the results fit with your general perception of real world?

Exhibit 10: Question framework for employee-oriented validation interview

The following graphical illustrations show the aggregate average scores resulting from the conducted survey. The scores are related to the 5-point Likert scale, which is structured as follows:

- 5 = To a very large extent
- 4 = To a large extent
- 3 = To some extent
- 2 = To a limited extent
- 1 = To a very limited extent

Employee perceptions: Factors affecting the client purchasing decision

--- Insert graphical presentation of relevant results ---

- How do the results fit with your general perception of real world?

Choosing customers

--- Insert graphical presentation of relevant results ---

- How do the results fit with your general perception of real world?

Effect on employees – a breakdown

--- Insert graphical presentation of relevant results ---

- How do the results fit with your general perception of real world?
- How is the satisfaction/motivation of the professional affected by:
 - Client relations
 - Challenging projects
 - Prestige-value of client
 - Innovative projects
- How is the quality of the service affected by:
 - Client relations
 - Challenging projects

- Prestige-value of client
 - Innovative projects
- How is capability building affected by:
 - Client relations
 - Challenging projects
 - Prestige-value of client
 - Innovative projects
- How is a professional's wish to remain with his current employer affected by:
 - Client relations
 - Challenging projects
 - Prestige-value of client
 - Innovative projects
- What is the value of:
 - Increased motivation
 - Increased service quality
 - Capability building
 - Employee retention