The effects of perceived subjectivity and pay transparency on client capture in large law firms*

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Abstract

This paper examines how two fundamental elements of the compensation system used to allocate profits amongst equity partners in large law firms, use of subjectivity and profit allocation transparency, interact to affect how law partners manage the complex relationships with their clients and fellow partners involved with their clients. We interviewed 56 corporate law partners working in large Canadian law firms. The interview includes a vignette describing a hypothetical low moral intensity ethical issue involving a triangle of relationships between themselves, another relationship partner, and a major client that provides business to multiple lawyers in the firm. The interviewee, as the partner providing the legal advice, is asked to acquiesce to the client’s wishes by the relationship partner who is primarily responsible for managing the firm’s relationship with that client (i.e., client capture). We find that there is a significant positive interaction effect between the perceived use of subjectivity and transparency in the profit allocation system, where pay transparency decreases client capture when less subjectivity is perceived to be used but pay transparency increases client capture when more subjectivity is perceived to be used. Analyses of the interviews suggest that pay transparency in combination with greater perceived subjectivity increases the sensitivity of partners to firm politics, which may explain the increase in client capture. In contrast, pay transparency in combination with less perceived subjectivity increases the perceived economic independence of partners, which may explain the decrease in client capture. Implications of our results are discussed.

Keywords: Subjectivity, Pay transparency, Law firm compensation
Respondent 36 (Senior partner working in closed compensation system): “It's an interesting sidebar for research someday as to do that... whether a confidential compensation system works better than one where everybody knows everybody else's compensation.”

Respondent 90 (Executive partner working in a closed compensation system): “And, really, I mean, it is an important thing. I mean, if you don't get the compensation right, then it's very hard to have a successful firm.”

Introduction

Pay transparency is a controversial practice in management, and yet there is relatively limited research on its impact on organizational members (Colella, Paetzold, Zardkoohi, and Wesson 2007; Gely and Bierman 2003). This study examines how two fundamental elements of the compensation system used to allocate profits amongst equity partners in large law firms, perceived use of subjectivity and profit allocation transparency, interact to affect how law partners manage the complex relationships with their clients and fellow partners who are involved with their clients either in providing other legal services to the client or being responsible for managing the firm’s relationship with the client. We are interested in how law partners respond to a hypothetical low moral intensity ethical issue, which is one that does not involve illegal behavior or significant unethical behavior. Specifically, law partners were presented with a vignette where they are acting as the partner providing legal advice to a major client of the firm and they are asked by a relationship partner (i.e., the partner primarily responsible for managing the firm’s relationship with the client) to acquiesce to the client’s wishes, although doing so may potentially expose the client to an inappropriate level of risk.¹

¹ The vignette described a situation in which a corporation is a longstanding client of the firm, and several practices within the firm provide service to this client. In the vignette, it is a senior manager at the client that is placing pressure on one of the partners of the firm to provide an opinion. This partner is not the main relationship partner. The facts of the vignette are rather nuanced and complex, but for the sake of simplicity in this article we are referring to the senior manager at the client as the client, since the arguments presented here are not impacted by this difference. The full vignette is presented in Appendix 1.
We predict that the perceived use of subjectivity in profit allocation in combination with profit allocation transparency interacts to increase the sensitivity of law partners to firm politics and increase the likelihood of acquiescing to the client and the relationship partner. We test this hypothesis using data from interviews with 56 law partners working in 11 large corporate law firms in Canada. We asked law partners about their perceptions of the one or two most important factors that their firm uses to allocate profits to equity partners and then we coded the responses for whether or not the use of subjectivity is explicitly mentioned. Subjectivity can be used by considering factors such as efforts at attracting clients and managing relationships with clients, firm management, mentoring and training, helping colleagues, beyond objective measures such as billings and hours. We also asked law partners whether their firm uses a closed or transparent profit allocation system. In a transparent or open profit allocation system, data about the amount of profits distributed to individual partners is shared with all partners (Regan and Rohrer 2013). In a closed system, however, partners do not know the actual amount of profits that are allocated to individual partners although they often know the distribution (i.e., the profit allocation bands and how many partners are in each band). We coded partners’ responses to the vignette for the degree to which the partner is willing to provide the legal opinion required by the client and the relationship partner (i.e., client capture).

A transparent compensation system reveals the compensation of each partner and we argue that transparency can have different effects on partner behavior depending on whether more or less subjectivity is used to determine those compensation figures. Consistent with our hypothesis, we find that the perceived use of subjectivity in profit allocation in combination with pay transparency is positively associated with client capture. Our results are consistent with our argument that law partners who are in transparent (versus closed) systems and who perceive
greater use of subjectivity in their compensation system may have heightened sensitivity to firm politics that increases their willingness to provide the legal opinion required by their client and the relationship partner. At the very least, these partners exhibit a greater awareness of the need to more actively manage the potential negative reactions of the client and the relationship partner should they decide not to provide the legal opinion required by the client. In contrast, law partners who are in transparent (versus closed) systems but perceive less use of subjectivity may have a stronger sense of economic independence from their fellow partners such that they may be more willing to disagree with the relationship partner and not necessarily provide the legal opinion required by the client.

Our study makes several contributions to the literature on subjective performance evaluation as well as the literature on compensation transparency. As far as we know, we are the first study to examine in the field the consequences of interacting subjectivity and pay transparency. Law partners in our interviews indicate that the design of their compensation system and its effects on how partners practice and the long-term success of their firms are critical issues. We respond to the calls in the accounting literature to examine how different compensation design choices interact with each other (e.g., Sprinkle and Williamson, 2006). The use of subjectivity can improve the incentive contract when objective measures are inadequate in capturing all dimensions of a person’s job as well as the long-term effects of a person’s actions, such that the person’s incentives are distorted if compensation is only based on objective measures (Bol 2008; Gibbs, Merchant, Van der Stede, and Vargus 2004; Hoppe and Myers 2011). In the context of performance of law partners, subjectivity may be particularly important because there are many different tasks and behaviors that are critical for the long-term success of the firm that are not captured by objective measures such as billable revenues and billable hours.
Furthermore, the balance between satisfying clients and professional/ethical obligations is a delicate and complex one, and law firms likely face significant challenges using subjectivity to guide their partners to achieve the appropriate level of balance for the firm.

We also answer the call for more research on the effects of pay transparency in actual work settings and organizations as opposed to lab experiments to test the external validity of results found in recent lab experiments (Bamberger and Belogolovsky 2010; Belogolovsky and Bamberger 2014). There is little agreement amongst academic scholars regarding the overall effect of pay transparency. Some scholars argue that pay transparency has negative consequences such as increased perceived inequity, decreased discretionary effort from employees, lower job satisfaction and increased turnover intentions from lower-paid employees (Tremblay and Chênevert 2008; Card, Mas, Moretti, and Saez 2012). Yet, recent research using lab studies finds that lack of pay transparency (i.e., pay secrecy) generally has an adverse effect on individual task productivity and continuation intentions, although the effect is moderated by individual traits such as inequity tolerance (Bamberger and Belogolovsky 2010) and other compensation design features such as the use of subjectivity and the use of absolute versus relative performance assessment (Belogolovsky and Bamberger 2014). However, these lab studies acknowledge that the small size of the compensation, the limited interdependencies of tasks amongst experimental participants, and the short time frame of lab studies may not be conducive for the negative effects of pay transparency to emerge (e.g., jealousy, employee conflict, and dysfunctional organizational politics).

We find that perceived use of subjectivity and pay transparency has interactive effects on how law partners respond to a low-intensity ethical dilemma and manage pressure from their clients and fellow partners. Pay transparency (as opposed to a closed system) decreases client
capture under lower perceived subjectivity, but it increases client capture under higher perceived subjectivity. Increased perceived subjectivity decreases client capture in a closed system, but it increases client capture in a transparent system. We are careful not to overextend our conclusion about whether higher versus lower client capture that we observe in our study is the same as more versus less ethical behavior. However, we know that client capture is behavior that both law firms and the law profession as a whole are concerned about and that client capture at the expense of professional and ethical standards is undesirable (Galanter and Henderson 2008). The legal opinion required by the client in our vignette setting is not illegal and client capture in the vignette is unlikely to be perceived as a significant ethical violation. Even when the partners in our study express higher client capture, the mean level of client capture does not reach a high level that would indicate complete client capture. The majority of partners, even when they express higher levels of client capture, often express a desire to consult with others in the firm to ensure that the legal opinion required by the client is appropriate and that others in the firm are in agreement with their action.

The remainder of the paper is organized as follows. We first provide background on law partner compensation and develop the hypothesis. We next describe the design and results of the study. Finally, we conclude with a discussion of the findings and limitations of the study.

**Theory and Hypotheses Development**

*Compensation of Partners in Law Firms*

Designing the compensation system of partners is a significant challenge for law firms (Gilson and Mnookin 1985; McKiernan 2014). Partners are not employees but they are owners and residual claimants of their law firm. Nevertheless, the fundamental issue surrounding how to use the compensation system to motivate individuals to meet the strategic goals of the firm and
ensure the firm’s long-term profitability is similar whether it is about motivating employees versus partners (Anderson 2001). However, in contrast to employees, partners not only have a larger and more direct share in firm profits, their actions also have a more significant and direct impact on firm profits. Partners often have direct responsibilities for obtaining clients, maintaining relationships with clients, and providing the legal services for clients that generate firm profits. As such, the effects of using subjectivity and pay transparency in partner compensation may be stronger than in employee compensation.

Law firms typically hire young lawyers as employees and eventually offer those who meet certain criteria, the opportunity to be promoted to equity partners, sometimes after a short period as a non-equity partner. Equity partners are generally required to inject capital into the firm and they share in the profits of the firm (Gaffney 2014; Mucalov 2014). The share of an equity partner in the law firm’s profits is adjusted periodically, typically on an annual or biennial basis. The profit allocation is usually determined by a compensation committee and it is based on the number of equity partners and the compensation committee’s assessment of the contributions of the equity partners (Regan and Rohrer 2013).\(^2\) To determine the profit allocations, the compensation committee usually gathers objective data from the firm’s information systems (e.g., billable revenues, billable hours, client originations), interviews partners, and requests memos from partners that detail their own contributions as well as other partners’ contributions to the firm which are not evident from the objective data (Mucalov 2014; Regan and Rohrer 2013; Winders 2005). The contributions of an equity partner to the firm may be a function of revenues generated by clients that a partner brings to the firm, the number of billable hours a

\(^2\) The contributions we are referring to here are not the monetary capital contributions that equity partners are required to make for partnership admission. Rather, we are referring to the efforts of partners, during the period assessed by the compensation committee, that contribute towards firm profits or more generally the firm’s long term success.
partner is responsible for, or other qualitative contributions to the firm. Increasing competition in the legal marketplace has increased the role of business generation or “rain-making” in determining who is offered equity partnership and how partnership profits are allocated (Baker and Parkin 2005).

Some firms may also employ subjective factors to assess the contributions of partners, either in the weights assigned to various factors and/or in the actual factors that are considered. For example, in addition to billable revenues and billable hours, the compensation committee may consider other factors such as client management (even if the partner is not responsible for bringing in the client or for actually delivering the legal services required by the client), firm management (e.g., serving on committees, practice group leadership, recruiting), training or mentoring junior colleagues, cooperating with colleagues, willingness to share clients with others in the firm, and activities that enhances the firm reputation (Anderson 2001). According to Regan and Rohrer (2013), a majority of U.S. law firms employ subjectivity in their profit allocation with about 54% using a purely subjective approach and 38% using a combination approach where compensation is first derived from a formula that is then modified by subjective factors.3 Similar to U.S. law firms, a majority of large Canadian law firms use some degree of subjectivity and a combination of factors that include both billable and non-billable performance in allocating profits (McKiernan 2014; Mucalov 2014).

Compensation and client capture

From an economic perspective, how profits are allocated to law partners would have a significant impact on how partners manage their relationship with clients from whom profits are

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3 In addition to the subjective method of profit allocation, a minority of law firms use the lockstep approach or the formula-based approach (Regan and Rohrer 2013). In the lockstep approach, partnership profits are allocated based on seniority. In the formula-based approach, partnership profits are calculated using a fixed formula from partners’ financial contributions such as billable revenues and billable hours.
generated. However, the relationship between a partner and a client for whom s/he is providing the legal service is a complex one, often involving a fellow partner who, while not directly providing the legal service, is primarily responsible for managing the firm’s relationship with the client and therefore often has an economic interest in the outcome of the legal opinion expressed by the partner (Dinovitzer, Gunz, and Gunz 2014a). Further, individual clients often receive legal services from more than one partner of the firm. In other words, the economic perspective incorporates not only the direct benefit to the partner of their own client billings, but the benefits that may accrue to their fellow partners (and thus to the firm as a whole under the equity partnership model) from this same client.

Law partners have to balance the economic pressures of pleasing their clients with their professional obligations to uphold the law and provide competent and honest advice. For example, in the context of providing competent and honest advice, the Rules of Professional Conduct (2015) adopted by the Law Society of Upper Canada state that “a lawyer should be wary of bold and over-confident assurances to the client, especially when the lawyer’s employment may depend upon advising in a particular way”, and that “the advice must be open and undisguised and must clearly disclose what the lawyer honestly thinks about the merits and probable results.” In the last few decades, the increasing competition that law firms face has resulted in a greater focus on client service and the ability to attract and retain clients (Regan and Rohrer 2013). A significant concern is that lawyers may also find it increasingly difficult to fulfil their professional and ethical obligations when those obligations run counter to the client’s business objectives, and that law partners facing significant competitive pressures are more likely to resolve ethical dilemmas in favor of their clients (Dinovitzer, Gunz, and Gunz 2014b; Galanter and Henderson 2008). This is termed as “client capture” in recent literature, where the
client is so important to the professional that the professional’s advice to the client is more strongly influenced by the client’s business interest and less by the standards and obligations promulgated by the profession (Dinovitzer, Gunz, and Gunz 2014a; Gunz and Gunz 2008; Leicht and Fennell 2001).

In the interviews we conducted, we asked law partners to think about a major incident in which they had to say “no” to an important client because of the advice they felt obliged to give them and to explain what factors weighed on their mind in deciding to say “no”. Their responses indicate that while partners often articulate that they cannot compromise on their legal advice and integrity, they also stress the importance of being able to find solutions for their clients to keep their clients happy and satisfied, suggesting that partners indeed try to strike a fine balance between their professional/ethical obligations and economic pressures.

**Respondent 43 (Senior mid-level partner, works in a closed system, does not mention subjectivity):** “Well, you know, because I think, no matter what a client wants, you could usually find a way to give them something. It might not be ultimately be what they want, so it's very rare that you have to say just like "no"; but I guess what you're asking is if you have to say ultimately "no"... I mean, I would think that they're probably asking me to do something illegal, in which case I would ... you know, there's no way around it. I would just say, well, "No, I cannot participate in something like that."

**Respondent 62 (Junior mid-level partner, works in a transparent system, does not mention subjectivity):** “what makes a very good business lawyer is someone who can dovetail those two [legal requirements and client’s business objectives] well, and in a way that's pleasing to the client. You don't want a lawyer that finds issues and finds legal issues with everything the client wants to do. ... what I try and do, and I think what all good lawyers should try and do is you want to marry that with, you know, what is the client trying to do, and get them to that end goal, and sometimes, you know, it is a flat-out, "No, you just can't do it that way," and then, you know, you have to leave it but, you know, you usually can find a way. It's a craft that as such that they can get to where they want to go, and that's what makes a happy client.”

The partners in our study acknowledge that they are concerned that when their legal opinion is not in line with what the client wants, it would impinge on the client’s satisfaction and on whether the client would stay with the firm. In other words, law partners are acutely aware of
the impact of their legal advice on firm profits, and ultimately on their own compensation and the compensation of their fellow partners.

**Respondent 65 (Senior mid-level partner, works in a closed system, does not mention subjectivity):** “the key issue ... is the difficult balance between the business agenda of our clients and the legal possibilities of the solutions. So, I mean, clients will push you. They always push you. They have deal fever or they want to do it. Our job is to minimize risk, and sound the bell when it doesn't make sense. ... You may refuse to do it, I mean, but most of the time you can reverse that situation and convince them. Some people may just walk away and go to next door and get a law firm that will do it; but that’s the biggest ... the ... enormous economic pressure to perform. Therefore you must have clients. Therefore you must have billings, and to have billings you have to be good with your clients. You have to say yes to your clients, and that’s the biggest pressure against law. So individuals handle it differently.”

**Respondent 81 (Senior partner, works in a transparent system, does not mention subjectivity):** “The concern that the client is going to be very upset and is going to shop around and find somebody who is willing to give that opinion because it’s a question of judgment.”

**Respondent 88 (Senior mid-level partner, works in a transparent system, does not mention subjectivity):** “Oh, fear, constant fear. I can deliver bad news to a client and be petrified that they’re going to be so annoyed with me that they won't want to work with me again.”

**Respondent 91 (Executive partner, works in a transparent system, mentions subjectivity):** “I’m sure what goes through your mind is, you know, a million dollars in fees out the window, and a million dollars next year and the year after. That’s kind of what you’re... and it’s... so before you say "We can't; we won’t," you’d better be pretty sure that you can’t or you won’t, and those are all judgment factors, right, so I’m sure like... and there’s a continuum that some people will stretch more than other people will stretch. It’s a hard one like because if you find yourself having stretched, or someone did something they shouldn’t, and you get involved with a lawsuit, and you can see this has happened historically in Canada with some very large legal actions, which were previously unprecedented, right? “

As such, we expect that the design of the compensation system would have a significant impact on the degree to which law partners acquiesce to clients for whom they are providing legal services and to fellow partners who are primarily responsible for managing the firm’s relationships with those clients. Our study examines two design features, the perceived degree of subjectivity used in profit allocation and the transparency of profit allocation. We first discuss
each design feature separately, and then we discuss our hypothesis regarding the interactive
effect of these two design features on client capture.

**Effects of perceived use of subjectivity in profit allocation on client capture**

Subjectivity can improve an incentive contract and reduce the distortion of incentives
when the available objective measures are not able to capture all aspects of performance that are
important for the long-term success of the firm (Baker, Gibbons, and Murphy 1994; Bol 2008).
In law firms, although billable revenues and billable hours are objective measures that can be
used to allocate profits to partners, there are many tasks and behaviors that are critical to the
long-term success of a law firm that these objective measures are not able to adequately capture,
such as client development, building firm reputation, firm management, collegiality and being a
team player, and training junior colleagues. Subjectivity can be used to reward these myriad of
behaviors in law firms (Winders 2005). Allocating profits to partners based solely on objective
measures in a formula may motivate partners to behave in ways that maximize their own pay
under the formula to the detriment of other behaviors that benefit the firm overall (Gilson and
Mnookin 1985). Indeed, the partners we interviewed who perceive more subjectivity in the profit
allocation system in their law firms recognize the deficiencies of relying completely on objective
measures.

*Respondent 86 (Senior mid-level partner, works in closed system, mentions subjectivity):* “because if you try to create a formula people would work to the formula and, inevitably, the formula would be imperfect, and therefore you'd get people working to an imperfect goal. So you want people working towards something that's more of an ideal, which again must be subjective which... as, you know, what is in the best long-term interest of the firm. So if that's the goal I think you want every decision that lawyers make to be put into the perspective of that goal. What's in the best long-term interest of the firm - well, yes, it's to bring this client in and, yes, it's to maintain our relationship with this client and, yes, it's to do the work for that client; ... they should put that decision in the context of what's going to be in the best long-term interest of the firm, right?”
Respondent 90 (Executive partner, works in a closed system, mentions subjective): “I can’t answer that question because no matter what I tell … I mean, there aren’t one or two most important … I mean, it’s contribution and contribution can be in the form of, you know, financial contribution. It can be firm leadership. It can be helping raising the profile of the firm through, you know, presentation seminars, writing books and articles. It can be through mentoring associates through training within the firm. All of those things are important. … we believe very strongly that there were both measurable and un-measurable factors that went into it, and that if we looked at the measurable ones, inevitably they would eclipse the un-measurable ones just inevitably.”

When partners are trying to balance their professional/ethical obligations with clients’ business objectives, a profit allocation system that relies too much on objective measures such as billable revenues and billable hours may create strong economic incentives for partners to succumb to the wishes of their clients or for relationship partners to put pressure on partners to do so (Gilson and Mnookin 1985). However, law firms value their reputation for competence and integrity as an asset critical for its long-term viability, and ethical lapses are threats to the firm reputation (Galanter and Henderson 2008). As such, law firms can use subjectivity in profit allocation to reward behavior that protects the firm reputation or penalize behavior that harms the firm reputation. To the extent that client capture has the potential to harm the firm reputation, subjectivity in profit allocation can be used to discourage inappropriate levels of client capture.

However, subjective measures also have inherent limited verifiability. Subjectivity can increase the likelihood of bias and favoritism on the part of evaluators (Prendergast and Topel 1993; Ittner, Larcker, & Meyer 2003). Subjectivity can also increase the extent to which evaluatees engage in influence activities that are aimed at affecting the subjective judgments of potential evaluators rather than at improving objective performance (Du, Tang, and Young 2012). In many large law firms that exercise subjectivity in profit allocation, a compensation committee interviews individual partners and/or requests that partners submit memos about their own contributions as well as the contributions of other partners (Mucalov 2014; Regan and
Hence, partners recognize that the subjective opinions of their fellow partners can have an impact on their profit allocation. The rotating nature of compensation committees where elected partners serve for a limited term also mean that the targets of influence activities may include not only partners who are on the current committee but partners who may be on the committee in the future. The partners we interviewed who perceive a greater use of subjectivity in the profit allocation system note the important roles that the compensation committee and the peer review process play in the profit allocation system.

**Respondent 36 (Senior partner, works in a closed system, mentions subjectivity):** They put in submissions to the compensation committee, and they see their data, and they can comment on it and so on and ... They can comment on others. They have the information for others. Like some firms don't have the data available to all partners. All partners, equity partners, have the information of other partners, and so there's input from all kinds of people. We have a departmental system here, so the practice group leaders comment on the people. It's quite an elaborate system. It takes weeks and weeks and weeks of our time to do it. It costs us... we did a costing at one point to see what this process cost us, and it is a big number - just in lost hours and making sure we get it right - and it's a point allocation.”

**Respondent 39 (Senior partner, works in a transparent system, mentions subjectivity):** “In terms of the qualitative things, peer... we place a high degree of emphasis on peer reviews in our compensation process, so all partners are expected to comment substantively on the performance of other partners, and qualitatively as well as their view on their contribution, and that is... that's given a great deal of weight; and then I guess another, I mean it’s constantly in flux and it's very difficult to assess,”

**Respondent 57 (Senior partner, works in a transparent system, mentions subjectivity):** “it’s not a mathematical calculation. There are firms, including in Toronto, who try to be quite precise about the equation of how much money you’ve personally generated and how much you've generated for others, and they have a mathematical formula. We don’t do that. We have a committee who tries to know everybody and understand their practice. Everybody makes submissions to it as to what they've accomplished. We’re allowed to comment on each other, and then this committee of wise people sets an allocation, and it's a report that goes to the partnership. It gets approved by the partnership. It never gets rejected by the partnership. Every year there are a few people who are deeply unhappy and, hopefully, that gets remedied over time, but it's a subjective system, not an objective one.”
People’s political sensitivity in organizations comprises of their awareness of organizational norms, awareness of the interpersonal interactions that take place underlying observed organizational outcomes, and awareness of significant persons and their motives and agendas; all of which then affect people’s own engagement in organizational politics aimed at advancing their personal objectives (Vredenburgh and Maurer 1984). The use of subjectivity in the determination of compensation can heighten political sensitivity and increase organizational politics (Vredenburgh and Maurer 1984; Longnecker, Sims, and Gioia 1987). Therefore, greater use of subjectivity may increase the sensitivity of partners to firm politics and the impact of firm politics on their compensation, thereby increasing the likelihood of partners engaging in client capture to influence the subjective evaluations of potential evaluators.

In summary, subjectivity can be used by law firms to curb client capture that is perceived to be risky to the firm reputation. However, increased use of subjectivity may also heighten the sensitivity of partners to firm politics and how their relationships with each other, the management team, and the compensation committee members affect each others’ profit allocations; thereby increasing client capture.

**Effects of pay transparency on client capture**

There are competing theories as to the relative effects of pay transparency versus pay secrecy on the behavior of law partners. On the one hand, pay secrecy is argued to have positive motivation and sorting effects in comparison to pay transparency because it allows firm management to institute larger pay differentials that are more reflective of differential performance and contributions to the firm value without the potential negative effects of perceived unfairness that may arise when people are able to compare their pay with those of others (Leventhal, Karuza, & Fry 1990). On the other hand, pay secrecy and the associated
information asymmetry increase the perception of opportunism, deceptive intent, and bias on the part of firm management (Gupta and Jenkins 1996; Wanasika & Adler 2011).

Equity theory (Adams 1965) and justice theory (Greenberg 1990) suggest that pay transparency can have beneficial motivational effects as compared to pay secrecy. Equity theory posits that people desire to maintain fairness between the outcomes that they receive and the inputs that they have provided vis-à-vis what they perceive to be the outcomes and inputs of other people in their own firm and in other firms. Pay transparency can provide information on the outcomes and inputs of individuals and others so that individuals can verify that pay (or outcome) differentials are equitable, which then improves individuals’ perception of fairness. People’s perceptions of fairness are also a function of perceived procedural fairness (i.e., the fairness of the processes and procedures through which outcomes are determined) and informational fairness (i.e., the adequacy of explanations of processes and procedures used to determine outcomes), in addition to distributive fairness (i.e., the fairness of the outcomes) (Greenberg 1982, 1993). Pay transparency may bolster perceptions of procedural and informational fairness. In turn, procedural and informational fairness have positive effects on trust in the firm management, organizational commitment, job satisfaction, job motivation and performance (Cloutier & Vilhuber 2008, Colquitt, Colon, Wesson, Porter, & Ng 2001; Colquitt et al. 2013). Futrell and Jenkins (1978) use a field experiment and find that salespersons who are in an open pay system performed better and are more satisfied with various aspects of their job (work, pay, company promotional policies) compared to salespersons who are in a control condition where pay is secret.

However, pay transparency may result in the compression of performance ratings and pay, which then reduces task motivation because of the reduced linkage between performance
and pay (Leventhal, Karuza, & Fry 1990). Compression of performance ratings and pay may arise because raters try to avoid the unpleasantness associated when unequal pay information is made public. Pay transparency has also been argued to increase perceived inequity, jealousies, conflict, and dysfunctional politics when people are able to compare their pay with that of others (Ackley 1993, Case 2001). Tremblay and Chênevert (2008) survey HR directors and find that high-technology firms are less likely to adopt transparent compensation systems than low-technology firms, and that greater pay transparency is associated with lower self-reported market performance (e.g. sales growth, profitability, market share) and employees’ discretionary effort (i.e., willingness to exert more effort than normally required). Using university employees who are either informed or uninformed about pay disclosures of fellow employees, Card, Mas, Moretti, and Saez (2012) find that employees in the lowest pay quartile and working under pay transparency are less satisfied with their job and more likely to report searching for a new job compared to their quartile peers working under pay secrecy.

Prior research on pay transparency has not examined its effects on client capture in law firms, and the theoretical relationship between pay transparency and client capture is not clear. A transparent system makes salient pay differences and increases the extent to which partners compare their profit allocation against that of other partners. However, how the increased salience of pay differences and increased pay comparison that partners engage in affect client capture may be a function of what partners perceive the pay differences to be attributed to. Below, we argue that the perceived degree of subjectivity used in profit allocation affects what partners attribute salient pay differences to, and therefore moderates the effects of pay transparency on client capture.
Interactive effects of perceived subjectivity and pay transparency on client capture

Our discussion above suggests that a greater degree of perceived subjectivity used in profit allocation could increase client capture if partners become more aware that fellow partners’ subjective opinions may have a significant influence on their compensation. Alternatively, increased perceived subjectivity could decrease client capture if partners become more conscious that the firm may use subjectivity to discourage excessive client capture that is a threat to its reputation. In addition, the increased salience of pay differences and increased pay comparisons created by pay transparency (versus pay secrecy) may have differential impact on client capture depending on what partners attribute the salient pay differences to. These suggest that there may be an interactive effect between perceived subjectivity and pay transparency.

We first posit that pay transparency (versus pay secrecy) decreases client capture when the law firm is using subjectivity to a lesser degree and relying more on objective criteria such as billable revenues and billable hours when allocating firm profits. A transparent profit allocation system makes salient pay differences and increases pay comparisons. Partners are more likely to attribute the salient pay differences to objective economic factors than to bias or favoritism, and they are then less concerned that not succumbing to the wishes of clients and fellow partners would negatively impact their own compensation through the use of subjectivity. This can increase the sense of economic independence from a single client and from fellow partners which better enables partners to reject client capture that is perceived to comprise the integrity of their legal advice. In a closed compensation system, partners are less able to verify the degree to which relative compensation amongst partners, which is presumably based on more objective factors, is susceptible to bias and firm politics.
We then posit that pay transparency (versus pay secrecy) increases client capture when the law firm is perceived as using subjectivity to a greater degree when allocating firm profits. Pay transparency makes salient pay differences and increases pay comparisons, and partners may then attribute the pay differences less to objective factors and more to subjective factors that are susceptible to bias and firm politics. This increases partners’ sense of economic interdependence with their fellow partners and makes them more conscious of how client capture affects their own pay vis-à-vis the pay of other partners. In other words, the combination of salient pay differences and higher perceived subjectivity greatly increases the sensitivity of partners to firm politics that can increase client capture. When a closed profit allocation system is used in conjunction with higher perceived subjectivity, while partners understand that fellow partners’ opinions may influence relative compensation amongst partners, they are not able to verify if that is the case and pay differences are also less salient. Because pay differences are less salient in a closed system, partners may be less conscious of the economic interdependence with their fellow partners and be less sensitive to firm politics. If so, their legal advice to a client may be made with less focus on how not acquiescing to the client and a relationship partner would negatively impact their own pay vis-à-vis the pay of other partners. Our hypothesis is formalized below:

**Hypothesis:** Pay transparency and perceived use of subjectivity interacts to affect client capture. Specifically, a transparent (versus closed) profit allocation system decreases client capture when there is lower perceived use of subjectivity in allocating firm profits, but it increases client capture when there is higher perceived use of subjectivity in allocating firm profits.

**Methodology**

This study is based on data drawn from interviews with 56 partners working in 11 large corporate law firms in Canada. The demographics of our interviewees are reported in Table 1.

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4 This is a sub-set of 106 interviews that we conducted. The questions on the use of objectivity/subjectivity and the transparency of the partner profit allocations are asked in only 64 of the 106 interviews. Of the 64 interviews, 8
We used an advisory group of three senior partners in commercial law firms (two of whom had experience as managing partners of large Canadian law firms) to guide us on selecting law firms and to help us gain the participation of these law firms. Of the 11 law firms, five are national firms with offices throughout the country and six are regional firms with offices primarily in certain regions of the country. Together, these law firms have offices in four major cities in Canada (Toronto, Vancouver, Calgary, Montreal). These four cities hold the largest concentrations of corporate law firms in Canada. Five of these firms have respondents only from offices in Toronto, one firm has respondents only from a Vancouver office, one firm has respondents only from a Calgary office, two firms have respondents only from a Montreal office, and two firms have respondents from offices in all four cities. Based on discussions with our advisory group, the distribution of the interviewees across the four cities is representative of the distribution of the overall number of commercial lawyers in those cities. Our advisory group contacted the managing partner of each firm to obtain their agreement to participate in the study. The managing partner of each firm then contacted all commercial lawyers in the respective offices to give individual lawyers permission to participate and to provide a statement of support for the study. We provided the managing partner and individual lawyers with appropriate assurances of confidentiality.

--- Insert Table 1 about here ---

We selected only lawyers who indicate that they practice commercial or business law on the firm’s website as potential interviewees. We excluded corporate litigation practices from our interviews were with associates and 56 were with partners. We exclude the associates from our analyses. However, the inferences are similar including the data from the associates. Data from the 106 interviews are analyzed in three other papers examining the types of influence clients have on their lawyers (Dinovitzer, Gunz, and Gunz 2014a), the strategies lawyers use to balance their legal obligations with client demands (Dinovitzer, Gunz, and Gunz, 2014c), and the relationships between the nature of client capture and the strategies lawyers use to balance their legal obligations with client demands (Dinovitzer, Gunz, and Gunz, 2014b). None of these three papers examines how the nature of the profit allocation system affects the degree of client capture, which is what our current study focuses on.
study because the nature of corporate litigation practice and client relationships is substantially different than that in other fields of commercial work such as securities or mergers and acquisitions (Kirkland 2005; Suchman 1998). We focus on only commercial or business law practice, while excluding corporate litigation, to obtain a sample of respondents who we believe are responding to differences in profit allocation practices while working in practices exposed to similar competitive and business pressures. We selected partners from all hierarchical levels, including junior-level partners with between five to 10 years of experience as partners, senior mid-level partners with between 11 to 20 years of experience as partners, senior partners with 21 years or more of experience as partners, and partners who hold current executive level positions. Partners with executive level positions are those who are members of the national or regional management team with responsibility for the strategic direction of the entire firm. We also selected potential interviewees based on a gender distribution that our advisory group believe is representative in private law firms at each seniority level (about 25% at the partner level). However, our final sample of 56 interviewees comprise of 14.3% women at the partner-level.

We constructed a semi-structured interview protocol for the lawyers covering a broad range of topics such as the nature of their practice, the factors that make clients important to them and to their firm, their assessment of what it takes to be a successful commercial lawyer, and firm structures and training that support lawyers in making professional decisions. However, our analyses focus on the portion of interviews that deals with how the firm allocates profits amongst its equity partners, how partners would respond to a hypothetical vignette detailing a client capture scenario, and how partners balance the economic pressures from their clients with their professional/ethical obligations. Interviews were conducted at the interviewees’ offices by three researchers from September 2009 through November 2010. Each interview lasted
approximately one hour. Interviews were tape recorded and then transcribed by a professional transcriber.

**Independent Variable Measures**

We asked lawyers to (1) identify one or two of the most important factors the firm uses to allocate profits to its equity partners, and (2) whether the firm uses a closed profit allocation system (i.e., partners do not know the exact amount of profits allocated to specific individual partners in the firm although they may know the profit bands and the number of partners who are in each band) or a transparent profit allocation system (i.e., partners know the exact amount of profits allocated to specific individual partners in the firm). For the first question regarding the one or two of the most important factors that the firm uses to allocate profits, the interviewer reminded interviewees that we are interested in the responses that come first to their mind and the actual practices of the firm as opposed to official rules. We do this to ensure that we are getting responses about the actual perceived degree of usage of subjectivity in profit allocation rather than what the firm may formally espouse.

Two of the study’s authors independently coded the first question for whether the partners mentioned the use of subjectivity when discussing one or two of the most important factors used in profit allocation and any disagreements in the codings were resolved. All partners in our sample indicate that their firm uses objective factors such as billable revenues and billable hours in allocating profits. However, the extent to which lawyers mention that their firm employs subjectivity in either how they use the objective factors to allocate profits or in considering other non-objective factors (e.g. intangible contributions to the firm through mentoring junior colleagues, willingness to share clients with others, raising the profile and reputation of the firm, participating in firm management) varies. Respondents who indicate that their firm uses a
subjective process to allocate profits or that the firm considers non-objective factors in addition to objective factors (such as billings and hours) in allocating profits are coded as “1” whereas those who do not explicitly mention the use of subjectivity or non-objective factors are coded as “0”. It is important to note that even when partners do not explicitly mention the use of subjectivity when discussing the most important factors used in profit allocation (and are thus coded as “0”), it does not mean that these partners perceive that no subjectivity is used at all. As discussed earlier, the majority of large Canadian law firms use subjectivity and a combination of billable and non-billable factors in their profit allocation process (McKiernan 2014; Mucalov 2014). Therefore, our “1/0” coding should be interpreted as higher versus lower degree of subjectivity rather than the presence versus absence of subjectivity.

One of the authors coded the question on whether the firm uses a closed (coded as “0”) or transparent (coded as “1”) profit allocation system, because it is a straightforward question that does not require judgment on the part of the respondent or the coder.

**Dependent Variable Measure**

In order to capture the degree of client capture, we presented our interviewees with a vignette describing a low moral intensity ethical issue that involves client capture. The complete vignette is reproduced in Appendix 1. Vignettes are commonly used in studies to measure ethical decision making (O’Fallon and Butterfield 2005). A low moral intensity issue does not require respondents to engage in illegal behavior or significantly unethical behavior with serious and immediate consequences (Barnett 2001; Jones 1991). In contrast to a high moral intensity issue where people are more likely to respond with the easily recognizable legal and/or ethical behavior, a low moral intensity issue allows for a broader range of responses that could be influenced by situational factors such as compensation design features. Further, the majority of
unethical behavior in law firms does not involve blatant illegal or unethical actions that most lawyers would recognize as inappropriate, but rather behavior that involves wider latitude in interpretation as to whether it is an ethical violation or not (Schiltz 1997).

The vignette was developed based on materials from an earlier and separate study (Gunz and Gunz 2008) where 30 corporate lawyers were interviewed about incidents of client capture that they have observed in practice. We piloted the vignette with eight subjects over three rounds of interviews and adjusted the vignette after each round, and further refined the vignette with input from our advisory group. In the vignette, the interviewee is asked to assume the role of a lawyer asked by a senior manager in a major client of the firm to give a legal interpretation and assurance about an undertaking being provided by an important customer of the client in order to close a major deal. The interviewee is told that “it is ultimately a matter of the client determining the amount of risk it wishes to assume” and that “there is nothing at law that would suggest that XYZ [the client] should not proceed” with the deal. The deal will likely fall through without the assurance and the interviewee is advised that there has been “a real change to the manager recently because of the pressure she is under”. The lawyer is uncomfortable about the issue because s/he believes that the assurance will potentially expose the client to an inappropriate amount of risk. The client provides substantial work for different practices within the firm. The lawyer providing the specific legal service to the client is not the relationship partner (or the principal contact partner) managing the relationship with the client, which is common in large law firms. As such, the vignette is structured such that the outcome of this issue has repercussions not only for the lawyer in question but also other lawyers in the firm providing legal services for the client and especially the relationship partner. The lawyer discusses the matter with the relationship partner who expresses no concern about the legal issue but stresses
that it is critical to meet the client’s time lines. The relationship partner indicates that the lawyer should advise the client that there are some risks associated with the undertaking and s/he should therefore write a note to file to protect him/herself and the firm. The interviewee is asked how s/he would handle the situation as the lawyer in question.

Two of the study’s authors independently coded the responses to the vignette for the degree to which the lawyer would acquiesce to the client and the relationship partner, and any disagreements in the codings were resolved. We use a five-point scale, in increasing degree of acquiescence. We code responses as “1” when the lawyer indicates that s/he will not give the assurance unreservedly and expresses either no or limited concern about the response of the relationship partner; as “2” when the lawyer indicates that s/he will not give the assurance but expresses a greater degree of concern about the implications of his/her action for the firm and the relationship partner; as “3” when the lawyer indicates that s/he would like to consult with others in the firm about the appropriate course of action and stresses coming up with alternative solutions (other than providing the assurance required by the client) that satisfy everyone involved; as “4” when the lawyer indicates that s/he will provide the assurance if it is deemed legally sound after further consultation with the relationship partner and/or others in the firm; and as “5” when the lawyer indicates that s/he will give the assurance and expresses that the approach suggested by the relationship partner is appropriate. Responses that are coded as “4” and “5” would often indicate that if there is nothing illegal about the providing the assurance and/or that it is ultimately the client’s business decision on how much risks it wishes to undertake.

Control Variable Measures

Our advisory group and our interviews of tax partners both indicate that while tax
practice is considered part of commercial law practice, it has a somewhat different nature from the other areas of commercial law. Tax is seen as a specialized area that demands very strong technical competencies that are often necessary to support major client transactions and it does not necessarily demand very strong rain-making abilities in terms of external clients. Good internal relations are, however, particularly important since much of the work comes from internal referrals. (Dinovitzer, Gunz, and Gunz 2014a, 2014c). We therefore code whether the respondent has a tax practice (coded as “1”) or not (coded as “0”).

We also control for two demographic variables which may be related to client capture. First, we control for gender, coding female partners as “1” and male partners as “0”. Prior research on ethical-decision making finds mixed results on whether women behave more ethically than men (O’ Fallon and Butterfield 2005). Hatamyar and Simmons (2004) analyze disciplinary actions of attorneys in the United States and find that female lawyers are disciplined less than male lawyers taking into account their relative proportions in the population of lawyers in the United States, suggesting that there may be gender differences with respect to ethical decision-making amongst lawyers. Second, we control for the number of years the lawyer has been practicing since s/he was called to the bar, which is a variable proxy for experience and seniority. Increased experience and seniority may give a partner more confidence in his/her own legal opinion as well as a more established client base, such that the partner may feel less inclined to acquiesce to a single client or to fellow partners.

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5 Respondent #46 when asked how many clients s/he has primary responsibility over: “It's not much. Why? - because these clients are firm's client, or they first of all come from another corp, either the corporate group, for example, or real estate or even litigation group. In other words, you know, tax is accessory to a transaction, so normally if... when issue would come, because there is a transaction somewhere, or there is something that they want to achieve or... you know, and they want to accomplish something; and by doing that, then that's where you deal with tax because tax will necessarily connect to that transaction. So it's more like a group type of approach and being part of the group tax is there.” Respondent #13: “Tax lawyers tend to be more introverted, and least they are more interested in the legal matters rather than the behavioural aspects of the client. They're not people people. … They tend to spend a time thinking about the legal issues, and they may not be so good at bringing in the work, which is why they tend to end being tax lawyers.”
Lastly, we asked respondents to indicate what proportion of their practice comes from referrals from other partners in their firm. The bigger the proportion of a partner’s practice that comes from referrals from other partners, the more economically dependent of the partner is on other partners in the firm, which may increase client capture. Therefore, we control for this variable in our analyses.

Results

Descriptive results

Descriptive statistics of the number of partners who mentioned that their firm used subjectivity in profit allocations for equity partners (versus no mention of subjectivity), the number of partners working under transparent (versus closed) profit allocation systems, and the mean client capture rating under each condition are reported in Table 2. The largest percentage of respondents (23 out of 56 or 41.1%) indicates that their firm uses the transparent system with subjectivity. The smallest percentage of respondents (8 out of 56 or 14.3%) indicates that their firm uses the closed system with no mention of the use of subjectivity. These two settings (transparent with mention of subjectivity and closed with no mention of subjectivity) are also associated with higher mean client capture ratings (2.74 and 2.88, respectively). Approximately similar percentages of respondents report that they are in the closed system with mention of subjectivity (12 out of 56 or 21.4%) and the transparent system with no mention of the use of subjectivity (13 out of 56 or 23.2%). These two settings (closed with mention of subjectivity and transparent with no mention of subjectivity) are also associated with lower mean client capture ratings (1.75 and 2.00, respectively). The descriptive results suggest that pay transparency decreases client capture when there is no mention of subjectivity, but it increases client capture when there is mention of subjectivity; a pattern which is consistent with our hypothesis.
Random effects regressions and control variables

Random effects regression is used to assess the effect of subjectivity and pay transparency on the client capture variable. A random effects regression controls for multiple observations being drawn from a single firm with a firm-specific error term. We test for the interactive effect of subjectivity and pay transparency by assessing the significance and the sign of the interactive effect.

We first conduct the simplest random effects linear model, which models how much firms vary in their client capture (Model 1). We then include the firm-level variable on whether the profit allocation system is transparent or not, the partner-level variable on whether s/he mentions subjectivity as being one of the most important factors used in the profit allocation system, and the interaction between transparency and subjectivity (Model 2). We then add the control variables (i.e., tax practice, gender, number of years in practice after being called to the bar, proportion of practice generated from internal referrals) in the final model (Model 3). The inferences are similar whether we use Model 2 without the control variables or Model 3 with the control variables. The results for the different models of random effect regressions are reported in Table 3. Tax practice (p = 0.668) and gender (p = 0.484) are not significantly related to client capture. However, as expected, years in practice after being called to the bar is negatively and significantly related to client capture (coefficient = -0.043, p = 0.016), suggesting that more senior partners are less sensitive to pressure from their clients and their fellow partners. The proportion of one’s practice that is generated from internal referrals, as expected, is positively and significantly related to client capture (coefficient = 1.566, p = 0.016), suggesting that partners who depend more on referrals from other partners in the firm are more likely to
acquiesce with the client/partner.

--- Insert Table 3 about here ---

We also tested additional models (not tabulated here), adding to the final Model 3 other control variables such as whether the partner is a non-equity partner (p = 0.211) or a lateral partner who moved from another firm to the current firm (p = 0.673), and these control variables are not significant. Dummy variables to control for the city in which the partner operates, whether it is Toronto where many of Canada’s largest law firms are located (p = 0.569), Montreal which is the only province in Canada that practices civil law in conjunction with common law (p = 0.968), Calgary (p = 0.776), or Vancouver (p = 0.360) are all not significant. We also controlled for the prestige of the law school from which the respondent graduated and it is not significant (p = 0.803).6 Lastly, based on this same set of interviews, Dinovitzer, Gunz, and Gunz (2014b, 2014c) identified four typologies of lawyers in terms of how they respond to our questions on client relations (specifically how they balance legal obligations and clients’ business objectives, work with difficult or pushy clients, and say “no” to an important client). The four typologies of lawyers differed on whether they tended to reference the firm or others in the firm, and on whether they tended to reference the law versus their experience to explain their responses. None of these four typologies is significant in the model (all p values > 0.104).7

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6 We code the prestige of the law school attended by respondents as “1 - Elite”; “2 - Good”; or “3 – Others”. The ratings are based on the 2013 Maclean’s Canadian Law School Rankings (with Common Law Schools ranked 3rd and above and Civil Law Schools ranked 2nd and above rated as “Elite”, Common Law Schools ranked between 4th and 10th and Civil Law Schools ranked as 3rd rated as “Good”, and Common Law Schools ranked 11th to 16th and Civil Law Schools ranked 4th and 5th as “Others”.

7 Specifically Dinovitzer, Gunz, and Gunz (2014b, 2014c) categorized lawyers into “team lawyer”, “team player”, “lawyer’s lawyer”, and “lone ranger”. Both the “team lawyer” and the “team player” tend to reference the firm and others in the firm, but the “team lawyer” relies more on the law than experience to explain his/her responses whereas the “team player” relies more on experience than the law. Both the “lawyer’s lawyer” and the “lone ranger” rarely reference the firm and others in the firm, but the “lawyer’s lawyer” relies more on the law than experience to explain his/her responses whereas the “lone ranger” relies more on experience than the law. The only typology that approaches significance in the model is the “team lawyer”, which is negatively associated with client capture (coefficient = -0.578, p = 0.104). This result makes intuitive sense if a “team lawyer” is more concerned about the
Importantly, including any of these additional control variables does not change the inferences from our results (i.e., the sign and significance of the coefficients on the two independent variables and the interaction effect are similar with and without these control variables).

**Test of hypothesis**

Based on our hypothesis, we expect the coefficient for the interaction between pay transparency and subjectivity to be positive, indicating that the negative effect of pay transparency (versus pay secrecy) on client capture under less perceived subjectivity would be reversed under more perceived subjectivity. Random effects regression shows that the coefficient on pay transparency (Model 3 coefficient = -0.796, p = 0.086) is negative and marginally significant, indicating that pay transparency is marginally associated with lower client capture. The coefficient on subjectivity is also negative and significant (Model 3 coefficient = -1.16, p = 0.018), indicating that subjectivity negatively impacts client capture. However, the interactive effect of pay transparency and subjectivity is positive and significant (Model 3 coefficient = 1.835, one-tailed p = 0.002), indicating that using subjectivity in conjunction with pay transparency increases client capture, consistent with our hypothesis and the descriptive results.

Our random effects regression models all indicate that the variance of the random effect is zero, which suggests that the firm as a random effect does not contribute to any variation in the client capture variable. Therefore, we conduct ANCOVA of client capture as an alternative test for our hypothesis, with subjectivity and pay transparency as the independent variables and tax practice, gender, years practicing after being called to the bar, and proportion of practice from internal referrals as control variables. Similar to the random effects regression, untabulated ANCOVA indicates that the interactive effect of subjectivity and pay transparency is significant potential negative impact of client capture on the firm’s reputation and is also more concerned about his/her legal obligations.
(p = 0.003). Pairwise contrasts indicate that, as hypothesized, client capture decreases with pay transparency when subjectivity is not mentioned (least squares means decrease from 2.69 to 1.89, one-tailed p = 0.042), but it increases with pay transparency when subjectivity is mentioned (least squares means increase from 1.52 to 2.56, one-tailed p = 0.004). Pairwise contrasts also show that client capture decreases from less subjectivity to more subjectivity under a closed system (least square means decrease from 2.69 to 1.52, one-tailed p = 0.009), but it increases from less subjectivity to more subjectivity under a transparent system (least square means increase from 1.89 to 2.56, one-tailed p = 0.035).

**Analyses of Interviews**

Analyses of the interviews provide interesting insights into how partners perceive pay transparency and the use of subjectivity in profit allocation. We make three main observations. First, supporters of the transparent system argue that pay secrecy breeds mistrust but qualify that the pay differentials that are made known to partners under the transparent system must by perceived as fair. Second, supporters of the closed system argue that pay transparency leads to pay comparisons that may result in perceived inequities and dissatisfaction amongst partners. Third, there is support that pay transparency used in conjunction with a less subjective system can increase partners’ perception of economic independence whereas partners are sensitive to the subjective influence that they have on each other’s compensation in a transparent system that also uses more subjectivity. We discuss these observations in greater detail below.

First, respondents who support the transparent system believe that pay secrecy breeds distrust when partners do not have information about how profits are distributed and that transparency enables partners to collaborate better when they know how each other’s profit allocations would be impacted by their actions. However, the support for a transparent system is
qualified in that respondents indicate that the pay differentials that are disclosed to partners under the transparent system must be perceived as fair. In particular, when the pay differentials in a transparent system are a function of more objective factors or external market factors that are well understood by partners, they are more likely to be perceived as fair. The ability to understand and verify the factors that cause pay differentials also motivate partners because of the clear pay to performance linkage.

**Respondent 40 (Senior mid-level partner, works in a transparent system, mentions subjectivity):** “Yes, we have a transparent system so the partners know what all the other partners are allocated. There is a wide spread from top to bottom. That’s probably true at most law firms, and it’s a reflection, to some extent, of the business model that the firm is using. So there are some areas of practice that can support hourly rates at one level; other areas of practice that can only bear hourly rates at a much lower level. If someone chooses to practice in an area with lower hourly rates, generally they have to understand they’re going to be compensated lower.”

**Respondent 60 (Junior mid-level partner, works in transparent system, no mention of subjectivity):** “… like I’m okay with eat what you kill on some levels, but I don’t… I think it’s got to be fair in the sense of I need to understand what other people’s contributions are on a personal level, and I realize that there’s some people who believe that if you give all those numbers of people it’s going to create a bunch of internal bickering, but I’d much rather have that discussion out in the open rather than have it, you know, speculated in the background. … as we get bigger and as this gets more sophisticated, it becomes necessary to sell work or gain client… gain additional client trust and build the client base on a team basis, and selling the firm as opposed to individuals; and if you aren’t open and transparent with regards to what people’s inputs are, then there’s limited loyalty between those people, and there’s a bunch of distrust amongst those people. So I want to be able to walk down the hall and say to, you know, whoever it is, ”Look, let’s go and pitch to these guys; it’s in both our interest to do that,” but if I don’t know where his or her position is in certain context, or if it’s against his interest to work with me on that, then either it just doesn’t get done or it gets done in a disjointed manner.”

**Respondent 62 (Junior mid-level partner, works in transparent system, no mention of subjectivity):** “I’m quite fine to have, you know, big difference in bonus, and the bonus really is part of what… part of what your… you know, eat what you kill - it’s really to drive… to get people, you know, to really strive to do more and then really build the business, so it’s really there to incentivize people; and if someone is doing… you know, if somebody is bringing 10 times the work to everybody else, you know, they could get a very, very large one. Everyone one else could be quite small. It really could be that extreme. … you’d think it would create tensions but, no, it really doesn’t because I think, you know, everyone is, you know, quite… I think quite frank and quite fair and the
numbers are the numbers, and you can't shy away from the numbers tell you for that year so, you know, you see the number presentation that CLO would deliver to everybody for the year, and there are the numbers; and from that, you know, you draw... you draw the conclusions which are consistent year by year.”

**Respondent 81 (Senior partner, works in transparent system, no mention of subjectivity):** “... we obviously have to keep pace with the market, so if you have a few rainmakers who were underpaid and... very attractive to your competitors. You've got to make sure they're paid properly. ... And, if that results in a huge swing sometimes, then so be it.”

**Respondent 99 (Senior partner, works in closed system, mentions subjectivity):** “... I agree with ... the transparency. I think there's an element of distrust that creeps in; and when you start talking to other partners and nobody knows... well, you know, who's making all the money here, you know.”

Second, respondents who support the closed system indicate that a transparent system results in partners engaging in more comparisons of pay than in a closed system. Increased comparisons could result in perceived inequity and conflict among partners, particularly when the profit allocations are highly subjective and could be deemed to be unjustified. Increased comparisons could also lead to unproductive impression management if the performance assessment is highly subjective in nature. There is some support for the argument that a transparent system could potentially result in pay compression if the firm management is concerned about the negative effects on the reputations and egos of partners who are paid comparatively less. However, pay compression is more likely to happen when subjectivity is used in a transparent system and it is less likely to occur if profit allocations are based more on objective factors. In comparison, a closed system limits the ability of partners to make comparisons and allows firm management to institute bigger pay differentials.

**Respondent 34 (Junior mid-level partner, works in a transparent system, mentions subjectivity):** “Well, you know, the process isn't perfect. I mean, they... I mean, there's no good way to do this, but they... age, that year of call is important; but unintentionally, I think... I know this is because my immediate peers are... who were home grown seem... that make a little more than I do, I think that's just because they're a more known quantity. They also still do work for the more senior partners, which I don't. So, I mean,
those senior people are making decisions for their team, so to speak, so they're going to reward their men and women. You know, that's human nature.”

Respondent 36 (Senior partner, works in closed system, mentions subjectivity): “We love it [closed system] because we think it prevents comparisons – and also we think it’s good ... we have fantastic morale around here.”

Respondent 57 (Senior partner, works in transparent system, mentions subjectivity): “There are firms, including in Toronto, who try to be quite precise about the equation of how much money you've personally generated and how much you've generated for others, and they have a mathematical formula. We don't do that. We have a committee who tries to know everybody and understand their practice. Everybody makes submissions to it as to what they've accomplished. We're allowed to comment on each other, and then this committee of wise people sets an allocation, and it's a report that goes to the partnership. It gets approved by the partnership. It never gets rejected by the partnership. Every year there are a few people who are deeply unhappy and, hopefully, that gets remedied over time, but it's a subjective system, not an objective one. ... So now the management people have a larger say than they used to in the allocations process, and that has... that's probably made the management people more powerful than they ever were before because now if they ask you to speak at a conference or take on some project, people have in the back of their minds that they're talking to folks who have a large say in allocations. So linking those two functions has had consequences for how we run the firm. ... Yeah, it's good and bad, frankly. It's good in that it makes management more effective. It's bad in that it makes younger lawyers a little less willing to speak their minds to the people in management. It does change the way the law firm operates a little bit.”

Respondent 79 (Executive partner, works in transparent system, mentions subjectivity): “I resisted that disclosure and in fact I invited the managing partner for one of the leading [city name] law firms to ... talk to our partners at a meeting about their compensation where they didn't disclose anything. You didn't know what your fellow partners earned, and he indicated, this managing partner from [city name] that that was the best way to manage a firm because you can make tough decisions without having to worry that the person who is adversely affected is going to be embarrassed or... and it avoids other partners endlessly second-guessing your decisions so ...”

Respondent 85 (Senior mid-level partner, works in closed system, mentions subjectivity): “I've lived in both systems, and the amount of time that is wasted in your average law firm by people positioning themselves, you know, to get more than John or Susie down the hall, and the amount of ill will and the amount, frankly, of games that are played to rig - rig is maybe a strong word - but to cause the numbers to come out in a certain way. Compare that to a firm like this one where it's pretty hard to draw a very direct link from what you do to what you make, you know, you're actually only left with the right things to focus on, which is delivery of a super product to your client and spreading work out within the firm in a way that serves the client’s best interest, and trusting that the system will compensate you for acting in that client-focused, partner-
focused way, rather than a more self-centered way. I think it's brilliant.”

**Respondent 86 (Senior mid-level partner, works in closed system, mentions subjectivity):** “It [closed system] allows for greater flexibility. It gives the [compensation] committee more freedom to make the right decisions rather than to be influenced by how lawyers will perceive the decisions that are made? If someone has been under-performing and their compensation should be reduced, in a closed system the committee can do that. If it's an open system, then the committee may feel pressure not to reduce the compensation because then that would be a signal to the rest of the firm that that person is not performing, and that might be damaging to that person’s reputation or ego within the firm, or even within the community if word gets out, and so then the committee might feel pressured to maintain that person's compensation, which would be to the detriment of all of the other people who are performing because it's a finite pie, right?”

**Respondent 90 (Executive partner, works in closed system, mentions subjectivity):** “one of the problems with the open system is people often weren't that concerned about the dollars they were getting, but they were very offended that, you know, Joe Blow who they graduated with, articulated with, whatever, who they always considered their contemporary, was earning 20 percent more than they were; and in fact we have Joe Blows who would say to us, "I don't want to earn more than so and so." "You know, it's going to upset our relationship. I'd rather you just kept me at what they're earning."

**Respondent 96 (Executive partner, works in closed system, mentions subjectivity):**

“Yeah, I think the open system results in way too much scrutiny, way too much... I would just call it negative energy - worrying about what the next person is being paid.”

Third, we find evidence that partners who work in a transparent system and do not mention subjectivity cite their economic independence from fellow partners as a reason why they are less willing to acquiesce with the client and the relationship partner in the vignette.

**Respondent 41 (Senior partner, works in a transparent system, does not mention subjectivity):** “[do the other partners in the firm have any impact on how you handle cases] No, all that happens at the associate and junior partner level; and then once you've ... you know, once you become pretty much on your own and you're sort of running your own show, any influence is probably pretty much gone.”

**Respondent 46 (Senior mid-level partner, works in transparent system, does not mention subjectivity):** “... your biggest power, your largest sense of independence is that you have a client base. A client base is important, ... You know, even if you don't get recognized on dollar-for-dollar for your book of business as I explained earlier, that's your ultimate power - not in terms of earning power, but in terms of just your practice. You know, it gives you a certain degree of independence that you're never going to be beholden to anybody else in the firm, and that's always been... I guess, happily, I've
managed to develop, you know, my own modest success in terms of a book of business, and that's given me a lot of independence. I don't have to kowtow to anybody. It doesn't mean I walk arrogantly either; but just when you're in those situations, it's different if that's the hand that feeds you within the firm and your career depends on you pleasing this person. Well, then maybe you do things that ultimately you're not that comfortable with, but you need to do it. When you don't have that economic dependence on anyone within the firm, you can draw your own lines. That's kind of how I've been able to get through the practice, so in a situation like that I'm assuming I don't have economic dependence on this person who's trying to have me do something I'm not comfortable with. I simply wouldn't do it; and if they didn't like it, well, they wouldn't come to me the next time.”

There is also evidence that respondents who work in a transparent system and mention subjectivity are concerned about the opinions of their fellow partners, particularly if peer evaluations are taken into account in the profit allocation process.

**Respondent 39 (Senior partner, works in a transparent system, mentions subjectivity):**
“In terms of the qualitative things, peer... we place a high degree of emphasis on peer reviews in our compensation process, so all partners are expected to comment substantively on the performance of other partners, and qualitatively as well as their view on their contribution, and that is... that's given a great deal of weight; and then I guess another, I mean it's constantly in flux and it's very difficult to assess ... Yeah, I think it's much more qualitative than quantitative. We do client interviewing. We talk to our important clients. Once a year we'll go out and we'll have people not involved in the relationship go out and interview the client about their work with the firm, and so we ask them about people they work with. We do peer... partner peer reviews so everyone gets the chance anonymously - not anonymous to the people reading the reviews, but anonymous to the partner being commented upon so they can voice concerns that they may have. An isolated comment isn't going to be given weight, but you look for a pattern of comments like, “Oh, I was a bit worried about the way they dealt with this.” If you see that happening even twice, it would be a concern because people are reticent. They don't like to criticize. So if you see any pattern of that, you focus on it, yes.”

**Respondent 40 (Senior midlevel partner, works in a transparent system, mentions subjectivity):**  “I think a third thing is the balance in it is that it is competitive; and while I might think that the right answer is to say no to a client, I will in the back of my mind ask myself will other lawyers in other firms agree with me, or are there a significant number of lawyers in other firms that would disagree and would tell the client opposite advice. If on the quick gut check I feel like the client is most likely going to get the same answer from most other lawyers they consult, it makes it that much easier for me to give them that answer because I don't feel like they can shop around for a different opinion, a more favourable opinion from another law firm. If, however, I know that or suspect that there are a number of other reputable lawyers who will tell the client what they want to hear, I'll usually do some extra work to figure out why is it that I'm uncomfortable with
telling the client. In the end, that extra work sometimes pays off, and sometimes we find something we didn't think of before, or sometimes my gut reaction was wrong. When I do that, I usually have to do that on my own time without billing the client.”

Conclusion

This study uses interview data of law partners in large corporate law firms in Canada to examine how two features of compensation systems, pay transparency and perceived use of subjectivity, affect the degree to which partners are willing to go along with the wishes of a major hypothetical client and relationship partner. Lawyer partner compensation allocation is unique in that unlike employees, partners are actually residual claimants and are owners of law firms. However, unlike owners of corporations, the shares of the profits in the firm are adjusted periodically by a compensation committee based on the number of equity partners and the assessed contributions of the partners to the firm.

The conclusion of Belogolovsky and Bamberger (2014) based on lab studies is that pay secrecy (relative to pay transparency) has adverse effects on individual productivity on a task, and those adverse relative effects are amplified if subjectivity is used. The implication from Belogolovsky and Bamberger (2014) is that companies should adopt transparent pay systems, and that the relative benefit of pay transparency over pay secrecy in terms of individual productivity is particularly strong if subjectivity is used. Our study focuses not on the productivity of law partners in terms of the amount of profits they generate for the firm, but on a particularly nuanced aspect of their job performance that involves balancing their professional/ethical obligations with pleasing their clients/relationship partners. Specifically, we examine the degree to which partners are willing to acquiesce to the demands of the client and the relationship partner in their firm.
We find that when partners do not mention subjectivity as being among the most important factors in the profit allocation system, pay transparency decreases client capture. In contrast, when partners mention subjectivity as being among the most important factors in the profit allocation system, pay transparency increases client capture. A transparent profit allocation system (compared to a closed system) enables partners to more readily compare their pay with those of their colleagues and likely increase the salience of pay differences amongst partners. We argue that this increase in salience of pay differences arising from pay transparency would lead to a greater sense of economic independence when the pay differences can be attributed to more objective factors (i.e., when less subjectivity is used in the profit allocation system). Such contexts may increase the independence of partners when they are providing legal services to a client for whom there is a separate relationship partner in the firm. However, when there is an increase in salience of pay differences arising from pay transparency and pay differences are based more on subjective factors, it is more likely to increase the sensitivity of partners to their economic interdependence within the firm. This may result in a greater degree of client capture. We are careful to note that a greater degree of client capture does not necessarily suggest more unethical behavior for a couple of reasons. First, the vignette that we use to capture client capture presents a low-intensity ethical dilemma where acceding to the client’s wishes is not illegal and is not a significant ethical violation. Second, even when client capture is higher, the mean values only reach moderate rather than complete levels of acquiescence, where partners stress the importance of conferring with others in the firm to determine the appropriate course of action and coming up with alternative solutions that satisfy themselves, the client, and the relationship partner.
There are limitations to our study. First, we use the perceptions of partners about the use of subjectivity in their firm’s profit allocation system which may not be an accurate reflection of the actual use of subjectivity in their firm. However, we contend that lawyers’ behaviors are likely influenced more by their perceptions of reality than by reality itself. In that regard, in considering the actual usage of subjectivity and pay transparency in profit allocation, law firms should also consider the perceptions of their partners. Second, although our results suggest that pay transparency and perceived subjectivity interact to affect partner behavior in a low-intensity ethical dilemma, it is possible that partner behavior in a high-intensity ethical dilemma may be less sensitive to compensation design features. Third, the nature and the strength of the culture of the law firm are likely significant factors that affect how a law firm would use subjectivity and how individual partners would respond to subjectivity and pay transparency (Gilson and Mnookin 1985). The variations in firm culture may, in part, be controlled through random effects regression that account for firm-level random effects as well as through control variables such as whether the lawyer perceive the firm as a significant influence in how they respond to client pressure (see Footnote 7). However, future research could examine how firm culture interacts with subjectivity and pay transparency.
References


Appendix 1: Vignette

Question presented to interviewee: Here is a case drawn from professional practice. We’re interested to know how you’d handle the situation if you found yourself in it.

Your law firm has a large commercial practice, of which you are a partner. XYZ Corporation has been a major client for many years. In recent years XYZ has been expanding aggressively with considerable success. XYZ generates substantial work for several different practices within the firm. Smith is the principal ‘contact’ partner within your firm although XYZ managers often directly contact other partners and lawyers as needed.

You provide legal services to the commercial loans department of XYZ. You have been asked by the senior manager with whom you have a long-standing relationship, to give a legal interpretation and assurance about an undertaking being provided by one of its large clients. You have noticed a real change in the manager recently because of the pressure she is under and you know this is a very important client both to her and XYZ. She has stressed that the deal must be closed tomorrow. This is a major deal by XYZ’s standards.

You have examined the undertaking thoroughly and believe that giving the requisite level of assurance would expose XYZ to an inappropriate risk exposure. While you understand that it is ultimately a matter of the client determining the amount of risk it wishes to assume, this issue is making you uncomfortable. Further, if you do not provide the assurance, the deal between XYZ and its customer will probably fall through. However, if you give the assurance, but the undertaking is not enforceable, you have no doubt XYZ will hold both you and your firm responsible for the failure.

You elect to follow normal practices and take the matter to Smith to discuss. You explain the legal concerns and the time pressures the manager faces. While you know Smith’s primary concern is to maintain good client relations, his reaction is unusual. He is not concerned about the legal issue but stresses that it is critical to meet XYZ’s time lines. He reminds you to protect yourself and the firm by writing a full note to file, and to advise the client that, while there are some risks associated with the undertaking, there is nothing at law that would suggest XYZ should not proceed.
Table 1
Sample Demographics

| Gender | N   | Percentage
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Male</td>
<td>48</td>
<td>85.7%</td>
</tr>
<tr>
<td>Female</td>
<td>8</td>
<td>14.3%</td>
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<tr>
<th>Rank</th>
<th>N</th>
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<tbody>
<tr>
<td>Junior mid-level partner (5-10 years of experience as partner)</td>
<td>15</td>
<td>26.8%</td>
</tr>
<tr>
<td>Senior mid-level partner (11-20 years of experience as partner)</td>
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<td>30.4%</td>
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<tr>
<td>Senior partner (more than 20 years of experience as partner)</td>
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<td>32.1%</td>
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<tr>
<td>Executive (with executive experience)</td>
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<td>10.7%</td>
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<table>
<thead>
<tr>
<th>Firm</th>
<th>N</th>
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<tbody>
<tr>
<td>Firm 1</td>
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</tr>
<tr>
<td>Firm 2</td>
<td>11</td>
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<td>Firm 5</td>
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<td>Firm 7</td>
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<tr>
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<td>Firm 9</td>
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<td>7.1%</td>
</tr>
<tr>
<td>Firm 11</td>
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<td>5.4%</td>
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<table>
<thead>
<tr>
<th>Location of firm</th>
<th>N</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Toronto</td>
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<td>37.5%</td>
</tr>
<tr>
<td>Montreal</td>
<td>15</td>
<td>26.8%</td>
</tr>
<tr>
<td>Vancouver</td>
<td>10</td>
<td>17.9%</td>
</tr>
<tr>
<td>Calgary</td>
<td>10</td>
<td>17.9%</td>
</tr>
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</table>

*a Totals may add up to more than 100% due to rounding.*
Table 2
Descriptive Statistics of Client Capture Rating<sup>a</sup>

<table>
<thead>
<tr>
<th></th>
<th>Closed Profit Allocation System&lt;sup&gt;b&lt;/sup&gt; N = 20</th>
<th>Transparent Profit Allocation System&lt;sup&gt;b&lt;/sup&gt; N = 36</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Mention of Subjectivity&lt;sup&gt;c&lt;/sup&gt; N = 21</td>
<td>N = 8 Mean = 2.88 (std dev = 1.55)</td>
<td>N = 13 Mean = 2.00 (std dev = 0.82)</td>
</tr>
<tr>
<td>Mention Subjectivity&lt;sup&gt;c&lt;/sup&gt; N = 35</td>
<td>N = 12 Mean = 1.75 (std dev = 1.14)</td>
<td>N = 23 Mean = 2.74 (std dev = 1.05)</td>
</tr>
</tbody>
</table>

<sup>a</sup> Responses to the vignette were coded for the degree to which the lawyer would acquiesce to the client and the relationship partner on a five-point scale, with “1” indicating the lowest degree of acquiescence and “5” indicating a highest degree of acquiescence.

<sup>b</sup> The transparent profit allocation system was coded as “1” if the respondent indicated that the firm used a transparent system where the information on profit allocations to individual partners was openly shared with all partners and “0” if the respondent indicated that the firm used a closed system where partners did not know the actual profit allocations to specific individual partners.

<sup>c</sup> Respondents were asked to identify one or two of the most important factors the firm used to allocate profits to its equity partners. Respondents who indicated that their firm used a subjective process to allocate profits or that the firm considered subjective factors in addition to objective factors (such as billings and hours) in allocating profits were coded as “1” whereas those who did not explicitly mention the use of subjectivity or subjective factors are coded as “0”.
Table 3
Random Effects Regressions

<table>
<thead>
<tr>
<th>Dependent Variable: Client capture(^a)</th>
<th>Model 1 (n = 56)</th>
<th>Coefficients (t, p(^e))</th>
<th>Model 2 (n = 56)</th>
<th>Coefficients (t, p(^e))</th>
<th>Model 3 (n = 56)</th>
<th>Coefficients (t, p(^e))</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>2.375 (15.21, &lt; 0.001)</td>
<td>2.875 (7.36, &lt; 0.001)</td>
<td>3.522 (5.99, &lt; 0.001)</td>
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<tr>
<td>Subjectivity(^a)</td>
<td>-1.125 (-2.23, 0.031)</td>
<td>-1.163 (-2.46, 0.018)</td>
<td>-0.796 (-1.76, 0.086)</td>
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<tr>
<td>Transparency(^a)</td>
<td>-0.875 (-1.76, 0.085)</td>
<td>-0.862 (-1.76, 0.086)</td>
<td>-0.796 (-1.76, 0.086)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subjectivity(^a)*Transparency</td>
<td>1.864 (2.94, 0.003(*))</td>
<td>1.835 (3.12, 0.002(*))</td>
<td>1.864 (2.94, 0.003(*))</td>
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<tr>
<td>Tax practice(^b)</td>
<td>-0.201 (-0.43, 0.668)</td>
<td>-0.278 (-0.71, 0.484)</td>
<td>-0.043 (-2.53, 0.016)</td>
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<tr>
<td>Gender(^c)</td>
<td>1.566 (2.52, 0.016)</td>
<td>1.566 (2.52, 0.016)</td>
<td>1.566 (2.52, 0.016)</td>
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<td></td>
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<tr>
<td>Years in practice after being called to bar(^d)</td>
<td>1.566 (2.52, 0.016)</td>
<td>1.566 (2.52, 0.016)</td>
<td>1.566 (2.52, 0.016)</td>
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<td></td>
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<tr>
<td>Proportion of practice from internal referrals(^e)</td>
<td>1.566 (2.52, 0.016)</td>
<td>1.566 (2.52, 0.016)</td>
<td>1.566 (2.52, 0.016)</td>
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</table>

Fit Statistics (smaller is better)

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
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<tbody>
<tr>
<td>AIC</td>
<td>179.3</td>
<td>170.3</td>
<td>159.9</td>
</tr>
<tr>
<td>BIC</td>
<td>179.7</td>
<td>170.7</td>
<td>160.3</td>
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</table>

\(^a\) See Table 2 for description of client capture, use of subjectivity, and pay transparency.

\(^b\) Tax practice is coded as “1” if the respondent has a tax practice and “0” if the respondent does not.

\(^c\) Gender is coded as “1” if the respondent is female, and “0” if the respondent is male.

\(^d\) We asked partners for the year that they were called to the bar and calculated the number of years they have been practicing since they were called to the bar.

\(^e\) We asked partners to indicate the proportion of their practice derived from referrals from other lawyers in their firm. The possible range of values is from 0 to 1.

\(^f\) All p-values are two-tailed, except for the one-tailed p-value for the predicted positive interactive effect of pay transparency and subjectivity, which is indicated with \(*\).