

# Chapter 2

## The Business of Professional Service Firms

As already outlined in the introduction, the professional service firm sector is characterized by a couple of commonalities, such as the critical resources. Despite all these commonalities it must be forgotten under no circumstances that there are considerable differences between individual companies within the sector. These differences on the one hand manifest in more differentiated types of businesses and remuneration forms. On the other hand they are based on the fact that professional services vary depending on the subsector. These subsectors will be portrayed in detail in the following chapter. When comparing the range of services of a management consultancy and the one of an insurance broker this is more than obvious. In the following types of businesses (Sect. 2.1) and remuneration forms (Sect. 2.2) are presented as can be generally found in the PSF sector.

### 2.1 Types of Professional Service Firm Businesses

The business basis of professional service firms in principle rests on the demand for additional qualitative or quantitative problem solving competence on part of clients. In some cases the involvement of professional service firms is a statutory obligation. Companies have to have their annual accounts performed by neutral parties, i.e. auditing companies.<sup>1</sup> The businesses, which professional service firms are able to conclude against this background, are often of highly diverse nature. There are three basic *types of business* (see Fig. 2.1):

- The first type of business is the *consulting business*. It tackles problems which can often not be clearly defined by clients. The objective of this kind of service is to develop ideas and concepts which form the basis of the client's decision-making. A typical claim of consultants is the development of constantly new specific solutions for each client. This is also referred to as 'expert economics'.<sup>2</sup> Whether firms like management consultancies are actually able to live up to this claim in the individual case remains questionable.

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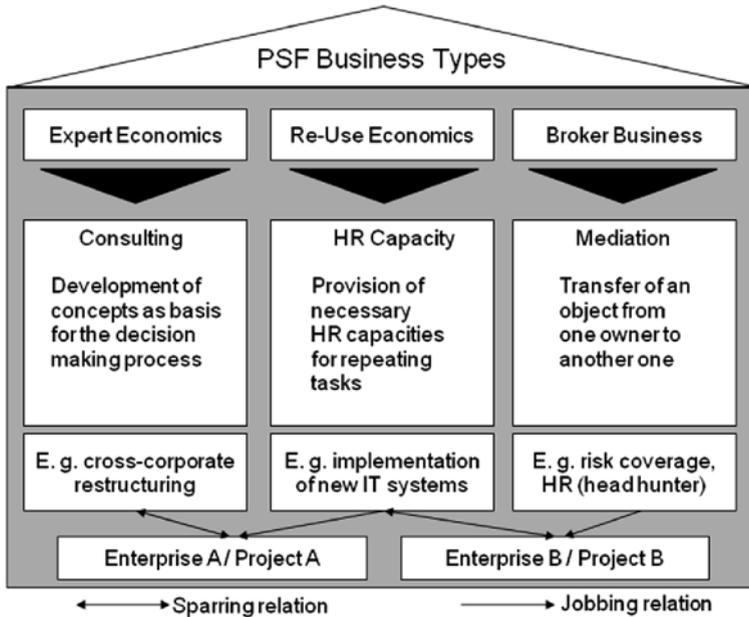


Fig. 2.1 Various types of businesses in the PSF sector

- When additional quantitative problem solving competence is required professional service firms which only provide *personnel capacities* are mainly used. With the help of these additional capacity client problems can be solved which are complex, but at the same time relatively similar. The term for this is 're-use economics'.<sup>3</sup> A classical example of such a case is the implementation of a new IT system.
- *Brokering*, or the so-called brokerage, has a main focus. Simply put, objects are transferred from one owner to the other on behalf of the client. The broker typically works as the mediator in a triangular relation between two companies. The brokered objects can have different form: In case of insurance brokers it is comprehensive risk coverage, for head hunters the 'objects of desire' are human resources.
- In practice the *combinations* of types of businesses are manifold. Often statements regarding this can be made only for specific companies or projects. The services insurance brokers provide for instance often exceed the brokering service. In addition clients often expect an individual consulting service and finally also general service and the administration of insurance products.<sup>4</sup>

The three different types of businesses can furthermore also vary in terms of the *relation*, in which the service is provided. In particular the so called *jobbing* and *sparring relations* are differentiated in that context (see Fig. 2.1).<sup>5</sup> The point of origin in both cases is a complex client problem.

- *Sparring* relations are often characterized by intensive reciprocal interaction. Client and consultant alternate taking on the role of guide and guided.
- *Jobbing* relations on the other hand are rather implementation oriented. The client outsources specific tasks and ensures the respective coordination.

Chapter 4 deals with quality management and looks at clients relations from a different perspective.

## 2.2 Remuneration Forms in Professional Service Firms

It can be concluded that a professional service firm can perform various types of businesses. However it depends on the agreed remuneration form whether every partial service provided is invoiced at the end of the day. The main *remuneration forms* are briefly presented below:

- The payment of a *commission* is a remuneration form with decisive parameters or percentages. In case of insurance brokers e.g. the broker fee depends on the amount insured as decisive parameter.
- *Profit sharing* is a special form of commission payment. While in case of commissions the decisive parameter can be specified in advance, success orientation can be an element of uncertainty both for professional service firms and for their clients: Since success, directly allocatable to a certain project, is not always measurable or is sometimes not revealed unless several years have passed, the determination of this decisive parameter is problematic.
- The probably most common remuneration form is the *hourly fee*. Irrespective of the result the client pays pre-defined hourly rates to professionals involved in the provision of service. Partner rates are significantly higher than the junior employee rates. Such remuneration can be anticipated very well by professional service firms. Clients could face a problem though, if the productivity of professionals turns out to be insufficient.
- The remuneration in form of fixed prices, so-called *retainers*, is invoiced on a regular basis. Similar to hourly rates this form of remuneration can be well anticipated by professional service firms; however, for clients it also bears disadvantages.

It can be useful for the individual professional service firm to combine different remuneration forms. Furthermore remuneration forms are subject to strong temporal development dynamics. Over many years it was general practice for head hunters to receive commissions and for consulting firms to invoice hourly rates. Clients, however, have now begun to postulate profit sharing, not least due to the economic downturn.

After having introduced key terms and types of businesses as well as remuneration forms of professional service firms the following chapter takes a closer look at the individual subsectors.

## Notes

1. See Gillmann and Ruud (2002), p. 21
2. See Hansen et al. (1999), p. 110.
3. See Hansen et al. (1999), p. 110.
4. See Griess and Zinnert (1997), p. 33 et seq.
5. See Tordoir (1995), p. 139 et seq. The 'sales relations' described by Tordoir are rather atypical for Professional Service Firms.



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