6 ☆ Organization

Aligning Stars and Strategy

HOW SHOULD a professional service firm organize to achieve its strategic goals in a fast-changing and tumultuous business environment? The question is straightforward. The answer is anything but.

In most manufacturing and service companies (and most management texts), strategy leads and organization follows. Decisions about who reports to whom and how the organization will be structured follow closely on the heels of new strategic choices. The implementation may not be seamless, but there's no question about whether the CEO can redraw the organization chart, reengineer the company, or spin off an underperforming unit based on his judgment of what needs to happen. In PSFs, this neat cause-and-effect relationship falls apart. Decisions about organization and strategy go hand in hand—and often it's the organization that leads, while the firm's strategy limps along behind.

What makes PSFs *different*? In traditional corporations, power is essentially positional and top-down, while financial success depends heavily on the efficacy of the company's operations, marketing, and distribution activities and on the systems and organization that shape them. In PSFs, power is attached to individuals as well as to positions. Professionals derive power from their accomplishments and expertise: Peers and younger professionals will respect you and follow your lead if you are outstanding at your craft and effective with clients, regardless of your formal position in the firm. Even senior leaders are likely to allow you to follow your instincts. As a result, power and influence are more widely distributed among the partners of a PSF than they are in a typical, large corporation with a more rigid, hierarchical structure. The better the performance and capabilities of the senior group, the wider the distribution of power reaches.

Equally important, the quality and productivity of this senior group is what drives the PSF's business model. Where manufacturing companies can rely on a production line or a distribution system, PSFs are dependent on the capabilities and motivation of their senior stars. If these highly paid, relatively independent men and women can't—or won't—implement a new strategic direction defined by the firm's most senior leaders, the strategy, however clever, is irrelevant.

Think back to the set of specific strategic choices we discussed in chapter 3. Can a firm *make* its partners pursue certain types of clients at the expense of others? Or make them stop working on low-margin projects for clients with whom they have long-standing relationships? Or tell them to hand off these long-standing personal clients to colleagues? In a word, No. The same answer applies to business-line decisions: Can the firm make an individual partner cross-sell services if she feels too busy or too uninformed to do so? To geographic choices: Can the firm make a star partner move to another continent if he, his wife, and his teenage children think it's a bad idea? And to pricing decisions: Can the firm dictate the fees quoted to a given client? Firmwide management can try to jam the implementation of such strategic choices down the throats of its senior stars, but the only thing this is likely to do is demotivate them (unless, of course, it provokes them to leave altogether).

Nevertheless, in the best PSFs, there is alignment between the senior stars' behavior and the firm's strategic goals. Individuals, on average, *do* adjust what might be perceived as their own self-interest to join their colleagues in enabling the firm to achieve its goals. They put the firm first. That is why enduring firms endure. The challenge is not a new one, nor is there magic to mastering it. The capacity to align stars and strategy, year after year, depends on the firm's culture and leadership (which we'll look at in the next two chapters) and its organization, broadly defined.

When we use the term *organization*, we have considerably more in mind than the number of offices a firm maintains, or the way professional work is divided into practice areas, or the intricacies of its reporting structure. Properly understood, *organization* encompasses a set of critical choices that every firm must make: About how it will attract, develop, evaluate, and reward its people (the "people systems" we examined in chapters 4 and 5). About its management structure. And about its governance, including the form and distribution of its ownership. On a day-to-day basis, these choices can surface as seemingly discrete and independent decisions. In fact, they are closely connected, and decisions made along one dimension sooner or later reverberate along the others. That is why PSFs are more successful in aligning their stars and strategies when their leaders approach these choices systemically, as parts of a larger, integrated whole. (See figure 6-1.)

Partnerships

Historically, PSFs were biased toward alignment—not because their leaders were thinking consciously about the concept, but because the firms' customary structure promoted it. For centuries, partnership was the only form of organization available to independent contributors who wished to band together in the pursuit of professional success. And historically, professional firms (in the United States and

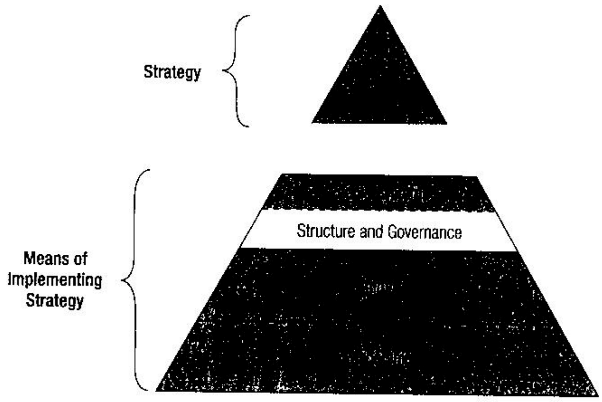

Figure 6-1 **Alignment Pyramid: Structure and Governance**

elsewhere) were firmly wedded to the general partnership tradition (as law and accounting firms still are).

Even as alternative legal structures such as incorporation evolved and a mix of financial, legal, and tax considerations led many firms to move from legal partnerships to some form of private incorporation, most professional firms continued to *think* of themselves as partnerships. Although their formal structures might be changing, they wanted to retain the *spirit* of partnership because they understood that its allure didn't lie in its tax implications or other legal details. What gave partnership its power (and still does) is a sense of shared destiny, the belief that "we're all in this together, no matter what." Benjamin Franklin articulated the principle in 1776, when he reminded his fellow patriot rebels: "We must indeed all hang together or, most assuredly, we shall all hang separately."

What made the partnership structure so useful for PSFs was that it fostered alignment between the professionals and the organization and strategy of the firm. It achieved this complex alignment, almost unconsciously, and it was able to do so for two important reasons.

First, in a partnership structure, all the partners were owners of the firm. Individually, of course, they made different contributions and held different stakes, but institutionally, they were equal. No partner was a superior or subordinate to any other partner. In other words, the leaders and experienced professionals of the firm were *peers*.

The second important aspect of the structure was that decisions about the firm were made by *all* the partners. At one time the partners probably sat around a table and debated with each other. But even as firms outgrew their tables, and the practice of participation changed or became less intimate, it remained an integral piece of partnership. Decisions might be made by a designated leader in a corner office, just as they would be in a large corporation, but they were still ratified by the partners. These strong *participatory processes* are the second reason partnership was so well suited to PSFs.

Today, partnership is under siege. Not just the structure of partnership, but even the *spirit* of partnership that so many firms have tried to retain. Less than a decade ago, most U.S. PSFs looked similar. The great majority of service providers functioned entirely within the United States, some with a few overseas branches. Whether they were advertising agencies or law firms, information technology specialists or executive search firms, they were mostly private partnerships of manageable size growing organically rather than through acquisitions. Even among successful firms, the mindset was mostly "let's keep doing what we're doing." To the extent there was a "strategy," it was "more of the same." Why not? It had been working well.

That rather orderly world has disappeared. Within the past decade, more and more best-of-breed firms have decided to expand their service offerings and to become international, if not truly global. Most of those firms are growing through acquisitions and mergers as well as through more rapid internal expansion. The new PricewaterhouseCoopers has 9,000 partners. How does a firm of that size preserve the individual partners' feeling of being invested in the organization and the belief that what they think can influence the firm's future direction and success?

Many PSFs that can do so legally have also been making radical changes in their ownership. (Accounting and law firms in the United

States cannot have public ownership.) Some have gone public or have merged or been acquired by other firms, both public and private. In our sample of eighteen firms alone, there were four IPOs and four major combinations (mergers or acquisitions) in the five years we have been studying them.

What happens to a firm like Alex Brown, one of the oldest partnerships in the United States, when it gets acquired by Bankers Trust (in 1997), a public company, and a year later becomes part of a large German bank (Deutsche Bank)? What do these drastic ownership changes do to the principles of partnership that had been cultivated for almost two centuries at Alex Brown? The scope of the changes is difficult to appreciate.

The trends of growing scale and changing ownership put enormous pressure on the principles and practices of partnership. How do you make a decision to change your compensation structure, or replace your chief executive, in a manner that allows individual partners to feel vested in the firm's future when you have 2,000 partners instead of 200 and when they are scattered around the world instead of only in North America? How do you deal with the transparency—and second-guessing—that accompany public ownership? The pressures for quarterly earnings and growth?

It is far too early to tell whether such moves will destroy the *spirit* of partnership at these and other firms or whether the benefits of such moves will outweigh the liabilities. But whatever the outcomes, the game has irrevocably changed throughout the world of professional service. It takes only a few moves by some leading firms to change the competitive dynamics for everyone else in the industry. Hambrecht & Quist insisted for a long time that it wanted to stay independent. Then, in 1999, it allowed itself to be acquired by Chase to gain access to more capital and improve its competitive position. Did the fact that Alex Brown became part of Deutsche Bank influence H&Q's decision? Or Goldman Sachs's 1998 IPO, which also put pressure on competitors whose pockets weren't so deep? Maybe. Maybe not.

What can PSFs do as they grow, merge, or become public? They must make decisions about their structure and governance that reinforce as much as possible the two essential attributes that

partnership has always created: *peer relationships* and *participatory processes*.

Networks of Peers

There isn't an organization in the world that doesn't have some element of hierarchy. It is the underlying architecture for all sorts of religious, educational, and government organizations and, of course, for businesses. Ask the CEO of any big manufacturing or service company for a description of the organization and you're likely to get an elaborate chart, filled with lines and boxes arranged in a hierarchical fashion. For more than 100 years, the prevailing wisdom about organizing work has been to create a hierarchy. Divide the work into units; put someone at the head of each; and then rank the unit heads in a chain of command, with everyone reporting to a boss higher up until you reach the CEO. Hierarchy is in the Bible and the records of humankind's earliest civilizations. Even primate societies are hierarchical, as biologists and zoologists continually remind us.

Given how deeply rooted in human experience the concept of hierarchy is, it isn't surprising that we find it in PSFs too. But while hierarchy may be a great model for manufacturing companies and other businesses, it's a poor fit for talent-driven organizations (a fact that many traditional, multitiered companies are in the process of discovering as they become more dependent on knowledge workers). It is especially awkward in PSFs, where command and control are incompatible with the professional work required to serve clients, as well as with the psyches of the professionals themselves.

Fading Hierarchies

While no PSF that we know of has abandoned hierarchy entirely, the most successful firms limit the height of their pyramids and try to create a flatter structure that reinforces the sense of governing through a partnership of peers. The leaders of these firms are among the first to downplay hierarchy's importance. Steve Pfeiffer, of Fulbright & Jaworski, spoke for his peers in the study group in pointing out that "we don't have a lot of hierarchy, and we don't have a lot of bureaucracy."

Even larger firms like Ernst & Young, which, because of their size, inevitably have more levels of hierarchy and a more top-down form of governance, make efforts to preserve a partnership atmosphere. They solicit input from their partners, using representative democracy through committees of partners to keep them involved in decisions. They also make an effort to build consensus before decisions are made. Phil Laskawy, chairman and CEO, says, "Some outside observers would say that we have a hierarchical structure. But the reality is we have a more democratic process than most of these firms. We accomplish this by keeping our partners and personnel informed, and getting all partners to recognize that their input is important. What they say really counts. These are important elements of what makes this firm work, even though partners don't vote on every issue."

Because the management structures in these firms have only a few levels, and the trend is toward reducing their number rather than letting them grow, they are most aptly described as *fading hierarchies*. As Kelly O'Dea, worldwide president of client services at Ogilvy & Mather, explained, "The organization here is flatter than it was five, six, or seven years ago. Far flatter." In addition, what in other contexts would be called the "corporate office" is purposely kept as small as possible. Equally telling, in many firms, "headquarters" isn't necessarily where the CEO is located. When John Donahoe became the chief executive of Bain, for example, he stayed in San Francisco and the firm's headquarters remained in Boston. Similarly, when Rajat Gupta was elected managing partner of McKinsey, he stayed in Chicago and the firm's headquarters remained in New York City.

A Different Kind of Matrix

The phrase that comes up most often when professionals describe their firm's structure is "matrix" organization. Although the details vary, each of the firms in our study is structured as a matrix with relatively

fixed dimensions, which provides the firm's management skeleton, and a dynamic dimension, which changes to meet clients' needs. The matrix's fixed dimensions are the firm's management structure at any given time, including the geographic offices and professional practice areas that provide "homes" for the professionals: the New Delhi office of an advertising agency, say, or the intellectual property practice of a law firm. The partners who occupy the formal leadership positions in this portion of the matrix usually have some client responsibilities, but they are chiefly responsible for ensuring the health of the stars in their units and the economic success of the unit overall.

The variable portion of the matrix consists of client teams, which are always works in progress. Every time a project is completed, or a client relationship ends, the professionals engaged in that work are redeployed. Even in fields (such as accounting and advertising) in which long-term relationships with clients are customary, the professionals move frequently from one project to another and work on several simultaneously. As a result, the firm faces a constant stream of decisions about whom to assign where and whose activities will have to be integrated with whose.

Because a matrix blends the management side of the firm with the client-oriented side, it can facilitate these critical deployment decisions (as well as ensure the effective implementation of the people systems). Facilitate but not resolve. The matrices in PSFs differ from their counterparts in corporations (where the form originated) in two respects that make the work of managing them especially challenging. First, there is no common boss with the positional power to resolve conflicts. In traditional corporations, the matrices basically consist of at least two hierarchies, one vertical, the other horizontal, which report to a single executive. Subordinates lower down in the hierarchy resolve most issues themselves because passing decisions up the line is frowned on. But the fact that there is a common boss "up there" contributes to the pressure for timely resolution.

In PSFs, such hierarchical power to force decisions among the dimensions is limited. If an office head and a practice leader disagree about the expertise required on a particular client project or about the assignment that will best develop a young star, there's no "boss" to whom they can easily refer the decision. To resolve issues and get collaboration across the firm's many units, therefore, leaders and professionals alike have to develop the skills to resolve differences and the commitment to do what will serve the firm's interest best.

The other distinction between corporate and PSF matrices is that the structure of the latter is always in flux. Change is constant, even in such relatively stable units as geographic offices and industry practices, because the constellations of stars within these units are primarily defined by clients' needs, and those needs are a moving target. Dan Case, the chairman and CEO of Hambrecht & Quist, described some of the changes in his firm's structure. "Once upon a time, there was one investment-banking department. Now there is Technology, and Health Care, and Branded Consumer Products, and inside Technology there's a software group, and an Internet group, and so on. We keep breaking these things into smaller areas, smaller vertical industry groups."

Further complicating the work of coordination are the many small teams that form monthly—if not weekly—around client projects. As teams disperse and regroup, both the cast of decision makers and the responsibilities of particular individuals shift. In addition, since professionals often work with more than one team simultaneously, it's not uncommon for a partner to be "reporting to" a colleague on one project while taking the lead on another. So there's little opportunity to develop the kind of stability in roles and relationships that facilitates decision making and conflict resolution in traditional matrices. Professionals not only have to learn to work with new counterparts quickly but also have to be able to look at problems from new and different perspectives.

The omnipresence of challenges like these is what makes performance-measurement and reward systems that reinforce partnership behavior such an integral part of a PSF's organization. As you saw in chapter 5, the best systems track results on three dimensions to encourage collaboration and teamwork: the individual's personal performance, the performance of his or her unit, and the performance of the entire firm. What this comes down to, in the words of Patrick Pittard, Heidrick & Struggles's CEO, is "one very important criterion, which has got heavy weight and can hit you in the pocketbook: partnership. Do you work in teams and do you invite other people into your clients?"

The matrix structure in PSFs also contributes to a form of governance that is effective and essential in managing senior professionals because it reinforces the sense of peer relationships. Partners have to work things out themselves. There is no "kicking it up to the next level" to resolve a conflict or to make a decision. Whatever their formal titles, therefore, in the final analysis "partners" are colleagues, not superiors or subordinates.

Limited Management Tenure

The policies that govern individuals' appointment to and tenure in management positions further reinforce peer relationships. The most conspicuous, of course, is the fact that management positions are almost all part-time: With the possible exception of the managing partner or CEO and other members of his leadership team, everyone is a producing manager. Second, leaders in many positions must be endorsed by their partners either formally or informally. Finally, senior stars rotate into—and out of—management and committee assignments on a regular basis. Limited tenure through term limits and rotation ensures that partners manage and lead the firm together, as a group of peers.

Ernst & Young's U.S. partnership, for instance, elects a partner advisory council composed of eighteen members that is responsible for ratifying the management committee's selection of the chairman of the firm as well as the chairman's selection of the members of the management committee. It also ratifies any merger that increases the firm's revenues by more than 5 percent and any partnership agreement changes. The members of the council serve staggered three-year terms, with one third of the council turning over each year.

Skadden Arps, to cite another example, has several committees comprising both rotating members, who are selected from the partners via a nomination process, and members who serve by virtue of their position at the firm. The policy committee, for example, is chaired by Robert Sheehan, executive partner, and made up of thirteen members who serve staggered five- and four-year terms, plus two legal practice partners (one from the firm's corporate side, the other from litigation). Sheehan and the two legal practice partners also serve ex officio on the compensation committee, which has eight rotating members, and the financial-oversight committee, which has three rotating members.

Together, these organizational choices create structures that can best be described as networks of peers. The elaborate hierarchical organization charts that map the reporting relationships in most companies have no analog in the flat structures of PSFs. Peers are not necessarily equals: Some partners hold larger ownership stakes than others, or deliver more outstanding performances year to year, or provide better counsel to their partners and younger staff. But despite these differences, the mindset is basically democratic—"we're all partners here." So for all the healthy competition among partners, in the best firms there is an equally healthy measure of collaboration and cooperation in the interest of the firm.

The Power of Participation

Historically, partnership has done more than define the structure and ownership of a firm. Its democratic bias has also affected how professional organizations deal with governance issues. *Governance* answers the questions, "How are the senior stars involved in significant firmwide decisions?" "In what decisions do they become involved?" and "How are such decisions made?" In some firms, this bias goes so far as to mandate a "one partner, one vote" approach to all critical decisions. But even where the democracy isn't quite so literal and extensive, the notion of participation, of actively involving senior stars who don't occupy formal management positions (as well as those who do) in key decisions is firmly ingrained in the governance processes.

Here, again, the contrast with traditional corporate practice—where decisions are wired in from the top, down, and everyone knows who the decision makers are—is dramatic. In a traditional company, if someone steps out of line and oversteps the authority of her position, she will hear about it quickly and forcefully. But that approach won't wash when the company's key revenue producers are also independent partners with the ability to directly influence firm profits—or to leave and hang out their own shingles. Senior stars expect to be consulted, not only on matters vital to the firm's future but also on the myriad day-to-day decisions that affect them personally. If they are not, they will voice their dissatisfaction or show it by moving toward the door. By necessity, therefore, the governance of professional organizations has to be more inclusive and participatory. That's why the partnership form worked so well. And why even where it is coming under pressure, firms must continue to reinforce the participatory nature that made (and continues to make) the principle and spirit of partnership so persistent.

While informal participation is a hallmark of many well-managed companies and typically takes place on an ad hoc basis, "partnership-like" organizations establish formal processes to involve their senior stars in critical governance issues. What's a critical issue? Anything that will vitally affect the organization's future. Across the board in the firms we studied, a handful of decisions fell into this category: decisions about the organization's long-term strategy, about its ownership form (whether to go public, merge, acquire, or be acquired), about admitting new partners and distributing the wealth (dividing the pie), and about choosing new leadership, especially the firmwide leader. For such decisions, the particulars of the process the firm uses are less significant than the fact that the partners have confidence in it and support the outcome. We saw this earlier in chapter 5, when we examined promotion and compensation processes (although we didn't label them as "governance" decisions). Here, as a further example, we'll consider one of the most unusual aspects of PSF governance—the selection of the managing partner or CEO.

Choosing Your Own "CEO"

Can you imagine the senior management of GE voting on the next CEO? Or the line management of GM initiating leadership change? Hardly. Yet that's what happens in outstanding PSFs. There are significant differences among their practices, as we'll see. But in each case, the succession process works. Every organization in our original research group has gone through a successful leadership transition at least once, and most have gone through several. (In fact, the capacity to bring in a new leader, at least once, was one of the criteria we used to select the eighteen best-in-class organizations we initially studied.)

The selection of a new leader is an emotion-filled event, not only for the candidates but also for the firm. Everybody cares deeply about who gets chosen and how because everyone knows that the choice will influence the direction of his or her career as well as the success of the firm. Too much emotion can fray the firm's cohesiveness, and too many disappointed candidates—and their supporters—can compromise the new leader's ability to lead. So whatever methods a firm uses, the partners must perceive them to be fair and rational, focused on objective factors tied directly to the needs of the firm. In addition, the successful candidate has to have the support of a substantial majority of the firm's stars. He or she can't just sneak in by a few votes.

Some firms, especially those that have kept a partnership- or private-corporate form of ownership, satisfy these objectives through a formal election process. Everyone knows who the candidates are, and the candidates, in turn, make their positions on firmwide issues known, so that all the partners can become informed before casting their votes. At Fulbright & Jaworski, for example, "the leader is elected by everybody, . . . with a secret ballot and KPMG doing all the counting, so no one knows where the power base is." Similarly, at Heidrick & Struggles, nominees write position papers and give speeches as part of an election process in which one person at a time drops out, and "usually someone gets a majority before it gets down to two candidates."

The process is more indirect in larger partnerships such as Ernst & Young. As Bill Kimsey, deputy chairman and COO, says, "Twenty-five hundred partners can't, through listening to campaign speeches, figure out who the chairman should be. It's not a beauty contest." It's also more indirect in firms that are publicly held or parts of larger public entities. Shelly Lazarus, the CEO of Ogilvy & Mather, was appointed by Sir Martin Sorrel, the chairman of parent company WPP, for example. Nevertheless, as she explains, her appointment "had to be approved by many other people. This company is a highly interdependent matrix . . . and all the dimensions had to come into play. So it is a democracy in this regard, because anyone could have stopped it along the way."

Even Goldman Sachs, whose succession process one partner likened to "a hummingbird—it shouldn't fly but it does," incorporated objectivity and a certain amount of democracy into what were, historically at least, somewhat autocratic decisions. A partner with a long memory remembers hearing that "when Gus Levy died, he left it in his will that John Weinberg and John Whitehead should be the next senior partners." But "they were clearly the people, there was no doubt about that."

The process became less top-down thereafter, when the firm's management committee took it over. But even so, Hank Paulson, the current CEO, and others could honestly claim that, when they were younger, they weren't bothered by the fact that they didn't have a say in who the senior partners would be. Why were they so sanguine? They were confident that the committee members would act in the firm's best interest: that choosing someone who was unacceptable to the partnership would be unthinkable because it would risk an awkward—and therefore potentially harmful—ratifying vote.

A Professional Democracy

Much like the U.S. Congress, PSFs work through a committee structure, which provides the primary mechanism for involving partners in major decisions. The names and functions of the committees vary among firms, as do the methods for selecting their members. In some firms, committee members are elected. In others, the firm's leader appoints them. And in others still, they're selected by some combination of the two methods. What's common—and crucial—is that regardless of how they're chosen, the members of these committees merit their colleagues' respect and trust. The words that one management consultant used to describe the members of his firm's compensation committee summed up a view we heard repeatedly: "The most trusted and least apparently self-interested partners are on [it]. There is a set of decision rules, but within that there are judgments. At the end of the day, it is a very trusted committee [and] that seems to work."

Accomplished stars expect and are expected to participate, from time to time, on one or another of their firm's committees. In addition to giving partners a voice in shaping the firm, these committees serve as an important vehicle for building consensus. If the members of a committee make a decision or agree to a proposal from the firm's leader, they can become its ambassadors with their associates throughout the firm.

McKinsey recently finished a strategy development process lasting a year and a half that intimately involved every partner in the firm. A task force of seventy partners selected by Rajat Gupta, the managing partner, designed the initiative, and together the rest of the partnership, including alumni of the firm, participated in a series of workshops to discuss, evaluate, and refine the firm's strategy.

"We had a dialogue together," Rajat Gupta told us. "Everybody now understands why different people think differently, whether it's a result of their immediate environment or whether it's the position in the life cycle of where they are in their careers, or their position about the particular client they are serving and what's happening in their industries. There's a much greater understanding and tolerance, even appreciation, of the diversity of the firm."

The process resulted in a series of new initiatives. One is a guiding principle McKinsey calls "100 percent Cubed," which means the firm is committed to delivering 100 percent of the firm, 100 percent of the time, in 100 percent of the world. As a result of the iterative, inclusive process, all of the partners "own" the idea and have a personal stake in its success in their specific offices, teams, and individual work within the firm. The key was that each partner felt involved and contributed.

Committees also help spread the work of governing the firm. In a world of time-pressed producing managers, the old adage "many hands make light work" is apt. The way Bob Hallagan, vice chairman and former CEO of Heidrick & Struggles, describes the firm's approach to its committee structure is representative: "When driving a firm like a partnership, people must be led not managed. At Heidrick & Struggles we first painted a future vision of the firm that everyone was excited about. Once we gained their enthusiasm, we broke the vision down into absolute key success drivers and established committees to drive the programs. The committees get everyone involved and feeling part of the success."

Last but hardly least, the fact that these committees exist creates a counterweight to the power of the firm's leadership. A partner at McKinsey explained the logic: "The line organization is the managing director and the office heads, but committees elected by the partnership are there to be a sort of check-and-balance that promotions and partner compensation are all done fairly and equitably, and that the right decisions are made." In the event that the firm's leader or those she appoints to leadership jobs misuse their positions, or move in directions that are inconsistent with the views of their partners, the committee structure provides a remedy. Perhaps most important, the mere existence of these committees reminds each firm's leader that it is a democracy—that his power ultimately rests on the support of his partner-peers.

Committees aren't the only sign of democratic process, however. Formal partnership votes on issues such as admission to the partnership, leadership succession, or a change in the firm's form of ownership are also common. Often such votes are required by the partnership agreement or the firm's bylaws. But the leaders of these organizations also have to develop a sixth sense about what should be put to a vote. The reason: Only a small proportion of the senior stars can serve on a committee at any given time, and yet everyone expects to be informed about and involved in major issues nevertheless. As Hank Paulson, CEO at Goldman Sachs, put it, "We'd vote on anything big, whatever that means, and we'd all know it when we saw it. . . . We'd rather not define it and we haven't bureaucratized any of that stuff."

In addition, most of these firms, if practical, hold periodic meetings of all the partners to discuss major issues, facilitate communication, and, perhaps most important, strengthen the bonds among them. The most unusual of these retreats may be the weeklong meetings McKinsey held in Portugal in 1996 for partners and their spouses. The assignment: Write and produce an opera. Were they trying to improve the musical abilities of the partnership? Not really. The goal was to build personal ties and reinforce the sense that "we're all partners here."

Executives who have spent their careers in traditional corporations would doubtless find these meetings and committees a source of frustration and irritation. Not the leaders of these firms, who know what's involved in sustaining partnerships. They understand that the governance system gives them a set of tools to work with, and they use the committee structure to help build consensus. Beyond this, they spend countless hours talking one on one with the firm's senior stars to understand their perspectives and to discuss issues on which they want their support. Phrases like *working issues, building coalitions to support initiatives,* and *two steps forward, one step back,* which pepper their conversation, reflect their appreciation for the subtleties of democratic leadership.

The Dark Side of Participation

Up till now, we've been talking about participation as if it were an unalloyed positive. It's not, as anyone with experience in a highly participatory organization knows all too well. Broad participation in decision making and consensus building slows decisions down. It also can make it difficult to reach a definitive conclusion. Imagine, for example, that your firm has decided to expand into Europe, which means moving senior stars and resources out of existing U.S. offices and into new ones (and persuading a number of experienced stars to move). The partners in those existing offices are unlikely to say "No dice." That would be uncollegial. They are likely to drag their feet, however, and say, "Sorry, but we simply can't cannibalize this office for the sake of a new one in

Frankfurt or London or Milan." Getting them to agree will take time. If they really dig in their heels, it may lead to the abandonment of the idea. It just doesn't seem to be worth the effort to overcome their passive resistance.

Participation can also diffuse responsibility. If everyone is in charge, no one's in charge. In PSFs whose leaders are overly deferential to their partners' views, the decision-making process often seizes up. Unless a firm has leaders who, when necessary, will assert themselves and use their influence to press for action, the only decisions it's likely to make are decisions not to decide. Peter Georgescu, who recently retired as CEO of Young & Rubicam, summarized the leader's dilemma brilliantly: "I have knee pads and a 45," he said. "I get down and beg a lot, but I shoot people, too." In other words, persuasion and developing consensus are essential, but so is pressing for action, and at some point stragglers have to be prodded into line.

Although leaders of PSFs don't have the positional power and authority of corporate CEOs, they do have ammunition for the 45s they need to carry. First and foremost is their personal skill and expertise. Professional abilities and success with clients are an important criterion in selecting someone to become the leader of a firm. The new leader may not be the absolute best accountant, banker, or consultant, but she will be admired for her professional accomplishments, and they will be an important source of her ongoing influence. Professionals at Skadden Arps didn't follow Joe Flom because he sat in a corner office. They followed him because they respected his skill and success as a lawyer.

The fact that firm leaders are selected through processes that their colleagues accept as legitimate also strengthens their hand. Partners are more likely to follow their lead because they have agreed that this is the person they want to lead them. Direction from the center is unlikely to be resisted—as long as the firm is prospering, and its stars are enjoying their work. Let firm results turn sour, though, and the leader's ideas and initiatives will be scrutinized and challenged. Power can evaporate quickly, which is why interpersonal skills—the ability to listen and to understand others' points of view, to persuade others that a new direction makes sense, and to stay the course—are so extraordinarily important, not just to the leader's success but also to the firm's. We shall expand on this in chapter 8.

Structure, Governance, and Ownership: The "New" Bain & Company, Inc.

In 1990, Bain & Company initiated a complex ownership transition from its small founding group to a broadly diversified global partnership. The course of this management buy-out led the partnership to implement an integrated array of organizational changes designed to better align the "new" Bain around its ambitious goals. As with most such founder transitions, the process was challenging and cumbersome—but it worked.

Bain & Company had once been labeled "too hot to handle" in a magazine article reflecting the firm's successful hyper-growth through most of the 1980s. In 1988, however, the world's most secretive strategy consulting firm stumbled into view with the early stages of a comprehensive restructuring.

Simply put, Bain had outgrown its organization. Although there were more than fifty "vice presidents," nominally a partner-level title, ownership was concentrated in the hands of seven founders. Vice presidents were largely excluded from strategic decisions and often barely informed after the fact. Four layers separated the CEO from a new vice president, who had no formal way to participate effectively in firm governance. Vice presidents were well paid and aggressively managed, but the *really* big money still flowed to the founding group who controlled the business on a collegial—but top-down—basis. The organization was more like an atom, with a powerful core of founding partners surrounded by subsidiary stars, than a network of peers.

Throughout the 1970s and 1980s, this organizational approach had worked well. The founders were exceptional consultants, and they recruited talented stars excited to be part of an extraordinary team. Then, gradually, years before the restructuring, things started to change. The vice-president group expanded and became more geographically diverse as Bain opened offices around the world. The younger stars' skills and client work began to rival those of the founders (they had, after all, been trained by them); while the founders, on the other hand, were slowing down after decades in the consulting business (and plenty of money in the bank). At some point, the lines crossed. Without anyone realizing it, the vice presidents, as a group, eclipsed the founders. At that undefined moment, Bain's organizational structure and governance, already straining under years of aggressive growth, became an invisible liability.

Today, more than a decade later, the firm is once again a global leader in strategy consulting, with more than 2,700 employees in twenty countries and an array of successful adjacent businesses. Although today partners refer to "old" Bain and "new" Bain as road markers of the firm's transformation, at a distance the "new" Bain looks almost identical to the old version. The vice-president group (absent most of the founders) is essentially the same, although substantially larger. Not a word of the mission statement has changed. The firm's client strategy remains focused on delivering exceptional results to senior management across a broad array of industries. International expansion has continued. Bain's innovative pricing strategy (partially equity-based) remains a centerpiece of its practice. Bain people still look, talk, and act like "Bainees," singing along with the Bain Band at off-site meetings.

Nevertheless, beginning in the late 1980s something happened that fundamentally altered the organization and laid the foundation for its reinvigoration. That something was a set of integrated organizational changes that rewired the partnership and ultimately altered the behavior, values, and performance of its senior stars.

First, the old ownership model was scrapped, replaced by a new inclusive partnership. Ownership was extended from the small group of founders to a broad global team that today numbers more than 200 partners. A partner's equity stake provided the basis for participation in the firm's governance. For the first time ever, partners began to debate—and vote on—the central questions facing the partnership. The group elected a new managing partner (chief executive) and a non-executive chairman of the board from among their number. The compensation system was reborn: The partners voted on alternatives (designed to link individual incentives more closely with the firm's strategic goals) proposed by a task force of their peers. Even the firm's historically robust strategy was debated, refined, and ultimately reendorsed by the partnership.

A massive increase in communication augmented this formal participation. The firm's financial statements were shared with the partners for the first time. *Glasnost*—open, honest, and direct communication—emerged as a guiding theme. The first worldwide partner retreat in a decade took place, followed by another that included spouses. People who participated as partner–owners gradually began to feel—and behave—like partner–owners who put the firm's needs ahead of their own. An entirely new approach to governance, designed around the new Bain partnership, reinforced these emerging peer relationships.

Governance was aligned with other organizational elements. The partners elected a policy committee to lead long-term strategy development. A compensation committee was elected to oversee partner compensation and promotion. A nominating committee rode shotgun over the election process for committee members, the chief executive, and the chairman of the board. Every leadership position had term limits, from a minimum of one three-year term on the nominating committee to a maximum of three, three-year terms for the chief executive. The office heads formed regional operating committees, which became the backbone of firm management; and they were expected to return to full-time client work after serving for five to seven years.

The firm's approach to managing its partners' performance was also transformed. Increasingly higher standards that measured both financial and nonfinancial contributions were established for every partner. Partners were evaluated and rewarded on "people asset building," "one-firm behavior," and "knowledge contribution." Peer reviews and upward feedback surveys were instituted. Annual compensation came to depend upon a mix of individual and team contribution rather than on tenure and rank.

Within two years, ownership, governance, organizational structure, and partner performance management were entirely rethought and reconstructed to form a new, integrated whole. Externally, to clients and recruits, Bain looked the same. Internally, a new Bain was born, aligned around a set of new realities.

The particulars of Bain's experience won't be repeated—at least not by Bain. The transition from a founding group to a partnership is complete. What will recur, for Bain and every PSF that wants to survive and prosper, is the challenge of keeping its organization and strategy aligned in the face of aggressive growth, diversification, and intense competitive pressures.

Professional service firms are facing more pressure than ever before. At the same time that the forces that would pull them apart are intensifying, the countervailing forces holding them together are weakening. Growth, globalization, and changes in ownership are undermining the historic partnership structure and challenging the partnership spirit. In such an environment, firms must find a way to nurture the alignment between their stars and the firm's objectives. While organizational decisions that reinforce peer relationships and participation can help, they are useless without the basic underlying belief in these principles of partnership. How can firms maintain this belief and commitment to partnership when so many forces are at work eroding them? Ultimately, the answer lies in their *culture*. A strong culture can weave new strategic and organizational choices together, and hold them in alignment, despite revolutionary pressures, as Bain's transformation attests. A strong culture can also provide enormous help in attracting, retaining, and motivating stars. In the following chapter, we'll look at the down-to-earth ways in which this sometimes amorphous-seeming concept works.