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## AN OPTIONS-BASED MODEL OF CAREER MOBILITY IN PROFESSIONAL SERVICE FIRMS

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Contemporary career mobility models do not fully explain up-or-out promotional systems in professional service firms (PSFs). We propose a PSF career mobility model, which represents hiring decisions as investments in options on future human capital acquisitions and promotions as exercise of those options. Promotional outcomes depend mainly on the development of employee's human capital and business conditions at the time of partnership consideration. The model explains seemingly paradoxical firm behavior, such as dismissal of nonpromoted but productive employees.

Career mobility in organizations continues to receive a good deal of attention in the management literature. For example, promotion interdependence (Barnett & Miner, 1992), managerial career development (Demougin & Siow, 1994), promotion/turnover relationships (Johnston, Grif-feth, Burton, & Carson, 1993), promotion equity (Schwarzwald, Koslowsky, & Shalit, 1992), and tournament mobility (Sheridan, Slocum, Buda, & Thompson, 1990) have been the subject of contemporary researchers' investigations. However, most of this work has been conducted with respect to classical business firms, in which ownership, management, and production functions are separate; promotions entail incremental advancement along multistep job ladders; and nonpromoted individuals are typically retained in their current positions (Kilbourne, Miller, & Cardinal, 1993). It remains unclear whether theoretical models developed in this context should apply to professional service firms (PSFs), in which ownership, management, and production functions are concentrated among the same persons; promotions entail few, large steps toward partnership; and nonpromoted individuals historically have left the organization pursuant to an "up-or-out" rule (Nelson, 1988).

The up-or-out system perhaps most distinguishes professional service organizations from other types of firms (Maister, 1982). Nevertheless, despite prevalence of this system in organizations ranging from law,

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accounting, and consulting firms to academic institutions and military service branches (Gilson & Mnookin, 1989), contemporary mobility models fail to account for the operation or existence of the up-or-out phenomenon (Siow, 1994). For example, the tournament model, which says nothing about up-or-out practices, has been applied to PSFs such as law firms (Galanter & Palay, 1991), despite warnings regarding its generalizability outside the context of corporate hierarchies (Rosenbaum, 1989) and despite critical assumptions of the model (e.g., numerous promotional tournaments) appearing tenuous in such firms (Nelson, 1992). Moreover, proponents of the tournament model and its component mobility concepts (those of human capital and structural theories) are silent regarding important strategic aspects of PSF operations, such as entry into new practice areas, which may relate directly to career mobility processes and outcomes. Given the growth of particular professional service industries (e.g., corporate law; Curran & Carson, 1991), and the ongoing emergence in the United States of a service-oriented economy generally (Gilson & Mnookin, 1989), misapplication of contemporary models to the study of career mobility in PSFs would risk misunderstanding an increasingly important, yet underresearched, organizational form (Hinings, Brown, & Greenwood, 1991). We believe that a fuller understanding of mobility processes in PSFs, including operation of up-or-out promotional systems and related strategic outcomes, can be attained through an options-based, multidisciplinary approach (see Arthur, Hall, & Lawrence, 1989; Ornstein & Isabella, 1993).

This article incorporates fundamental ideas from multiple disciplines within an options framework to develop a new model of career mobility in professional service firms. Our intention is (a) to provide insights into the unique dynamics and seemingly paradoxical behavior of PSFs when examined from the viewpoint of traditional mobility models and (b) to better explain outcomes and related costs of PSF mobility processes such as hiring, training, professional development, promotion of new associates, and the disposition of associates who are not promoted.

Our central thesis is that the hiring of junior associates by PSF partners represents an investment in a portfolio of options to acquire the future value of associates' human capital after it has developed over time. Deferral of compensation pending possible promotion to partner/co-owner status, as well as training and development during an extended professional apprenticeship period, serves to maintain and enhance the value of these options by conforming associates' behavior to the interests of partners, and by bonding associates to the firm until their human capital can be developed and assessed. Conduct of associates during this period reflects the extent of their professional development and suitability for partnership. These factors and the perceived strategic needs and opportunities of the firm at completion of the apprenticeship period will determine whether partners seek to exercise options on particular individuals by offering to promote them to partner status in the firm.

Within this framework, seemingly paradoxical firm behavior, such as dismissal of competent and productive associates who are not promoted to partner, can be conceptualized as strategic abandonment of options to promote these associates. Some associates will be seen as not having developed to a level appropriate for investment at the partner level by the time they are considered for promotion. Others, even though qualified to become partners, will be passed over for promotion, if the firm does not perceive the existence of growth opportunities in their areas of professional expertise. Under these circumstances, partners in a firm will prefer to abandon their options on these associates and reinvest their resources in options on other associates whose professional growth potential or practice areas hold greater promise for adding future value to the firm. Dismissal of nonpromoted associates, for whom the possibility of partnership no longer serves as a bonding mechanism, will also protect a PSF from potentially opportunistic behavior such as associates leaving the firm and taking some of its former clients with them. These dynamics will have an impact on a firm's ability to acquire and develop future associates. The extent to which a firm's partners recognize strategic opportunities and skillfully manage their associate option portfolios will be related to the overall success of the firm.

The remainder of this article is organized as follows. We begin by identifying unique aspects of PSFs, and promotions within them, which differentiate PSFs from classical business firms regarding career mobility. For present purposes, PSFs are defined as autonomous, self-owned organizations that have traditionally managed and developed human resources through a system of professional apprenticeship, culminating with promotion to partnership or dismissal from the firm (Galanter & Palay, 1991). We include large law firms (Gilson & Mnookin, 1989) and accounting/consulting firms (Maister, 1982, 1993) as our primary examples, although we believe our model can be applied to architecture or engineering firms, physician groups, investment banks, and others. Although we note the partial similarity of mobility systems in these firms to those in academic institutions and military service branches, we focus our attention primarily on those firms in which promotion signifies formal accession to partner/co-owner status in a privately held organization.

After identifying unique mobility-related aspects of PSFs, we review prevailing contemporary theories of career mobility and conclude that their potential to explain mobility processes in PSFs is limited. We then discuss options theory and its application to PSF mobility systems. Thereafter, we refine the options basis of our model by drawing on fundamental principles from agency, deferred compensation, and firm-specific human capital theories and develop research propositions suggested by the resulting multidisciplinary approach. After acknowledging limitations of our model, we suggest practical modifications to career mobility systems in PSFs, which we believe hold potential for enhancing the effectiveness of such firms. We conclude by discussing potential generalizability of our

model to other types of organizations and by proposing directions for future research into PSFs and related career mobility processes.

### UNIQUE ASPECTS OF CAREER MOBILITY IN PSFs

According to neoclassic economic theory, firms exist as a device for combining labor and capital (physical or human) to produce end products (Boudreaux & Holcombe, 1989). Because labor and management typically have been separated from capital ownership (Alchian & Demsetz, 1972; Jensen & Meckling, 1976; Williamson, 1975), the interests of workers and managers (internal agents) can diverge from those of owners (principals), because the former make decisions within the firm but do not bear the full wealth consequences of their actions (Fama, 1980). Problems that can result from this potential divergence have led to development of control systems such as decision hierarchies. Decision hierarchies require higher level agents to evaluate and ratify the performance of lower level agents, making it more difficult for those at all levels to act in their self-interest at the firm's expense (Fama & Jensen, 1983).

The foregoing analysis can be applied to PSFs, but only on a limited basis. Although PSFs combine labor and capital to produce end products, in PSFs the primary capital inputs are human, rather than physical (Gilson & Mnookin, 1985; Maister, 1982; Sander & Williams, 1992). These "human capital inputs" consist of job-related knowledge, skills, abilities, education, training, credentials, expertise, reputation, and relationships with partners and clients (Becker, 1975; Galanter & Palay, 1991). Moreover, in PSFs, ownership, management, and production functions typically are performed by the same individuals (Hinings et al., 1991; Howard, 1991). Thus, PSFs must select new employees with regard for their potential future partnership/co-ownership suitability, as well as for their short-term productive value.

Promotions to partner/co-owner status in PSFs differ substantially from those in other types of firms. In most firms, promotions represent incremental increases in responsibility and authority, which accompany upward progress in a formal, multilevel hierarchy (Barnett & Miner, 1992; Siow, 1994; Williamson, 1975). In PSFs, however, formal hierarchies are rare, in part because those who choose professional careers tend to exhibit strong needs for autonomy and are averse to constraints on their professional judgment and freedom (Hinings et al., 1991; Howard, 1991). Where status distinctions are made in PSFs (e.g., senior associates in law firms or supervisors/managers in accounting firms), they tend to be few in number and to be limited to the largest firms (Kilbourne et al., 1993; Maister, 1982; Nelson, 1988). Such distinctions typically do not correspond to a fixed number of positions or "slots" in a formal sense (Leblebici, 1990).

Moreover, despite professionals' having joint responsibility for directing firm activities once promoted to partner, they typically do not view management skills as essential for attaining professional success (Fogel,

1989). For most professionals, the critical motivational aspect of promotion to partnership is that it denotes joint ownership status, which brings with it a share of residual claims to firm assets and profits (Hansmann, 1990; Howard, 1991; Wholey, 1985). Though deferred (typically for seven or more years in law firms; Galanter & Palay, 1991; O'Flaherty & Siow, *In press*), and highly uncertain, partner status provides the opportunity for compensation far in excess of that typically received as an accounting firm junior or law firm associate (in this article, the term *associate* refers to any nonpartner professional employee in a PSF).

Deferral of promotion to partnership pending an extended apprenticeship period serves several functions. First, it allows for training and development of professional competence in client relations and other areas commensurate with partnership status (Galanter & Palay, 1991). Second, it allows for evaluation, screening, and eventual ouster of associates who do not achieve such competence (O'Flaherty & Siow, *In press*; Stiglitz, 1975; Waldman, 1990). Third, it provides disincentives for associates who might otherwise perform minimal or substandard work, which could damage the firm's revenues and reputation, or leave prematurely with specialized skills and client relationships the firm has paid its associates to develop (Galanter & Palay, 1991).

The extent of these latter risks is also alleviated by deferring a portion of associates' compensation during the apprenticeship period (Gilson & Mnookin, 1985; Lazear, 1990). During this period, associates are paid only a portion of revenues generated by their labor, and the difference is retained by the firm until these associates are considered for partnership (Nelson, 1992). This deferral of associate compensation can be thought of as the exaction of a performance bond from individual associates (Main, 1990), which will be returned only upon satisfactory completion of the apprenticeship. In other words, if an associate performs well, and does not "shirk" (fail to produce an acceptable work product for the agreed rate of pay), or "grab and leave" (take clients and depart from the firm; Fama, 1980), the deferred sum will be remitted in the form of shared ownership in firm assets upon admission to partnership. The apprenticeship period allows partners to assess these factors, as well as associate development of human capital (e.g., practice skills or client relationships), which the firm can acquire by making the associate a partner.

Of course, not all associates make partner, and it is here that paradoxical aspects of up-or-out promotional systems emerge. From a common sense standpoint, it is difficult to understand why able associates, in whom the firm has invested substantial developmental resources but who are not perceived as "partner material," should be expected to leave the firm. As Siow (1994) pointed out, a firm that adheres to this system dismisses otherwise competent employees who are typically at least as productive as their replacements. Gilson and Mnookin (1989: 578) attempted to explain the up-or-out phenomenon by characterizing it as a mechanism "that will assure associates at the time they are hired that the firm will

treat them fairly at the time they are considered for partnership." Their argument is that an absolute up-or-out promotional system guarantees that a PSF will not act opportunistically (i.e., continue indefinitely to buy associates' time at "wholesale" while selling it to clients at "retail") by permanently retaining as an associate one who actually meets partnership standards. However, it also can be argued that associates would consider it just as fair, and perhaps more attractive, to have the opportunity to remain as salaried employees if not promoted, rather than being forced to establish professional reputations from scratch. It is therefore likely that this "moral hazard" argument provides only a partial explanation for use of a strict up-or-out policy (Holstrom, 1979; Kahn & Huberman, 1988; O'Flaherty & Siow, In press).

We believe that the options basis of our model, as well as its related multidisciplinary perspectives, enables us to better explain the up-or-out phenomenon by providing insights into its relationship with strategic management of professional firms. Before discussing our model in detail, we briefly address contemporary mobility theories and their limited applicability to PSFs.

### CONTEMPORARY THEORIES OF CAREER MOBILITY AND THEIR LIMITED APPLICABILITY TO PSFs

The study of career mobility found its roots in sociological theories of stratification and status attainment. Early research in this area focused on ethnicity, family connections, and various kinds of sponsoring alliances that helped to determine how vacancies in pyramid-shaped organizational hierarchies would be filled (see Forbes & Piercy, 1991; Rosenbaum, 1984; Schein, 1971). As the field developed, researchers began to focus on either individual or organizational aspects of career advancement, as reflected by the emergence of two major subdisciplines: human capital theory and structural theory. Human capital theorists (e.g., Becker, 1962, 1975; Blaug, 1976; Mincer, 1974) focused mainly on the extent to which individual factors such as abilities, education, and training influence career advancement. Structural theorists (e.g., Doeringer & Piore, 1971; Spilerman, 1977; White, 1970) focused mainly on the extent to which organizational factors such as job vacancies, job ladders, and "vacancy chains" influence internal career mobility. (An analogous conceptualization concerns the notion of graded *personnel* systems, in which promotions are a function of individual qualifications and competence, as opposed to graded *position* systems, in which promotions are a function of vacancies; Reed, 1978; Wholey, 1985.) Dissatisfied with partial shortcomings in either of these approaches, Rosenbaum (1979, 1984, 1989) developed the tournament model (see also Lazear & Rosen, 1981; Rosen, 1986), which incorporates elements of both human capital (e.g., individual ability) and structural (e.g., vacancy networks) theories (Sheridan et al., 1990). We now briefly identify problems with applying human capital, structural, and tournament theories to PSFs.

**Human capital theories.** Application of human capital theories to PSFs would leave important aspects of PSF career mobility unexplained without assistance from other perspectives. First, it is difficult to assess human capital distinctions among professionals with relatively homogeneous abilities and educational backgrounds (Rosenbaum, 1989). Second, human capital models make no provision for arbitrary delays (e.g., a seven-year apprenticeship) prior to promotional consideration (Rosenbaum, 1989). Third, human capital models do not explain why PSFs dismiss otherwise productive associates when they are not promoted to partner status. Empirical evidence regarding human capital models and professional career mobility supports the notion that such models are of limited viability in the PSF context. For example, Kilbourne and her colleagues (1993) found that the effects of initially perceived human capital distinctions among academics dissipated rapidly and failed to predict later career advancement.

**Structural theories.** Application of structural models to PSFs is likewise problematic, primarily because vacancies and vacancy rates, the principal concerns of most structural theories, appear largely irrelevant in PSFs. For example, Wholey (1985) found that partner exits from PSFs failed to create "openings" for new partners that were subsequently filled through promotion of junior associates. Although many PSFs have implicit or explicit target promotion rates and partner/associate ratios (Galanter & Palay, 1991), these targets are subject to change over time (Maister, 1982), and promotions are neither required nor constrained in PSFs.

**Tournament models.** In recent years, the tournament model has garnered a predominant share of both theoretical and empirical attention (e.g., Cooper, Graham, & Dyke, 1993; Forbes & Piercy, 1991; Galanter & Palay, 1991), and it will thus be addressed in somewhat greater detail here. The tournament model conceptualizes career mobility in organizations as a sequence of promotional competitions in which early-round success is critical. Early successes keep an individual active regarding further competitions, and they signal a person's suitability for further promotions in the presence of imperfect information about a candidate's qualifications (Spence, 1973; Stiglitz, 1975). Promotional tournaments clearly distinguish winners from losers. The former remain in the running for future tournaments, whereas the latter are relegated to plateaued or burdened promotional status. In the tournament model, "'ability status' is assigned to individuals based on their job [promotional] histories, effectively providing an operational definition of ability" (Rosenbaum, 1984: 274). Eventually, this form of social Darwinism selects the "fittest" promotional candidates for a fixed number of job slots by eliminating less qualified individuals through repeated competitions (Rosenbaum, 1984, 1989).

Application of the tournament model to PSFs has been criticized (Nelson, 1992; Sander & Williams, 1992), because promotional systems in PSFs do not satisfy assumptions central to application of the tournament model

(Rosenbaum, 1989). First, the tournament model assumes repeated competitions for incremental promotions, but PSFs have few, if any, competitions for intermediate positions, and often only one (e.g., law firms; Gilson & Mnookin, 1989) or two (e.g., accounting/consulting firms; Maister, 1982) large steps toward partnership. Second, the tournament model assumes that early successes count to an inordinate extent. In PSFs, an extended observation period precedes partnership consideration, and early task assignments, which may contribute little toward skill development (Nelson, 1992), are afforded no special status in the promotional process. Third, the tournament model assumes that nonpromoted employees will retain mobility, but at a disadvantaged rate. The model does not explain outright dismissal of nonpromoted associates pursuant to a strict up-or-out rule.

In addition, the tournament model makes no provision for strategic discretion in identifying and adjusting to dynamics of the business environment (e.g., greater uncertainty, changing demand for particular services, variable availability of firm resources). As Sander and Williams (1992) noted in their critique of Galanter and Palay's (1991) application of the tournament model to large law firms, it is doubtful that PSFs would continue to hire and promote associates in the face of adverse economic conditions solely to meet the advancement expectations of employees. Wholey (1985) found that partner exits (and the presumed creation of partnership openings) had no effect on promotions in law firms. Like its implications for structural models in the context of PSFs, this finding raises further doubt about the applicability of a tournament model that assumes competitions for specific openings.

In summary, contemporary career mobility models do not correspond well with known aspects of PSF promotional systems.

### **OPTIONS THEORY AND ITS APPLICABILITY TO CAREER MOBILITY IN PSFs**

Options represent the ability, but not the obligation, to take advantage of future opportunities that would not be available without earlier investment in those options (Sharp, 1991). The simplest typology of options distinguishes "calls" (options to buy) from "puts" (options to sell), with the sale of a call option equivalent to creation of a put option (Bowman & Hurry, 1993). Since the insightful work of Myers (1977), it has been generally recognized that organizational resource investments are analogous to options, despite the lack of formal contracts such as those used in securities markets (Bowman & Hurry, 1993). One area in which this analogy is particularly apt is that of future organizational growth (Myers, 1984). Kester (1984) argued that the option value of future growth opportunities generated by current resource investments often may exceed the short-term profits (or project value; Hurry, Miller, & Bowman, 1992) of such investments. The value of these growth options will depend on such

factors as the length of time the options can be held, the exclusivity of rights to exercise (or strike) the options, the level of risk or uncertainty associated with underlying growth opportunities, and strategic judgment brought to bear on the recognition, acquisition, maintenance, and disposition of the options (Hurry, 1994; Kester, 1984; Sharp, 1991).

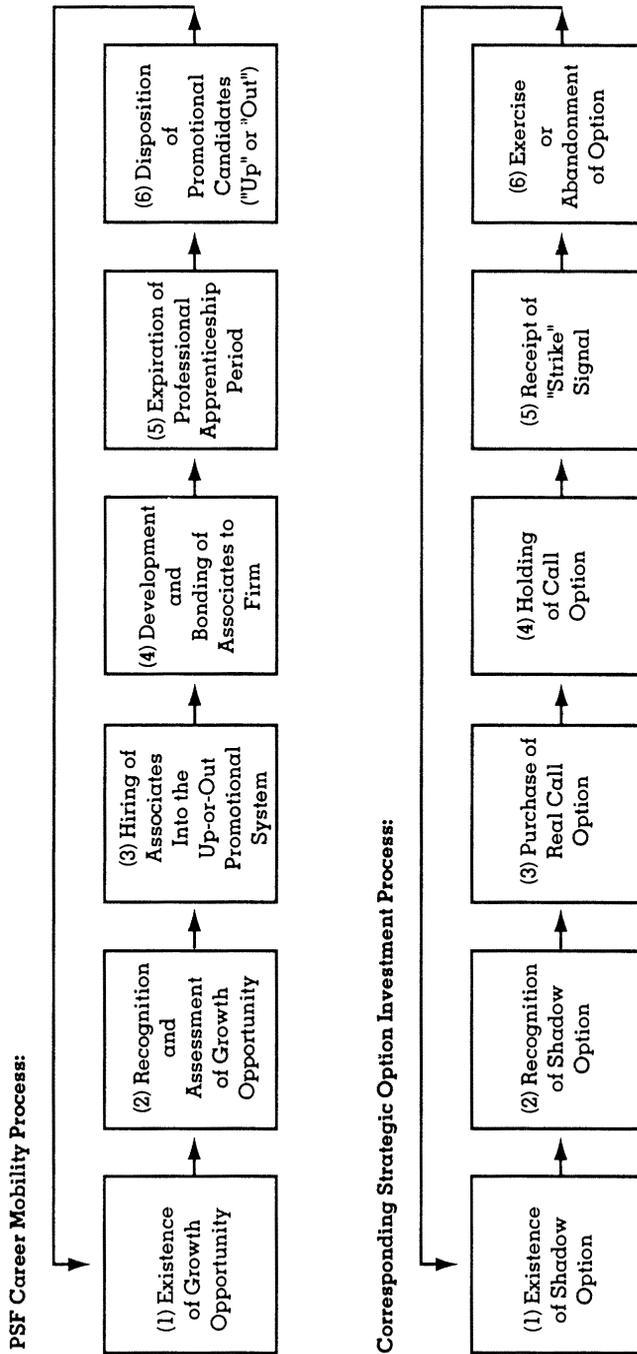
Hurry and his colleagues (1992) proposed a systematic sequence of processes by which organizational strategies for the investment of resources in growth options may be developed. First, existing organizational resources (e.g., relationships or competencies) create a shadow, or latent, option such as a new business opportunity. Second, the existence of this shadow option is recognized, and possibilities for capitalizing upon it may be considered. Third, a real call option (to acquire resources or invest in future organizational growth) is purchased. Fourth, the call option is held for some period of time, and additional resource investments are made to maintain or enhance the value of the option. Fifth, some type of signal is received, which indicates whether or not the option should be exercised. Sixth, the option is either exercised or abandoned, depending upon the type of signal received. Thereafter, new shadow options may emerge as the result of action taken on prior options at their disposition stage, thus completing a cycle, or option chain (Bowman & Hurry, 1993) of strategic option management. For example, entry into a new line of business upon exercising a call option on a particular growth opportunity might create new shadow options to merge with or acquire technology from a supplier or client firm.

The potential applicability of this options framework to incremental promotional systems in hierarchical firms has been previously recognized (Hurry & Jackofsky, 1992). We think the framework is particularly applicable to up-or-out promotional processes in PSFs. For example, the existence of a growth opportunity that might lead to an associate's hiring can be viewed as a shadow option, the hiring of associates can be viewed as the purchase of call options on future partners, and the disposition of promotional candidates can be viewed as exercise or abandonment of those options. Figure 1 depicts the basic processes of our model, and it shows how these processes correspond to the generic options framework described above. As discussed more fully in the sections that follow, we believe that an options framework can explain otherwise paradoxical aspects of mobility processes in PSFs.

### **PSF CAREER MOBILITY: AN OPTIONS-BASED, MULTIDISCIPLINARY MODEL**

Options represent the right to participate in future opportunities without the obligation to do so. Within this framework, the hiring of associates can be characterized as an investment of resources to acquire a portfolio of options on associates' future human capital if its value is seen as likely to contribute to the needs of the firm *under conditions existing at the time*

**FIGURE 1**  
**Process of Career Mobility in Professional Service Firms (PSFs) and Corresponding Strategic Option Investment Process**



*of consideration for partnership.* Upon acquiring these options, the firm begins to invest the training and mentoring time of its partners, which could otherwise be spent directly servicing clients (Siow, 1994), to maintain and enhance the value of its options by developing the human capital of its associates. Because a PSF typically pays its associates only a portion of their billings while developing them into potential partners, this process represents a substantial source of revenue for the firm in both the short and long run (Maister, 1982; Nelson, 1992). Thus, resource investments in associate options can be analyzed in terms of both their project (current) value and their option (future) value (Hurry et al., 1992; Kester, 1984). Our model anticipates that the disposition of associate options (exercise or abandonment) will depend on both the project and option value of a particular associate. Option value will, in turn, depend on both associates' partnership qualifications (e.g., client relations and other elements of human capital; Gilson & Mnookin, 1985; O'Flaherty & Siow, *In press*) and business conditions facing a firm at the time of partnership consideration (Hurry, 1994; Hurry & Jackofsky, 1992).

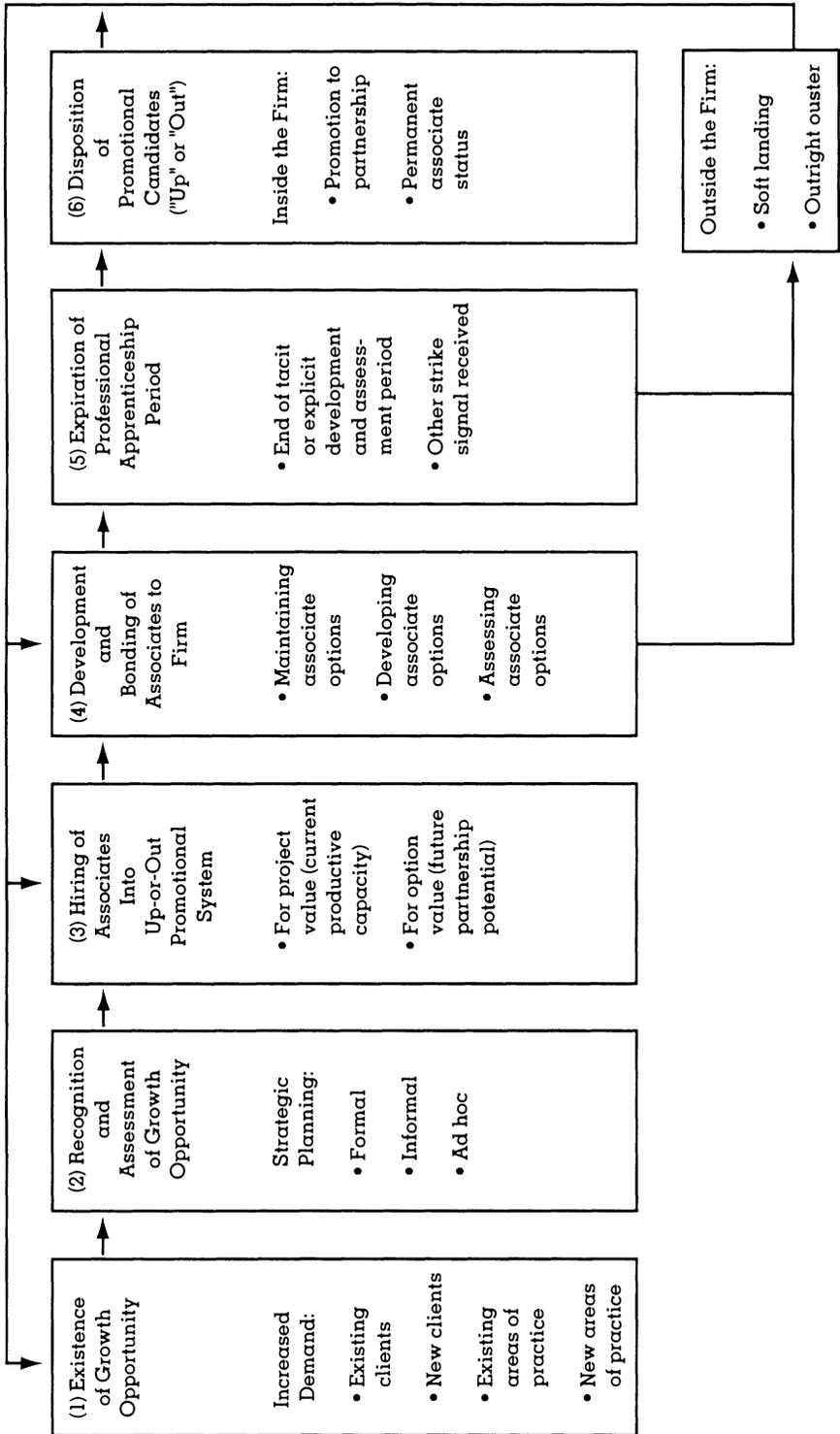
We now proceed to refine and fully develop our model (Figure 2) and related research propositions. Where appropriate, we draw upon ideas from other disciplines to explicate particular mobility processes within an options framework. Our principal focus is on factors that have an impact on the hiring, training, professional development, and promotion of new associates, as well as eventual disposition of those associates who are not promoted.

### **Existence of a Growth Opportunity**

We start with the existence of a latent growth opportunity for a PSF, which might lead to the hiring of a new associate. The simplest example of such an opportunity occurs where a one-person firm might wish to expand. Successful professionals will develop, over time, a growing number of client relationships that produce increasing demand for their professional services. Eventually, this demand will exceed an individual's capacity to provide such services (Nelson, 1988). Under these circumstances, the only way to further increase returns to that individual's particular elements of human capital (skills, training, reputation, client relationships) is to join forces with another, less busy, professional (Galanter & Palay, 1991). The first professional might therefore hire, as an associate, another professional who has yet to establish a reputation or client base that will support a self-sustaining practice. In such a case, the associate would work under the supervision of the first professional and be paid only a portion of revenue generated by his or her labor (Nelson, 1992). Alternatively, the first professional might join forces with one or more professionals who already have their own clients, but whose practice areas complement those of the first professional.

Whether these circumstances will be recognized as providing growth opportunities that would support the hiring of new associates will be

**FIGURE 2**  
**Full Options-Based Model of Career Mobility in Professional Service Firms**



expected to depend on (a) whether increased demand for services will persist and (b) whether that demand relates to new or existing areas of practice. For example, if increased demand were only temporary, the professional might simply work harder for a short period of time or hire temporary employees to help alleviate any short-term bulge in workload. If increased demand were persistent, however, an opportunity to grow by hiring a new associate might emerge, particularly if the demand related to an existing area of practice. Here, the professional would be able to adequately supervise an associate and provide corresponding quality assurances to his or her clients (Carr & Mathewson, 1990; Waldman, 1990). Conversely, if increased demand were temporary but in a new practice area, affiliation with an experienced professional might be sought, but only on a consulting basis. If such demand were persistent, however, an opportunity to grow by merging with an experienced partner or firm, or by hiring an experienced associate having expertise in the new practice area, might emerge.

*Proposition 1a: Persistent increased demand for services in current practice areas will be positively related to existence of a growth opportunity that would support new associate hiring.*

*Proposition 1b: Persistent increased demand for services in new practice areas will be positively related to existence of a growth opportunity that would support hiring of experienced associates or merger with another firm.*

### **Recognition and Assessment of Growth Opportunity**

The extent to which PSFs such as law firms regularly engage in formal strategic planning regarding employees and other matters remains a subject about which relatively little is known (Buller, Beck-Dudley, & McEvoy, 1990; Hengstler, 1987; Maister, 1993). However, options theory provides guidance for the application of such planning in the PSF context, because the hiring and mobility of new associates would be expected to relate to recognition of growth opportunities by partners in a PSF (Figure 2). Even with only informal or ad hoc attention to the existence of growth opportunities, the relative strategic managerial abilities of firm principals would be expected to relate to recognition and assessment of those opportunities and thus to the eventual execution of actions necessary to exploit them. For example, individuals with greater experience in their professional market, or formal training in economics, marketing, business strategy, or business policy, might be more attuned to possible areas of increased practice activity and profitability.

*Proposition 2a: Strategic managerial ability of PSF principals will be positively related to recognition of growth opportunities and the consequent investment in associate options.*

*Proposition 2b: Systematic strategic planning undertaken by a PSF will be positively related to recognition of growth opportunities and the consequent investment in associate options.*

### **Hiring of Associates Into the Up-or-Out Promotional System**

Once the apparent existence of a growth opportunity is recognized by a PSF, there are a number of alternative courses of action it might choose to pursue. Assuming the firm desires to take advantage of this opportunity (e.g., has not decided as a policy matter to avoid growth; Nelson, 1992), the course chosen would again be expected to depend upon factors such as the practice area of the perceived growth opportunity, and the apparent persistence of current and future demand for different types of services. For example, where a perceived growth opportunity existed in a current area of expertise, and demand for work in that area was unlikely to change in the foreseeable future, a PSF might hire associates primarily for their current productive (project) value, with little consideration for long-term potential to develop into partners. Under these circumstances, the firm might hire associates who required lower starting salaries (e.g., associates from less prestigious business or law schools; Spurr, 1987) than if it anticipated the eventual addition of new clients or new practice areas. If it did anticipate such additions, the firm might instead hire associates whose backgrounds and credentials (e.g., attendance at more prestigious schools) signaled not only the ability to perform well in the current term, but also the potential to develop client relationships and other elements of human capital reflective of future partnership qualifications (O'Flaherty & Siow, 1992; Waldman, 1990). Such associates would be likely to cost the firm more because of their potential (Siow, 1994), and these employees would be more likely to expect developmental opportunities leading to partnership (Porter & Steers, 1973; Shetzer & Stackman, 1990; Wanous, 1973).

On the other hand, if the addition of a new client or demand for professional skills outside a PSF's current areas of practice were contemplated in the short term, the firm might not want to wait for an inexperienced associate to develop the needed substantive or client relations expertise. In this case, an experienced associate or partner from another firm, who had an appropriate practice background, might be sought in order to provide both the substantive and client relations ability needed on a "turnkey" basis. Under these circumstances, the firm might pursue its perceived growth opportunity through lateral hiring or merger (Fergus, 1989). The hiring (and later promotion) of new associates would decline.

Hiring more developed professional employees (such as experienced associates or partners) from outside the firm would be expected to carry higher costs (e.g., larger starting salaries) than training and promoting similar but less developed employees (such as new associates) from

within (Demougin & Siow, 1994). Moreover, the possibility of merging with an ongoing firm of professionals can be compared to the existence of an option on an asset portfolio, whereas the possibility of promoting internally from among a cohort of associates can be compared to the existence of a portfolio of options. Because a portfolio of options is generally more valuable than an option on an asset portfolio (Bowman & Hurry, 1993), a firm that is positioned to take advantage of a growth opportunity via promotion would be expected, all else being equal, to be more effective (e.g., more profitable) than one that grows through merger or lateral hire. Hiring and training new associates would also be consistent with the incremental property of option investments (Hurry et al., 1992). That is, hiring and training many associates will require smaller individual investments and will provide greater flexibility for the firm (Sharp, 1991), compared to directly hiring a partner. An array of associates will likely develop a wider variety of practice skills than will an individual partner, and associates would be easier than partners to discharge if that became necessary (Freedman, 1989).

*Proposition 3a: Additional demand for services in current areas of practice will be related to hiring new associates for both project and option value; such associates will cost more to attract than those hired primarily for their project value.*

*Proposition 3b: Additional demand for services in new areas of practice will be related to hiring experienced associates or partners for both project and option value; such professionals will cost more to attract than those hired primarily for their project value.*

*Proposition 3c: A firm that is positioned to grow through promotion of its own associates will be more effective than one that is positioned to do so only through merging or lateral hiring.*

### **Development and Bonding of Associates to the Firm**

Once a PSF has hired new associates, the firm's partners must determine whether to continue to employ these associates pending partnership consideration. Options theory suggests that as long as uncertainty remains with respect to both associates' eventual development of partner-level skills and the firm's eventual need for new partners, it will be advantageous for a PSF to hold associate options (Bowman & Hurry, 1993; Hurry & Jackofsky, 1992). This advantage may persist, even if individual associate's project values fail to cover short-term costs, as long as the option values eventually provide an adequate payoff (Hurry, 1994; Kester, 1984).

Holding options requires the investment of additional resources to maintain, develop, and periodically assess their value (Hurry et al., 1992;

cf. Wholey, 1985). In the PSF context, maintaining associate options may be defined as bonding associates to the firm through various types of incentives, developing associate options may be defined as training associates and providing appropriate professional growth opportunities, and assessing associate options may be defined as periodically reviewing associates' performance and the firm's need to determine whether to retain particular associates. These processes are interrelated, as discussed next.

**Maintaining and developing associate options.** When a PSF hires a new associate for both project and option value, it typically anticipates an extended apprenticeship period before current partners can determine whether an associate's development and the firm's needs will justify promoting the associate to partner status. In the interim, potential problems with divergence between the interests of the firm and those of the associate may arise. Partners of the firm would like to obtain a high-quality work product from the associate in return for a fixed rate of payment, while retaining a residual profit. The associate, however, would like to obtain larger returns to his or her labor. This might be accomplished if an associate worked less hard for the agreed rate of pay. It might also be accomplished by the employee's remaining with the firm only as long as it took for him or her to deal with the firm's clients independently. In agency theory terms, the motivation arises for associates to "shirk" or to "grab and leave" (Fama, 1980).

Such problems give rise to the need for additional incentives that align the interests of both parties (Eisenhardt, 1989; Fama & Jensen, 1983). In PSFs, the primary incentives involve developmental opportunities and possible promotion to partner (Sander & Williams, 1992; Siow, 1994). Developmental opportunities (e.g., training, mentoring, and challenging work assignments) provide incentives for associates to remain with a firm while they increase their professional acumen (Gilson & Mnookin, 1989). The promotion-to-partnership system provides a disincentive for associates who might otherwise wish to depart prematurely, because it effectively defers a portion of their present salary that they are likely to recover only upon promotion to partner status (Lazear, 1990; Main, 1990). Possible promotion-to-partner/co-owner status also serves to align the interests of associates with those of the firm's principals (Hansmann, 1990) with whom they might someday become partners.

It is expected that a PSF's reason for hiring associates would relate to the type and amount of incentive investments a firm will make regarding the career mobility of its associates. For example, where a firm hires associates for their future partnership potential, it would be expected to provide both (a) strong, positive representations about the time and chances for making partner and (b) high-quality developmental opportunities to encourage an associate to remain with the firm (Galanter & Palay, 1991). In firms where these representations are credible (Sander & Williams, 1992) and substantiated by historical data, the possibility of

partnership will provide a strong incentive for associates to conform their conduct to the expectations of partners, and associates will utilize the training and mentoring of partners to develop professional skills needed for promotion.

*Proposition 4a: The hiring of associates for future partnership and the percentage of associates who make partner will be positively related to the amount of time spent on training, mentoring, and providing of high-quality work assignments; these factors will be negatively related to voluntary turnover of associates.*

A related perspective that concerns the extent to which training, mentoring, and high-quality work assignments will be provided to associates is that of firm-specific human capital development. Firm-specific (non-transferable) human capital has been characterized as a shared investment on the part of a firm and an employee that reduces the likelihood that either party will unilaterally terminate the employment relationship and impose on the other a loss of return on its investment (Becker, 1962; Hashimoto, 1981). Those associates who are retained by a firm pending possible promotion to partner status will be expected to develop firm-specific human capital such as knowledge of specialized firm practices, relationships with partners or clients, and a shared reputation (Carr & Mathewson, 1990; Wholey, 1985). The nontransferable nature of this capital will provide additional constraints on grabbing and leaving the firm to which it is specific (Gilson & Mnookin, 1989; Siow, 1994; cf. Waldman, 1990). Such constraints reduce the likelihood of voluntary turnover of associates prior to their being considered for partnership and thus increase the likelihood that associates will continue to develop further specific human capital. These processes should, in turn, lead to a greater likelihood of associates becoming qualified for partnership and, all else being equal (e.g., business conditions at the time of promotional consideration remain favorable for adding a new partner), to a greater likelihood of associates being promoted.

*Proposition 4b: The time partners spend on training, mentoring, and providing high-quality work assignments will be negatively related to associates' voluntarily leaving and positively related to perceived suitability for partnership and associates' promotions.*

**Assessing associate options.** As part of its ongoing process of determining whether to retain associates pending possible promotion, a PSF will periodically assess both the project value and future partnership potential of its associates, as well as business conditions that might point to the existence of a future growth opportunity (Hurry, 1994; Kester, 1984). So long as available information is favorable with respect to all three of these factors, a firm will be expected to retain its associates pending expiration of its tacit or explicit apprenticeship period. However, firms

typically will experience considerable uncertainty with respect to these factors. According to options theory, uncertainty with respect to an associate's professional development and business opportunities (i.e., option value) would be expected to have an impact on the decision processes regarding retention of associates (Bowman & Hurry, 1993).

Uncertainty with respect to these factors may be reduced or removed in a number of ways. For example, an associate lawyer who wins large cases, brings in large fees, or attracts new clients provides relatively clear information regarding both present (project) and future (option) professional development and growth opportunities for the firm. Such information would be expected to lead to interim raises, status enhancements, or encouragement about eventual chances for partnership. Conversely, an associate who turns out a poor work product, subjects the firm to malpractice liability, or exhibits unacceptable progress toward developing client relationships (Wholey, 1985), also would provide certain, but unfavorable, information. In the latter case, irrespective of business conditions, uncertainty with respect to both project and option value will have been removed. Reasons for holding an option will thus have disappeared (Hurry et al., 1992; Sharp, 1991), and the option will be abandoned by terminating the associate.

Another possibility is that prospects for growth in a particular associate's area of practice will suddenly appear bleak, as with, for example, a drop-off in demand when a client takes professional services "in house" (Hansmann, 1990). In this case, irrespective of the associate's professional competence, his or her option value will have markedly declined, and he or she may be dismissed prior to promotional consideration despite positive information regarding both present and future professional development. In contrast, if this associate maintains a high enough project value in a needed area of expertise and uncertainty persists with respect to both the associate's future development and the firm's future growth opportunities, he or she may be retained as a self-supporting option pending appropriate expansion opportunities at some future point in time.

In addition to the foregoing processes, some associates may choose to leave the firm voluntarily prior to partnership consideration and self-select out of the firm's promotional system. For example, where the percentage of associates receiving partnership offers appears to be on the decline, an associate might believe that earlier expectations regarding promotional prospects are unrealistic (Shetzer & Stackman, 1990) and that his or her continued investment in firm-specific human capital development might never pay off. This associate might decide to join another firm or open a solo practice before the present firm can signal an adverse judgment about the value of his or her human capital to alternative employers (Waldman, 1990) and before further compensation, which may never be recovered, is "deferred." In this case, the associate's decision will have removed any uncertainty regarding his or her future promotion potential. Where the firm chooses not to offer reassurances or other in-

centives to induce the associate to stay, it will in effect have chosen to abandon its option on this associate.

*Proposition 4c: Removal of uncertainty with respect to an associate's future professional development or business conditions will be positively related to early abandonment of options on that associate.*

### **Expiration of the Professional Apprenticeship Period**

For most associates who are retained by a PSF pending possible promotion, a time will come when they are ultimately considered for partnership. In many firms, this point will correspond to expiration of a tacit or explicit apprenticeship period. In other firms, the timing of partnership consideration might depend on factors such as the emergence of alternative offers of employment to valued associates by competing firms or "head hunters." These factors correspond to the arrival of "strike signals" with respect to particular associate options (Bowman & Hurry, 1993; Kogut, 1991) and may vary in both type and timing from one firm to another. In firms in which mobility practices most closely reflect an options-based approach, one would expect to find a well-understood or explicit partnership track with little variability, and expiration of the corresponding time period would provide the principal strike signal at which a firm either exercised or abandoned its options on associates. Conversely, in firms in which mobility practices reflected more of a project-based approach, productive associates might be retained either indefinitely or at least until particular associates were able to provide strike signals regarding their promotion on an individual basis (e.g., upon threatening to leave the firm and taking one of the firm's clients with them).

*Proposition 5a: Options-based mobility practices will be positively related to the existence of an explicit partnership track and will be negatively related to variability in the length of that track.*

If an appropriate growth opportunity exists when a strike signal is received, a firm will exercise one or more of its options if the underlying investment opportunity (i.e., an associate's human capital value) satisfies the firm's evaluation criteria (Hurry et al., 1992: 96). What are these criteria? One purely logical criterion would be whether the value of an associate's human capital exceeded the average capital value of existing partners. If a promoted associate's capital were of lesser value, total firm capital would be divided into a greater number of shares without a commensurate increase in value, and the firm's productivity and profits per partner would decline (Galanter & Palay, 1991).

Of course, firms cannot measure associates' or their own human capital in an entirely objective manner, and their decision processes are not entirely rational (e.g., Cyert & March, 1963). Given the subjective and

political nature of career processes in PSFs (Nelson, 1992; Pfeffer, 1977, 1989), mobility decisions may be only partly understood from a human capital perspective. For example, consider the associate in a consulting firm who lands a large corporate client. All else being equal, this accomplishment would be expected to indicate a level of professional competence and marketing ability that translates directly into increased human capital value in the form of added demand for services of the firm. Conversely, the associate who works hard but fails to develop client relations skills may appear to be merely a substitutable commodity whose efforts do not hold long-term growth-generating potential. The interpretation of both types of signals is subject to numerous biases that may affect the extent to which they ultimately determine promotional outcomes. These biases include information saliency bias (e.g., Kogut, 1991), escalation bias (e.g., Staw, 1981), risk-framing bias (e.g., Kahneman & Tversky, 1979, 1984), age bias (e.g., Lawrence, 1988), minority or gender bias (e.g., Kanter, 1977; Stroh, Brett, & O'Reilly, 1992), status or cultural bias (e.g., DiMaggio, 1982), and various types of relational demographic effects (e.g., Tsui, Egan, & O'Reilly, 1992).

A full treatment of such phenomena is beyond the scope of this article. Nevertheless, the effects of such biases and other aspects of bounded rationality (Cyert & March, 1963; March & Simon, 1958) might be minimized through consistent application of a strategic options-based approach (Bowman & Hurry, 1993). This approach would consist of systematic efforts to identify and acquire growth-related associate options, evaluate the environment and circumstances under which such options might be exercised, and assess whether the potential future value of specific options justified their short-term holding costs (Sharp, 1991). Partners in a PSF who adopted such an approach would be expected to more effectively manage their human resources (e.g., make better hiring and promotional decisions, achieve greater profitability) than partners who either blindly adhered to past or target promotion rates or succumbed to the political biases of powerful partners (Nelson, 1988; Sander & Williams, 1992; cf. Galanter & Palay, 1991).

*Proposition 5b: Perceptions that an associate's human capital value exceeds the average capital value of existing partners in the firm will be positively related to exercise of associate options.*

*Proposition 5c: Systematic application of a strategic options approach to promotional decision processes will be positively related to the effectiveness of a PSF's human resource management.*

### **Disposition of Promotional Candidates**

When the professional apprenticeship period expires for a given cohort of associates, there are four outcomes that may occur in PSFs that

utilize some form of an up-or-out promotional system. These outcomes include (a) promotion to partner status, (b) outright ouster from the firm, (c) ouster with outplacement assistance (e.g., a "soft landing" with a client firm), or (d) retention as a "permanent associate" (Maister, 1982, 1993; Nelson, 1988; Wholey, 1985). These outcomes would be expected to have differing antecedents, as well as differing consequences, with respect to their impact on the acquisition and retention of new associates.

**Promotion to partner status.** If business conditions at the time of consideration for partnership are favorable for the addition of a new partner, and an associate's developed human capital is perceived to be valuable enough, that associate will be promoted to partner. The associate's suitability as a partner will be evaluated with respect to his or her abilities to get along with colleagues and existing clients, to generate new business (i.e., new growth opportunities), and to supervise new associates, who might be attracted to the firm as these growth opportunities are exploited (see O'Flaherty & Siow, 1992). In other words, the promotion of associates, if they become successful partners, will create further shadow options on future growth opportunities, which may be acted upon by acquiring and holding new associate options. Thus, over time, effective promotion decisions will create regenerating option chains (Bowman & Hurry, 1993), which will continue to fuel the firm's growth so long as demand for services offered by the firm continues. This view of career mobility in PSFs provides a richer explanation for the observed growth of many law firms than does the tournament model, because it accounts for business conditions and the judgment of principals in the firm, rather than focusing primarily on competitive interactions within successive cohorts of associates (cf. Galanter & Palay, 1991).

As depicted in Figure 2, decisions to promote associates, or a particular percentage of associates, will, over time, have consequences that feed back not only on a firm's growth, but also on the acquisition and agency costs of new associates. For example, when former associates become partners, new associates must be hired to maintain the "leverage" ratio (Galanter & Palay, 1991; Maister, 1982; cf. O'Flaherty & Siow, 1992) of partners to less costly and more profitable associates or else the average and overall profit from a firm's client base will decline. However, the accession of former associates to partner status will have added to both the firm's average and total human capital, because principals of a firm would not have promoted an associate if they did not perceive his or her capital value to exceed that of the average partner. Thus, any future associate hired will be expected to attain a higher level of human capital value than those who were promoted before them in order to make partner. This problem can be addressed by hiring more costly associates (e.g., those from better professional schools) who have greater perceived growth potential than did previous cohorts, by hiring associates with growth potential similar to that of previous cohorts but investing more heavily in training costs (to develop the now higher capital value required

for partnership entry), or by lengthening the professional apprenticeship period to allow more time for human capital development. In any of these cases, both the cost of attracting and developing new associates and the time until partnership can be expected to increase. This proposition is in accord with previous research that has found current promotions to be negatively related to prior promotions in the same firm (Wholey, 1985).

*Proposition 6a: Promotion of associates to partner status will be positively related to increases over time in the cost of attracting and developing new associates, to the difficulty of making partner, and to the time it takes to do so.*

**Outright ouster from the firm.** In PSFs that adhere to a strict up-or-out policy, those associates who are not promoted can expect to be dismissed from the firm. Such practices may be conceptualized as strategic abandonment of options on particular associates (Hurry & Jackofsky, 1992). A PSF that adheres to strict up-or-out rules avoids the opportunity cost of holding associate options that appear unlikely to pay off (O'Flaherty & Siow, In press). By dismissing nonpromoted associates, a PSF can redirect its holding costs toward options on new associates who appear to have greater potential to stimulate future growth and profits for the firm.

Complementary explanations for strict up-or-out rules are provided by agency and deferred compensation perspectives (Fama & Jensen, 1983; Main, 1990). These perspectives suggest that firm partners may dismiss nonpromoted associates for fear that the bonding effects of promotional aspirations will no longer operate to effectively deter potentially opportunistic behavior (Galanter & Palay, 1991). Thus, reinvesting in options on new associates would have the dual effect of shifting resources toward better opportunities to develop future partners while eliminating spurned associates who might shirk, grab, and leave if allowed to remain in the shadow of failed partnership expectations.

Dismissal of associates pursuant to a strict up-or-out promotional system will again affect a firm's costs of options on new associates. The dismissal of competent, long-time associates may be seen by potential hires as a signal that the goal of partnership is either more difficult to achieve than previously supposed or illusory in practical terms. Therefore, associates will become more difficult to attract and will require a greater expenditure of firm resources (e.g., higher starting salaries) before agreeing to join the firm. If the firm were unwilling to provide more costly incentives to attract the same level of human capital as before, it could hire lower quality associates, who would require an even greater expenditure of agency costs (e.g., monitoring; Fama, 1980) to maintain the same quality of work. All else being equal, the cost of options on new associates would again be expected to rise.

*Proposition 6b: Outright dismissal of nonpromoted associates pursuant to a strict up-or-out policy will be posi-*

*tively related to increases over time in both the cost of hiring new associates and the difficulty of making partner.*

**Ouster with outplacement assistance.** It is not uncommon for PSFs to provide outplacement assistance to nonpromoted associates. For example, a PSF might help its nonpromoted associates obtain positions such as controller or in-house counsel with its clients. Such outplacement assistance may avoid creating spurned and disgruntled former employees who might ultimately disparage or compete with the firm. It also may create new growth opportunities (shadow options), because employees who depart from a PSF under friendly circumstances often direct business back to their former firm (Maister, 1993). Because sale of a call option is tantamount to purchase of a put option (Bowman & Hurry, 1993), the placement of nonpromoted associates with clients can be thought of as converting call options on associates' partnership potential into put options on associates' potential to direct client business to the firm. Providing this type of outplacement assistance to professional employees can thus be seen as investing associates' *general* (transferable) human capital toward the creation of additional option chains, as new associates are hired in response to resulting anticipated or actual growth (O'Flaherty & Siow, 1992). Such outplacement practices also would be expected to enhance the organization's profits by lessening the chances that a nonpromoted associate might become a successful competitor with the firm.

*Proposition 6c: Associate general human capital levels will be positively related to outplacement of nonpromoted associates to client firms.*

*Proposition 6d: Outplacement of nonpromoted associates to client firms will be positively related to a firm's future growth, profits, and the future hiring of new associates.*

**Permanent associate status.** The long-term retention of nonpromoted professional employees as "permanent" associates in some PSFs is a relatively recent phenomenon (Galanter & Palay, 1991; Siow, 1994). Reasons for emergence of this phenomenon are unclear and may simply involve differing philosophies about mobility systems or departure from institutionalized up-or-out rules (Wholey, 1985). Permanent associates generally do routine or highly specialized work and do not interact as much with clients (O'Flaherty & Siow, In press). Thus, their specialized knowledge may be useful to the firm, but not useful enough to justify promotion to partner status (Smigel, 1969). Typically, permanent associates receive higher salaries than other associates (Wholey, 1985), perhaps because a portion of their compensation is no longer deferred pending possible promotion. Thus, those associates with high degrees of firm-specific capital may find it preferable to remain with their current firm,

rather than accept a lower paying, but potentially mobile, position elsewhere.

The options framework of our model explains the retention of particular nonpromoted professionals as permanent associates. Consider the associate whose firm-specific capital (e.g., mastery of a firm's practice specialty or ability to work with a particular partner) is of sufficient project value to be self-sustaining, but whose growth in client relations ability is deemed inadequate for promotion. In this case, retention as a permanent associate, and the foregone opportunity to develop a new associate (O'Flaherty & Siow, *In press*), makes sense when the associate's high project value and low option value are taken into account. Option value also would be deemed inadequate for promotion where business conditions suggest that demand for services in the associate's practice area will persist but not grow. These points further underscore the utility of an options-based model for explaining mobility phenomena that have been observed in PSFs but are not yet fully understood.

The emergence of permanent associate positions in a firm would be expected to have an impact on both recruitment of future associates and the turnover intentions of current associates awaiting possible promotion. The presence of such positions might suggest that promotion will be less likely than previously supposed and that high promotional expectations will likely remain unmet (Porter & Steers, 1973). Although the presence of such positions might represent a comfortable career plateau for some associates (cf. Elsass & Ralston, 1989), for those associates who valued advancement over security, the emergence of permanent associate positions might increase (a) the likelihood of premature departure and (b) the future cost of hiring, training, and related incentives necessary to attract and retain promotable associates.

*Proposition 6e: Development of firm-specific human capital, in conjunction with nondevelopment of client relations or nonemergence of favorable growth conditions, will be positively related to relegation of professional employees to permanent associate status.*

*Proposition 6f: Emergence of permanent associate positions in a PSF will be positively related to increases over time in associate option acquisition and holding costs, and it will be positively related to increases in voluntary turnover of associates.*

### **CONTRIBUTIONS, LIMITATIONS, PRACTICAL IMPLICATIONS, GENERALIZABILITY, AND FUTURE RESEARCH**

In this article, we have pointed out the inability of contemporary models to explain promotions and related processes in professional service firms. We have proposed an options-based model of career mobility

in PSFs that incorporates perspectives from many theoretical disciplines. We have demonstrated the model's ability to account for seemingly paradoxical firm behavior, such as the dismissal of competent, nonpromoted associates pursuant to an absolute up-or-out rule. We also have explained other aspects of mobility-related processes, such as the emergence of permanent associate positions in some of these organizations.

### **Limitations of the Proposed Options-Based Model**

An obvious limitation of our proposed model is that it considers mobility processes in PSFs almost solely from the viewpoint of the firm and its partners. Although we speculate about certain aspects of individual participants' reactions (e.g., loss of the incentive value of possible partnership upon dismissal of nonpromoted associates), what remains is to systematically examine a fuller array of attitudinal and behavioral outcomes that might relate directly to career mobility processes in PSFs. Recent theoretical and empirical research has supported the notion that promotional processes may be significantly related to outcomes such as job satisfaction, organizational commitment, turnover intentions, employee stress, and burnout (Cordes & Dougherty, 1993; Johnston et al., 1993; Latack, 1989; Schuler, 1980; Schwarzwald et al., 1992). These outcomes are not unique to PSFs, but the uncertainty, high stakes, and strong developmental expectations associated with up-or-out promotional systems suggest that such phenomena deserve closer examination in the context of PSFs. That these phenomena deserve closer examination in PSFs seems particularly true when one considers that associates in PSFs may expect promotions to be awarded pursuant to a tournament system, in which promotions are a function of past effort and achievement, while the firm may be operating pursuant to an options framework, in which promotions are a function of current and future strategic needs. A fuller understanding of mobility-related phenomena in PSFs would likely be gained by examining such phenomena from both individual and organizational perspectives (e.g., Driver, 1988; Pfeffer, 1989; Taylor & Giannantonio, 1993). Space limitations, and the relative infancy of research on PSFs, inhibit our present ability to develop extensive analyses from both points of view.

In addition, our analysis of firm-driven processes does not account for the biases, politics, and power relations among particular partners and associates, which almost certainly have an impact on promotional processes in organizations generally (Pfeffer, 1989) and PSFs specifically (Nelson, 1992). Even those professional firms in which partners practice systematic strategic human resource management may be subject to the influence of promotional sponsorship by particular partners with respect to particular associates (Sander & Williams, 1992). Further exploration of the bounded rationality that affects mobility-related decision processes in PSFs would be potentially enlightening.

## Practical Recommendations for Modifications to Mobility Systems in PSFs

Notwithstanding these limitations, our model suggests possible improvements to current mobility systems in PSFs. Among these improvements are the implementation of procedural justice, graduated partnership systems, and diversity in hiring.

**Procedural justice and the up-or-out rule.** Research on organizational justice suggests that the perceived fairness of procedures used to determine promotions and other mobility-related outcomes may have important implications for effective human resource management (Greenberg, 1990). However, anecdotal evidence suggests that procedures used to determine mobility outcomes in PSFs are often subjective or political and that promotion criteria are only partly understood (and inconsistently applied) in many PSFs (Nelson, 1992). Our options-based analysis suggests a mobility decision framework that could help to clarify promotional criteria and reduce the effects of personal biases on promotional processes. By making clear at the outset that promotional criteria will include consideration of future business conditions, and making information regarding these considerations more readily available to system participants, a PSF could improve the perceived fairness of its mobility decisions (Gilliland, 1993) and reduce the resentment of nonpromoted employees. Improvements in procedural justice might therefore reduce the need to oust nonpromoted associates and facilitate their retention as productive permanent associates (Siow, 1994).

**Graduated partnership systems and the up-or-out rule.** One reason that up-or-out rules may have persisted is that for those denied partnership, promotional aspirations no longer serve as an effective deterrent to shirking, grabbing, and leaving, and a greater expenditure of agency costs might be necessary to constrain such behavior if nonpromoted associates were regularly allowed to remain with the firm. Our model suggests that such costs could be reduced if the interests of associates were more closely aligned with those of partners in PSFs.

One way to accomplish this objective short of promotion to full partnership would be to more rapidly make worthy associates in PSFs part owners of the firm (Hansmann, 1990). To do so, the firm could graduate the promotional process, so that associates would receive successive, incremental ownership interests that are commensurate with their ongoing specific capital development. A variation of this system would be the gradual vesting of interests in future partnership shares, a notion common in other deferred compensation arrangements (Lazear, 1990). Although there is no known research that addresses the possible application of such concepts to partnership systems, we suggest that such systems would advance the bonding effect of promised partnership and reduce the uncertainty attendant to promotional processes. These systems also would permit firm principals to observe associates' behavior as

co-owners on an incremental basis, an important consideration given the difficulty of discharging a partner once he or she is fully vested (Freedman, 1989). Moreover, such systems would be expected to generate positive outcomes, such as increased commitment and reduced turnover intentions. These outcomes have been theoretically (French, 1987; Hansmann, 1990; Pierce, Rubinfeld, & Morgan, 1991) and empirically (Buchko, 1992, 1993) linked to various forms of employee ownership.

**Diversity in acquiring associate options.** In our model we view the hiring of associates as investment in a portfolio of options to acquire associates' future human capital value. The essence of options and portfolio theory is diversification to limit downside risk and maximize the potential payoff of a group of related investments (Bicksler & Chen, 1990; Bowman & Hurry, 1993). However, most PSFs tend to hire associates from similar professional schools or homogeneous demographic backgrounds (Nelson, 1988; Spurr, 1987). Our options-based analysis suggests that this practice overlooks a major potential benefit of diversity in hiring—strategic diversification of a PSF's associate option portfolio. We have noted that the ability to establish effective relationships with colleagues, partners, and clients is an important criteria for promotion to partnership in most PSFs. Because workforce diversity, and therefore that of potential partners and clients, appears to be on the rise (Tsui et al., 1992), it stands to reason that diversity in a PSF's associate option portfolio can better position a firm for the promotion of candidates who are likely to establish effective relationships with partners and clients in the future.

### **Generalizability of the Proposed Options-Based Model**

We intend our model to apply to a wide range of PSFs. However, we realize that our theoretical basis is grounded heavily in the context of large law and accounting firms. The extent to which these firms are typical of other PSFs remains an issue for empirical investigation. In addition, given the changing structures of entire professional service industries (Hansmann, 1990), and the relative recency of phenomena such as the emergence of permanent associate positions, continued applicability of our model to law and accounting firms, as well as generalizability to other types of firms, should be reassessed periodically.

Hurry and Jackofsky (1992) have previously noted the possible applicability of an options framework to promotional processes in other types of firms. With increasing global competition leading to flatter organizational structures, fewer promotional opportunities, and the increasing use of temporary workers and contract laborers in both professional and classical firms (Galanter & Palay, 1991; Maister, 1993), it may be that mobility processes in more types of organizations will become subject to options-based analysis. The extent to which a PSF context defines necessary boundary conditions for application of our model may thus continue to evolve.

It also may be interesting to note that the development of self-managing work teams in a variety of organizational contexts might be complemented by the incorporation of systems that include accession to co-ownership, as do those in PSFs. Because of fewer promotions and less long-term employment in many organizations, the promise of co-ownership might fulfill a needed incentive function that is no longer present in many mobility systems. Although the literature on employee ownership thus far remains inconclusive about when such systems are most effective in achieving desired attitudinal and behavioral outcomes (cf. Buchko, 1993), self-managed, co-owned organizations, such as law firms, appear to be a comparative success story. A better understanding of these firms facilitated by research into the processes of our model might help to identify correlates of effective self-management and co-ownership systems in a broad range of professional and other types of organizations.

### **Future Research on PSFs and Related Mobility Systems**

Researchers should develop and test theoretical models of professional employee reactions to mobility processes and compare the resulting knowledge with that pertaining to a larger subset of service and related organizations. Such models should include career constructs such as individual career orientations (e.g., Derr, 1986; Derr & Laurent, 1989), career anchors (Schein, 1971), promotional expectations of individual associates (Shetzer & Stackman, 1990), and the strength or weakness of a PSF's up-or-out rules (i.e., the percentage of nonpromoted associates who have been expected to leave the firm). The relationship of these constructs to more mainstream attitudinal and behavioral constructs could then be explored. For example, the possible impact of mobility outcome uncertainty in up-or-out promotional systems on employee stress and turnover intentions presents a likely avenue for investigation.

With further regard to generalizability, we have previously noted the similarity of mobility systems in PSFs to those in academic institutions. Even though the notion of partly deferring compensation as a bonding device pending partnership consideration is not directly pertinent to universities, individual implications of up-or-out processes (e.g., promotion uncertainty) appear highly analogous. In addition, the tenure process may resemble the exercise of options on the perceived human capital value of junior faculty. In this case, signals such as research and publication quality (and quantity) may serve to predict ongoing human capital development that justifies elevation to tenured status. Processes by which tenured faculty mentor nontenured faculty also seem closely related to such processes in PSFs, because reputations of the former may be affected by virtue of institutional association with the latter.

In contrast, even though tenured academics may feel some form of emotional "ownership" or identification with a particular institution, they do not necessarily participate in financial or managerial aspects of that

institution's overall operations. Deferred job security, rather than deferred compensation, may thus be the primary bonding mechanism in most universities, and, consequently, the relative importance of outcomes associated with advancement and security may depart from that in most PSFs. Further development of these issues could advance our understanding of academic tenure systems and participants' reactions to them. It also could serve to isolate and compare elements of mobility systems in PSFs and academe (e.g., the up-or-out rule versus accession to employee co-ownership), to determine which of these elements, or perhaps interactions among them, most influence outcomes of interest to organizational researchers.

## CONCLUSION

Our proposed options-based model appears to hold promise for advancing the state of knowledge about mobility processes in a number of professional organizations. Although the extent of its applicability outside private firms remains to be determined, our model provides a framework for improving the effectiveness of mobility systems in current PSFs as well as for conducting research into the operations of evolving future firms. Investigating the processes of our model may help us to better understand the neglected and increasingly important service sector of our society. It may also hold promise for restructuring our way of thinking about career and promotional systems in a variety of organizational forms.

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