7 Changing career models and capacity for innovation in professional services

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INTRODUCTION

A number of professional sectors have recently moved away from their longstanding career model of up-or-out promotion and embraced innovative alternatives. Professional labor is a critical resource in professional service firms. Therefore, changes to these internal labor markets are likely to trigger other innovations, for example in knowledge management, incentive schemes and team composition. In this chapter we look at how new career models affect the core organizing model of professional firms and, in turn, their capacity for and processes of innovation. We consider how professional firms link the development of human capital and the division of professional labor to distinctive demands for innovation and how novel career systems help them respond to these demands.

The chapter proceeds as follows. First, we describe the nature of innovation in professional service firms (PSFs), arguing that in important ways this differs from innovation in other types of firm. Second, we outline the organizing model of professional firms, explaining how their incentive structure, leverage ratio, team composition and billing arrangements shape the transfer and utilization of expertise as teams of professionals transform know-how into services and client relationships. Third, we describe the career model, and specifically the tournament promotion system at its core, by which PSFs have traditionally staffed its ranks with professionals of adequate quality to sustain their organizing model. Fourth, we show how such tournament promotion systems have come under pressure and present data from our own research on how elite UK law firms have responded by introducing new positions and an alternative career model altogether. Finally, we discuss the impact of the alternative career model upon the organizing model of these firms and, in turn, on their capacity for entrepreneurial action and innovation.

INNOVATION IN PROFESSIONAL SERVICE FIRMS

PSFs are distinctive with regard to both their inputs and their outputs (Greenwood, Li, Prakash & Deephouse, 2005). On the input side, professional service firms are highly reliant on knowledge (Alvesson, 1995; Starbuck, 1992). They deploy a mix of formal and tacit knowledge that professional staff embody and translate into outputs, in the form of customized solutions for clients. Because these firms are built on the use of expertise, either held by their professional staff or embedded in codified methodologies and tools (Hansen, Nohria & Tierney, 1999; Werr & Stjernberg, 2003), innovation occurs through the development or recombination of existing knowledge in the firm (see also Chapter 2).

Innovation may be triggered by external technological or regulatory change (Suddaby & Greenwood, 2001) or by pressures from clients for novel solutions to their problems. Innovation may also occur as professionals inside the firm seek to create new services in order to cement their reputation and enhance their chances of promotion to partner (Anand, Gardner & Morris, 2007). Most importantly, innovation is constantly driven by the need to overcome the problem of knowledge commoditization. As solutions to client problems become widely known, professional service firms become susceptible to price reductions and reputational damage associated with delivering "cookie-cutter" solutions. In consulting firms this is particularly related to the spread of fads and fashions (e.g. Morris, 2001; Suddaby & Greenwood, 2001). In law firms, it is intrinsic to the provision of legal solutions where there are always at least two parties involved and each side can inspect the solutions of the other. Therefore, for PSFs, innovation is a necessity. While drivers to innovate may be similar to those of other organizations, the process of innovation in professional service firms differs considerably from that in other sorts of organizations.

Innovation in various types of organizations has been described as suffering from the dichotomy of "exploitation" and "exploration" (March, 1991). Both exploitation and exploration are associated with learning—but the nature of that learning differs. Exploitation incrementally builds on existing knowledge and aims to meet the needs of existing customers. Exploration, conversely, develops new knowledge, departing from routines, and drives entry into new product-market domains (Benner & Tushman, 2003). Typically, firms find it difficult simultaneously to achieve exploitation, the operation and incremental improvement of existing competences, and exploration, the search for new ideas and ways of working, because of the different competences and routines that underpin them (March, 1991).

This exploration–exploitation dichotomy, however, is less applicable to professional service firms. This is because innovation is embedded within the core production process insofar as professional firms are required to produce complex, customized and often novel solutions to client problems. In this context, exploitation pertains to new assignments for existing clients that impose familiar demands, whereas exploration involves relationships with new partners that pose unprecedented and divergent demands (Beckman, Haunschild & Phillips, 2004). In this sense, professional firms use not only their internal resources, but also their relationships with external parties, typically customers, to hone and extend their expertise (Fosstenløkken, Løwendahl & Revang, 2003; see also Chapters 4 and 5). Innovation occurs incrementally and continuously, as professionals often pursue exploitation *and* exploration in their client engagements, using knowledge in both well- and little-understood ways (Taylor & Greve, 2006).

This leads to one further distinctive characteristic of professional firms. Rather than driving innovation through a dedicated team, as is frequently noted in studies of structural "ambidexterity" (e.g. O'Reilly, Tushman & Harreld, 2009), or through an R&D department, the onus of responding to novel and divergent market demands rests squarely on the shoulders of front-line professionals (Heusinkveld & Benders, 2005; Mom, Van Den Bosch & Volberda, 2007; see also Chapter 4). Thus, the nature of innovation in professional service firms is distinctive in being embedded into the everyday work of professionals at the core of the firm rather than a separate organizational unit. Consequently, the way a professional firm attracts, organizes and retains staff through its career proposition is central to its capacity to innovate.

ORGANIZING MODEL OF THE PROFESSIONAL SERVICE FIRM

Professional service firms have a relatively simple production process. Compared, for instance, to manufacturing organizations there are relatively few complexities such as extended supply chains, highly departmentalized systems of production that need structural coordination or extended marketing channels. Instead, the core of service production centers on the deployment of expert knowledge to resolve client problems. Incentivized by learning opportunities, generous compensation and the prospect of promotion, teams of professionals use their own knowledge or leverage that of their senior colleagues to execute professional problem-solving tasks for which the client is typically billed on the basis of the labor time of the professionals (i.e. the input cost). This means that the organizing model that governs how input is transformed into output is also distinctive. It is characterized by four elements: (1) incentive schemes, (2) leverage models, (3) team composition and (4) fee billing arrangements. We discuss each of these elements below and argue why staffing the firm in ways that are appropriate to meeting client demands is critical. Figure 7.1 depicts the organizing model.

Incentive Schemes

Professional firms operate in two markets simultaneously: for clients and for staff who embody the expert knowledge needed to address client problems (Maister, 1993). A key challenge for the firm is to provide adequate incentives to attract and retain sufficient numbers of the right quality of associates (Greenwood et al., 2005). In professional firms, these incentives can encompass both current and deferred compensation of various types. First, firms directly compensate in ways that are consistent with the growing experience and productivity of associates. Second, firms provide junior professionals with opportunities for professional development by engaging them in challenging client work. Third, they offer opportunities for promotion to the partnership, which entails an equity stake in the firm and profit-sharing (Galanter & Palay, 1991; Greenwood et al., 2005; Malos & Campion, 2000). This combination of incentives, foremost among them the promotion system, secures the continued input and commitment of professional staff. Traditionally, for partners this has meant the delivery of innovative services by applying their knowledge and experience to novel client problems; for associates it has meant long hours of delivering more routine services and know-what from knowledge management systems, commensurate with their junior experience, or engaging in more innovative services by assisting seniors and learning from them.

Leverage Models

"Leverage" (Maister, 1993) closely relates to the human capital development offering to associates as well as the value of partnership. Associates initially borrow the skills and knowledge necessary to satisfy client demands from their principals (Gilson & Mnookin, 1989; Werr & Stjernberg, 2003) and gradually build up their own experience as they carry out professional tasks under their principals' supervision. Depending on the type of knowledge at stake, this leverage can take one of two forms (Werr & Stjernberg, 2003). Theoretical, easily articulated knowledge such as statutes, legal precedents, forms and applications can be codified in databases and knowledge systems for easy access and retrieval by juniors. More personal and tacit knowledge that features in the application of such theoretical knowledge is much harder to articulate and often remains embodied in the knowing individual. Hence, it is usually leveraged and transmitted in the personal supervision relationship, where associates can see it in action as their supervisors translate abstract theoretical knowledge into specific client solutions, or receive feedback on their own work.

Equally importantly, leverage sustains the basic division of labor between associates and partners in the professional firm and underpins the profits to partners (Hitt, Bierman, Shimizu & Kochhar, 2001; Malos & Campion, 2000; Sherer, 1995). By leveraging their knowledge and reputation through the employment of associates, partners can generate profits while not directly undertaking client work. Partners may then generate income from their own labor by undertaking chargeable work for clients, but they can also spend time generating future business and participating in the management of the firm, as owners. Juniors are freed from such managerial responsibilities to work on client assignments, where they are charged out at rates and for time periods that generate total revenue greater than the associate's employment cost. The resulting surplus accrues to the owners of the firm, namely the partners.

In this sense, leverage as associate-to-partner ratio, the level of innovation in services, and the economic performance of the firm are closely related. High leverage ratios are commensurate with highly codified knowledge packages and standardized methodologies that can be routinely applied by junior associates. Here, assignments are usually not cutting-edge, demanding innovative solutions. Conversely, lower leverage ratios are associated with experience or expertise models where knowledge is less reutilized. These models are geared towards more complex projects that place a premium on the experience or special expertise of more senior staff (Hansen et al., 1999; Maister, 1993). The mechanism that mediates this relationship between leverage, innovation and performance is team composition.

Team Composition

Team composition directly reflects leverage and how a firm uses it to make a specific project or transaction profitable. Decisions about team composition involve choices about the mix of partners and associates of different experience levels (Werr & Stjernberg, 2003) and about the distribution of tasks among team members. Partners or other seniors must actively delegate tasks to juniors rather than hoard work (Gilson & Mnookin, 1989) and, as a corollary, must devote some of their time to supervision and knowledge transfer by working alongside juniors. At the level of the firm or individual practice, staffing decisions are about making available appropriate numbers of professionals of differing seniority levels required to deliver the type of transaction on which the firm is typically engaged or expects to be in the future. Hence, this strategic decision influences how teams are composed and how partners' knowledge and reputation are leveraged (Maister, 1993).

In any case, the workforce of the firm and the membership of each team are described by the shape of a pyramid whose width varies with the leverage ratio and therefore with the strategic positioning of the firm. Firms which strategically position themselves for the delivery of high-volume, standardized services will predominantly deploy highly leveraged teams. Their staff pyramid will have a broad base for most teams and for the firm overall. Firms and teams geared for more innovative, customized services will display a narrower base of associates per partner. Innovation is likely to be concentrated in these low-leverage, high-experience teams or firms. Hence, team composition as a corollary of leverage strongly influences which teams are likely to deliver innovative services and where in the team innovation originates.

Fee Billing Arrangements

Fee billing conventions differ across firms and across practices commensurate with the expected novelty of client problems, team composition, and leverage. Some services, for example in consulting, audit and corporate law, are based on a fixed fee agreed *ex ante* (albeit often with additional charges for unexpected overtime), while others such as tax law, accounting and other types of specialist advisory services are charged according to work time. Despite this variation, time-based billing arrangements have become perceived as a strongly institutionalized practice across professional service firms (Kor & Leblebici, 2005; Yakura, 2001). Regardless of fee structure, firms valorize professionals' time in monetary terms using time sheets or recording devices and often explicit time targets for "billable hours." Associates' success in completing appropriate billing targets forms an important part of promotion to partner decisions (Landers, Rebitzer & Taylor, 1996).

Billing targets are therefore an important part of the monitoring and incentive systems in professional service firms. Moreover, they have an important influence on PSFs' ability to innovate. Firms' internal organization, promotion policies and economic models assume that they can deploy associates predictably on projects, ideally to the maximum of their billable hours target. The challenge for innovation is to balance this pressure to sustain high utilization levels, which fosters the exploitation of existing knowledge, with the need to explore and develop new knowledge, which requires non-billable activities.

Figure 7.1 summarizes the different elements of the organizing model and how each element impinges upon the firm's capacity for innovation. It reflects how innovation in professional service firms is embedded within the core of the production process of the firm. Professionals innovate continuously as part of their day-to-day service delivery.

Professionals are incentivized to deliver innovative services. Payment commensurate with experience, opportunities for professional development, and the possibility of

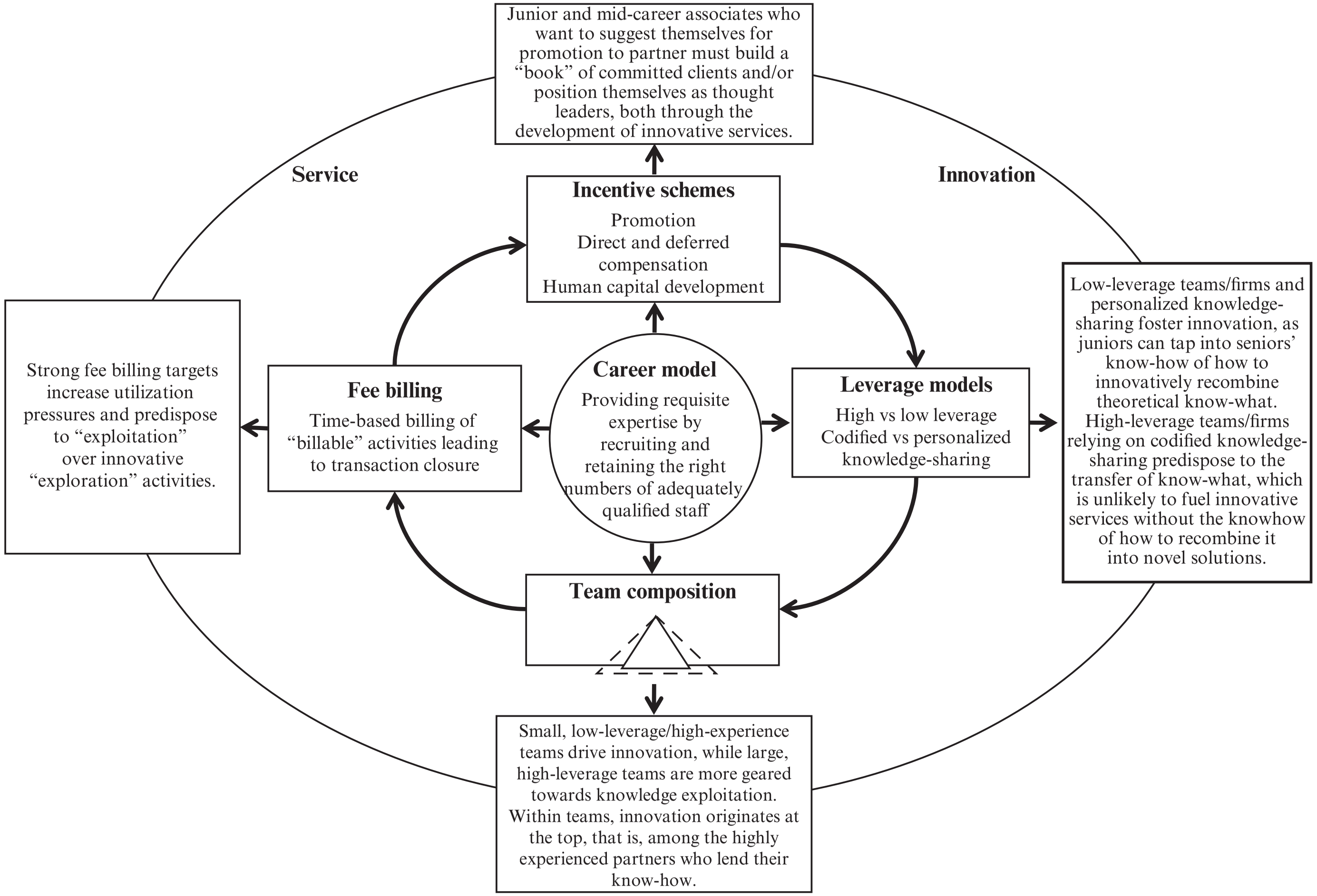

Figure 7.1 Organizing model of the professional service firm: its impact on innovation and links to the career model

promotion to partner and co-ownership of the firm are part of the package. Professionals utilize their own knowledge or leverage that of their senior colleagues. Leverage manifest in the associate-to-partner ratio is associated with different types of knowledge and knowledge-sharing. A high leverage ratio is associated with services built on highly codified knowledge that can be applied by junior associates. Low leverage is consistent with the application of less reutilized knowledge, drawing on the experience and expertise of senior professionals whose supervision enhances the potential for innovation. Closely related to leverage is the composition of professionals in teams. Low-leverage teams are richer in terms of the experience and know-how of senior professionals that can be shared with juniors, suggesting greater innovative potential. The fourth element of the organizing model is the billing arrangement through which the firm charges for the professionals' time. The billing arrangement has ramifications for innovation in the firm, because an emphasis on high utilization rates fosters exploitation of existing knowledge at the expense of exploration and the development of new knowledge. Non-billable activities of professionals are critical for the latter.

The four elements of the organizing model can be sustained only by recruiting, motivating, developing and retaining the right numbers of professionals with the right quality of expertise. That is why the career model fuels and sustains the organizing model (see Figure 7.1). In the following section, we elaborate on the traditional and distinctive career model, the "up-or-out tournament for promotion to partner" in professional service firms, shedding light on how it feeds the organizing model and, in turn, sustains the capacity for innovation. We then draw on our data that captures recent changes to the up-or-out tournament model in elite UK law firms and discuss the implications of these changes for the organizing model and, consequently, the capacity for innovation in these firms.

THE UP-OR-OUT PROMOTION MODEL

Given the centrality of professionals and their knowledge to the success of professional service firms, it is unsurprising that the career model plays a crucial role in sustaining PSFs' organizing model. Typically, elite firms in many professions have attracted, motivated and retained staff of adequate number and quality by using what is termed the "up-or-out" model of promotion to partner (Galanter & Palay, 1991; Malos & Campion, 1995).

The up-or-out model is a form of tournament promotion system (Galanter & Palay, 1991; Gilson & Mnookin, 1985; Kordana, 1995; Landers et al., 1996; Lazear & Rosen, 1981; Wilkins & Gulati, 1998). Candidates compete against each other for promotion to a limited number of positions at the next grade, and promotion is based on relative ranking rather than any individual's absolute merits. Those who fail to make the grade are barred from subsequent promotion rounds (or tournaments) and, in the up-or-out version of the tournament, expected to leave the firm.

In professional service firms, the critical tournament occurs when associates seek promotion to partner, moving from their status of salaried employee to co-owner and taking a profit-share of the firm. The promotion to partner decision has obviously desirable consequences for the candidate, but also important ramifications for the firm's reputation, ability to generate future profits, and number of co-owners who will share the total profits of the firm (Hitt et al., 2001). While the inevitable waste of good-quality professionals in whom the firm has invested substantial sums and who are likely to be highly productive makes this model seem a costly device to select a partner, its incentive and signaling properties explain its utility (Gilson & Mnookin, 1985, 1989). For the firm, the up-or-out system resolves the problem of incentivizing employees in a production process where effort is difficult to measure and the relationship between employee input (work effort) and output is complex. In such situations monitoring is costly and difficult, especially because partners or senior professionals are themselves engaged in production rather than management. Here an up-or-out promotion model provides a relatively cheap, easily manageable alternative. Employees sustain high effort and seek to develop competence in order to win the tournament prize of promotion to partner and a share of profits, as well as the status rewards which go with it.

Further, because the firm risks diluting profits per partner if it offers more new partnership positions than it can sustain, the model ensures that only the "best of the best" remain in the firm while underperformers leave. It maintains an elite reputation that facilitates client acquisition and justifies higher hourly fees, while simultaneously helping to manage the number and quality of those promoted to profit-sharing status. Along the route to partnership, firms can weed out associates who fail to perform adequately or hire laterally to fill gaps in their teams and sustain appropriate leverage. It can thus be argued that the up-or-out tournament is consistent with professional and organizational values because it is instrumental in harnessing organizational reputation and professional expertise.

By ensuring that candidates who fail to make partner leave rather than stay as non-partner associates the firm addresses three other related risks. First, it avoids the likely increased monitoring costs it would incur with passed-over candidates who lack the incentive of promotion to partner at a future point. Second, it frees up a development path for aspiring and competent associates who might otherwise be blocked by passed-over candidates. Third, it allows the firm to align its leverage profile (known as its leverage ratio) with its business model. A stock of career-plateaued associates is likely to be expensive to employ and, unless the firm can generate enough work of an appropriate level of complexity, these associates will be engaged in routine work that is likely to be incommensurate with their remuneration.

With these benefits accruing to the firm, why would employees take the risk of entering such a tournament for promotion? Undisputedly, the opportunity for promotion to partnership is the core component of deferred compensation. Gilson and Mnookin (1989) suggest that with low odds of tournament success the quid pro quo for taking this risk is that employees are also tacitly assured the promotion decision will take place within a finite period and they are not left hanging on indefinitely. Moreover, in preparing for the tournament, associates gain valuable general human capital that is valuable in the external labor market even if they fail to make partner in the current firm. Some elite professional firms, such as McKinsey or Accenture, even tacitly assure staff that they will use their alumni networks actively to help failed candidates find new positions in client organizations.

Therefore, the up-or-out model has benefits for both parties: It generates high productivity with low monitoring costs for the firm and general (as well as firm-specific) human capital for the individual. Accordingly, it became a strongly embedded institution in elite professional firms. The model originated among the elite New York law firms in the early years of the twentieth century as they institutionalized their employment models, ownership form and governance structures (Galanter & Palay, 1991). In conditions of stable or growing supply and demand for legal work, it developed into an industry norm (Galanter & Palay, 1991). It was widely adopted by leading New York law firms (Sherer, 1995) and then by firms in the UK as well as in other professional services sectors such as management consulting and accounting (Morris & Pinnington, 1998).

However, there is substantial evidence from the US—and some anecdotal evidence from other countries—that the up-or-out model has been modified or abandoned under pressure from market and institutional changes (e.g. Wilkins & Gulati, 1998). For over a decade, professional service firms have been under pressure to become more corporate or business-like in their structures and systems—including their promotion system. Changes in the labor market situation and the war for talent have especially challenged the utility of this model. Below, we present evidence from our own research that focused on how elite UK law firms responded to these pressures by adopting new career models and discuss implications for the firms' ability to innovate. For a detailed discussion of the social, political and economic pressures behind these changes see Malhotra, Morris and Smets (2010).

TOURNAMENTS UNDER PRESSURE: CHANGING CAREER MODEL IN ELITE UK LAW FIRMS

We studied a sample of ten London corporate law firms to examine external pressures on the tournament promotion system, responses to these pressures as they manifested themselves in formal promotion policies as well as actual practice, and the perception of these responses across a variety of internal stakeholders. The firms in our sample rank in the top 30 by number of partners and fee volume, and compete with each other in both client and labor markets.

In order to gain a comprehensive understanding of changing promotion patterns and to understand their implications for the innovative capacity of individual firms, we collected data at the field level, firm level and individual-actor level. First, we thoroughly scanned reports appearing in the legal media over the past five years to capture field-level discourse on career issues and policy responses by individual firms. Notably, during the core period of our data collection in 2007/08, the legal media was replete with examples of innovations to the promotion system being introduced in UK-based corporate law firms. For instance, the *Lawyer Daily*, the online newsletter of the largest trade publication for the UK legal sector, put out 380 news items related to issues of promotion to partnership and alternatives to partnership. This number makes up over a third of all news items the *Lawyer Daily* covered in this period. Among the headline stories highlighted in the subject line of the e-mail newsletter, promotion issues featured in over a quarter of all news items. This confirmed that pressures on the tournament system of promotion and emerging alternative structures were of central concern to the profession.

Second, we focused on firm-level data documenting changes to promotion policies in each firm in our sample. We accessed websites and intranets where policies are outlined in some depth, and discussion pages provide useful insights into feedback on policy proposals. Where available, we reviewed formal policy documents to understand how formal policies were changing, if at all.

Third, we interviewed a variety of internal stakeholders. We conducted 37 interviews, each interview lasting about one hour. Interviewees included two senior partners, four managing partners, eight other partners, ten HR managers or partners responsible for promotions, ten associates and three senior professionals in positions recently introduced as alternatives to partnership. We first interviewed the HR director, the managing partner and/or a partner responsible for promotions and careers, because they were expected to have played a significant role in devising the new promotion policy of the firm. We asked them to clarify the formal policy position of their firms, and to elaborate on recent or impending policy changes and how these were being enacted. We obtained rich information on the different types of alternative roles to partnership that had been formally adopted across our sample and found considerable variation in the range and the extent to which alternative roles had been adopted.

We then interviewed other partners in the firm, both senior and those recently promoted, who are likely to have a significant influence on how promotion policies get enacted on a day-to-day basis. We followed up with associates coming up for promotion to partner and senior professionals who had been bestowed with permanent, non-partner positions as part of the new promotion policy to capture their perceptions of and attitudes toward alternatives to partnership and how they affected their career plans and day-to-day work. The interviews with partners, associates and senior professionals in alternative roles revealed how the new promotion policy was being enacted and that there was a clear gap between the espoused policy and the policy in use. The interviewees also shed light on how changes to the promotion system were shaping the whole career model permeating the firm to affect the four elements of our organizing model. The latter gave us insights into how these changes would impact on the firm's capacity for innovation.

Our analysis showed that most of the firms we investigated do not have—and some never had—a formal up-or-out policy but that the up-or-out rule nonetheless operates in practice. It was striking that most associates who fail to make partner leave the firm voluntarily, even in the absence of an up-or-out policy and with new options of permanent employment available to them. While some pockets of permanent employment have always existed in law firms, these roles addressed specific business needs on an ad hoc basis. It is the recent changes in the market for professional talent that persuaded the majority of firms in our sample to introduce new permanent positions and formalize existing ones, giving them a distinct job title, job description, set of benefits and qualification criteria. We describe below the variety of permanent, non-partnered positions that have been formalized: of counsel and legal director, permanent associate, and professional support lawyer.

Of Counsel and Legal Director

The position of legal director or of counsel—a title borrowed and adapted from US law firms—is generally open to senior associates who are at least eight years qualified but have either not made partner or not applied to do so. Therefore, they are at or beyond the level of experience required for promotion to partnership but usually lack a strong enough business case to be selected. The work of both of counsel and legal directors is similar to that of the most senior associates, including some elements of management, but none of the "rainmaking" and business development responsibilities that characterize partners' work. Privileges of these positions include access to management information and a special status and respect within the firm and the marketplace. Additionally, remuneration differs from that of associates. In all but one of our sample firms, the base remuneration of professionals in permanent positions is higher than that of senior associates. In addition, of counsel earn bonuses linked to firm performance, while associate bonuses are more closely linked to individual and practice performance. Linking the of counsel's pay to that of the firm or practice in which they work is partly a motivating device and partly so that their pay is based on a similar principle to that of the profit-based rewards of partners.

Regarding the future career prospects for of counsel lawyers and legal directors, firms differ widely. Some firms did not expect them to be future candidates for partnership, while others would allow them subsequently to be proposed for partnership selection, provided a sufficiently strong business case could be made. However, without considerable control of clients this latter route is considered impractical. The re-entry of career-plateaued professionals into the partner tournament continues to be a highly contentious issue for HR directors and managing partners, because of its implications for the existing promotion to partner model, which includes selection criteria, competences and development tracks inside the firm.

Permanent Associate

Permanent associate positions tend to be concentrated in areas with a strong need for experienced lawyers but a weak business case for partnership. Although it was an accepted fact in all respondent firms that permanent associates existed and had done so for many years, the formalization of their position and the growth in their numbers make this position different from previous years. Like of counsel or legal directors, candidates for this position are generally those associates who are eight or more years qualified and have failed to obtain partnership or will not be put up for promotion. Unlike them, however, permanent associates are retained for their experience and do not assume managerial responsibilities. Formal permanent associate positions address not only issues of talent retention but also the paradox that, traditionally in PSFs, the only way for professionals with great technical expertise to permanently remain with their firm was to get promoted to management positions for which they had not received any formal training (Greiner & Scharff, 1980).

Professional Support Lawyer (PSL)

PSLs are qualified lawyers who provide support for fee earning colleagues. They are typically paid a salary linked to associate rates but with limited bonus opportunities. Many are technical specialists with strong drafting skills used to resolve legal difficulties during transactions. In contrast to other permanent positions, the position of PSL is not necessarily geared towards unsuccessful candidates in the partnership tournament who would have been forced out of the firm under a strict up-or-out regime, but towards senior associates who seek more flexible work demands. This role is not new, having existed for over 20 years in our sample of firms, but until recently it was very rare and informal. It rose to prominence with greater demands for work–life balance among "generation Y" associates. Accordingly, in each of our firms the overwhelming majority of PSLs are women, many of whom have taken the position to fit with raising a family. As PSLs are not directly fee earning, they can manage working hours more flexibly. With that, they are commonly assumed to be following an alternative path to that of the career lawyer and therefore off the partnership track.

However, we found formal policies on this point deliberately loose and varied. In two firms, policy initiatives are in place to create a separate career track to managing PSL, and in one firm it was considered to link to partnership selection. Four other firms considered medium-term changes to permit PSLs to move back into fee earning and re-enter the partnership track as associates. In this context, they are also expanding the position to a mix of retention and expertise building purposes or connecting it more closely to business development activities, establishing a closer link to criteria for partnership selection.

Intriguingly, while these new permanent, non-partner positions that formally contradict the traditional principle of up-or-out changes were supposedly introduced to satisfy associate demand for better work–life balance and improved career prospects, we found it was mostly the associates who kept the traditional up-or-out model alive. They simply continue to leave the firm when passed over for partnership, even though they know the firm would never force them to do so. For them, this response to "failure" in the tournament for partnership continues to be the "done thing." Hence, while new formal policies do away with the traditional "up-or-out" regime in theory, both career models coexist in practice. Thus, innovation in the promotion and career system has introduced important modifications to the traditional up-or-out model, but has not altogether displaced it (Malhotra et al., 2010; see also Galanter & Henderson, 2008; Wilkins & Gulati, 1998).

While modifications to the up-or-out model are enacted rather inconsistently, depending on associates' uptake of new career positions, there is a consistent change to the general framing of associates' careers. HR managers justified changes to the highly institutionalized up-or-out model with reference to socio-economic pressures in the labor market, but also by reframing the overall proposition of what a career should look like. In most of our sample firms, HR managers devised a structured career development process that emphasizes individual skill development to take associates up through the ranks of their current firm, but also enhance their external market value. Associates are to be offered a holistic learning and development experience without any expectation that unsuccessful candidates for promotion to partner should leave the firm. One firm explicitly formulated a framework called "the deal" in which the firm commits to providing associates with interesting and stimulating work on "leading edge" transactions, focusing on complex cases, and leaving more commoditized, routine tasks for their juniors.

This new framing is interesting, insofar as this development plan more explicitly acknowledges the need to build general skills that are valued in the external labor market and rests on two important assumptions: First, it assumes that there will be a steady flow of "leading edge" transactions on which to deploy junior professionals. Second, it assumes that these associates will be able to do more than routine work and will engage in more innovative tasks. These changes to the promotion system, but also its underlying assumptions, have implications for these firms' leverage model and incentive system that are likely to impact on their capacity for innovation.

CAREER MODEL, ORGANIZING MODEL AND CAPACITY FOR INNOVATION

In this section, we discuss how innovation in the career model of law firms entails changes to their organizing model, and how these, in turn, impact upon these firms' capacity for innovation. Returning to the four elements of the organizing model outlined above, we see a number of implications, summarized in Figure 7.2, that can follow from the introduction of a new career model in law firms.

Incentive Schemes

With the introduction of new permanent positions as alternatives to partnership, as well as the definition of clear criteria for admission to these, law firms have also highlighted more clearly what it takes to be promoted to partner. Those becoming PSLs, permanent associates, of counsel or legal directors invariably distinguish themselves through their long experience and technical expertise. However, they all usually lack the business case to qualify as a partner. Business development potential, the capacity to generate new business to an extent that at least maintains profits per partner, has become the sine qua non of partner selection. This shift in focus on what is considered a critical skill for advancement in the firm also re-shuffles the existing set of incentives for junior professionals as well as their involvement in service innovation.

Associates who aspire to partnership rather than any of its alternatives—and those are still plenty in our sample of firms—will want to develop and demonstrate their business acumen and innovation capacity. As the "book" of clients of senior associates is usually taken as a reflection of their revenue generating potential and, thus, a strong indicator of their quality as partner, they have a strong incentive to build a committed client base. The mere exploitation of established solutions, however, is unlikely to achieve that. Therefore, they are motivated to explore innovative ways of solving their clients' problems and convincing them that their current and future needs will be well served.

For the innovative capacity of the firm this means that within the new career structure innovation may spring from new sources in the organization, as entrepreneurial thinking and commitment to innovation trickle down the organizational hierarchy. As we elaborate below, partners are likely to be increasingly motivated and involved in winning challenging client business that poses novel problems, rather than in solving them. Simultaneously, technical experts with a considerable transaction track-record—but no fee billing targets—are explicitly rewarded for sharing their expertise and experience with the firm. As a result, more junior associates are incentivized, but also empowered to engage in more innovative problem-solving, not least by more aggressively leveraging the firm's knowledge base.

Leverage Models

The more firms pursue new career structures and deploy increasingly senior teams, the more their overall leverage changes—both in terms of their ability to deploy existing senior knowledge and in terms of their partner–staff ratio. Importantly, the increased leverage of employing a higher ratio of non-partnered staff to equity partners only improves the all-important profits per partner as the key metric of law firm profitability, if the "bulge brackets" in the middle ranks are carefully managed.

Senior staff in non-partner positions bring to the table invaluable experiential knowledge. However, the economics of positions such as of counsel and permanent associate require that these senior professionals are regularly deployed on client engagements that fit their seniority and therefore can be billed at rates that cover their relatively high compensation. Therefore, the logic for partners must be to feed them work that is challenging and consistent with both their capabilities and their remuneration. For instance, permanent associates are often introduced in practice groups where experience is paramount and—in contrast to other groups—clients are therefore willing to pay for it. As one partner clarified, "They wouldn't work in my area, corporate law, because they block the way for younger lawyers and they are too expensive to justify. But in tax they would be useful." Partners seeking challenging work ensure not only that the firm reaps sufficient value from its senior non-partners to justify the costs of their retention, but also that they do not become demotivated by the lack of challenge. Hence, there is a strong incentive for the firm to seek more than the exploitation of routine know-how and to encourage the exploration of new applications for existing senior knowledge.

This means that the effects of a new career model on the firm's leverage eventually also impact upon its motivation and capacity to innovate. Like the firm's pledge to junior associates to expose them to leading edge transactions, the accumulation of senior non-partners also motivates partners to seek business that intellectually stretches them and creates the opportunity for these senior professionals to draw on their accumulated experience to drive service innovation. However, the accumulation of senior experience increases not only the firm's motivation but also its capacity to innovate.

On the one hand, parking talented non-partnered employees in permanent positions frees up partners' time to win more cutting-edge business that requires innovation and is likely to involve clients in the co-production of new knowledge. Senior non-partner professionals are capable of taking on more challenging work than is expected of associates in the traditional up-or-out model, and they are also less reliant on partners for input.

On the other hand, the increased availability of experienced professionals in positions such as permanent associate, legal director or of counsel addresses the problem of sharing hard-to-codify, tacit knowledge. Werr and Stjernberg (2003) suggest that such knowledge is more effectively managed and innovation fostered through "interaction between knowledgeable individuals," ideally those who form part of the same community of practice. As qualified professionals, experts in permanent positions are members of the same community of practice as those applying it, and often directly assist in application.

PSLs, for instance, maintain systems of codified theoretical knowledge, but also template methods, put together warnings of potential pitfalls in the application of certain documents, and directly interact with those tasked with the actual transaction. They thereby enhance the flow of both "know-what" and "know-how," provide relatively generic information without losing its richness, and foster the integration of theoretical and hard-to-articulate knowledge. Hence, employing a larger number of senior knowledge carriers for database management while simultaneously making them available for personal knowledge-sharing facilitates the translation of codified theoretical knowledge into specific—and innovative—client solutions. As Werr and Stjernberg (2003) found in their study of management consultancies, knowledge codification strategies enhance service speed and quality, while personalization strategies enhance innovation. The use of PSLs as database managers and implementation assistants brings together both benefits in a single function.

The introduction of permanent positions in more experience-based practice groups, thus, achieves an interesting split: It responds to the career needs of technically excellent employees who lack the skills to progress to partner, and it creates a distinct knowledge structure that makes tacit, project-based experience available to the wider organization. In this sense, law firms develop structural capital in knowledge and innovation management that is largely built from human capital and can therefore actively participate in the translation of existing knowledge into innovative solutions (see Werr & Stjernberg, 2003). Such interaction between tacit and explicit knowledge has been considered critical for innovation (Nonaka & Takeuchi, 1995). In our cases, juniors may turn to codified databases for the theoretical knowledge that their task requires, but their senior colleagues can contribute the experience and tacit knowledge to apply and recombine it in innovative ways—especially where they are part of the same transaction team.

Team Composition

The retention of more senior non-partner fee earners and the emergence of PSLs in the firm are reflected in the composition of each team. To pay for this, two things must happen: First, as explained above, partners have to keep feeding them work which is challenging and consistent with their experience. Second, associates must be able to rely less directly on partner input, both to keep billings under control and because partners will be increasingly preoccupied with gaining additional work rather than doing it.

With regard to the latter point, senior non-partnered staff play a crucial role, making sure that junior staff are not only required but also enabled to engage in innovation. They function as the kind of "centers of excellence" that Werr and Stjernberg (2003: 891) identify with database maintenance and innovation in consulting firms, but fulfill a broader, double role in this context. On the one hand, PSLs codify knowledge by running precedent databases and other forms of knowledge codification, such as the templating of know-how to make it accessible to junior associates and enhance their capacity for independent work. As Werr and Stjernberg (2003) argue, the on-demand availability of this type of information facilitates leverage by improving the quality and speed of knowledge exploitation. The availability of such codified knowledge can indirectly foster innovation, as it accelerates access to the basic building blocks and frees up time to recombine these in innovative ways.

Simultaneously, however, the availability of a larger number of non-partnered seniors per team means that associates can also access the rich experiential knowledge of other senior non-partner professionals. As former fee earning lawyers, PSLs not only catalogue precedents and documents, but also sanitize them for re-use in future transactions, and assist in their application. This can be especially helpful in making sense of theoretical knowledge that is especially complex and abstract and in translating it into innovative services. In sum, associates can tap into codified databases that help efficiently exploit existing theoretical knowledge as well as into their senior colleagues whose experience and tacit knowledge help in exploring innovative ways of applying it (Hansen & Haas, 2001; Werr & Stjernberg, 2003). Hence, moving from a pyramid-shaped team composition, as was typical of the traditional up-or-out model, towards a rather diamond-shaped alternative fosters innovation by junior staff.

This means that innovations in career models offer the opportunity for firms not only to adjust their leverage and change team composition, but also to re-construct the roles of team members and create a clearer and sharper division of labor between associates, senior non-partner professionals and partners. Partners can be relieved from day-to-day work to a greater extent and focus more on client relationships and winning business. In turn, this clearer division of labor between winning work and doing it makes it more likely that innovation will spring from among the most experienced non-partners, that is, of counsel and permanent associates and those juniors who have been promised "leading edge" work as part of their skill development (Werr & Stjernberg, 2003).

Fee Billing Arrangements

We argue that the impact of permanent employees on the locus of innovation within the firm depends on the fee billing arrangements that apply to their positions. It will be more pronounced where they are not driven by billable hour targets, which are at the centre of the traditional logic of fee billing. The current logic favors current utilization over the "down-time" necessary to reflect on experience and generate innovations; that is, it reinforces the pursuit of exploitation over exploration. By developing roles such as the PSL that are not driven by utilization targets, firms create a win–win situation insofar as they respond to their employees' wishes for better work–life balance and institutionalize innovation capacity.

Following the new logic, there is a strong incentive for the firm to seek more than the exploitation of routine know-how but to encourage the exploration of new applications for knowledge held by senior professionals. In other words, positions that are not driven by utilization targets are more likely to reinforce the pursuit of exploration over exploitation. Exempt from the billing pressures that constrain the colleagues they serve, permanent non-partnered staff have more time to develop original knowledge that forms the basis of innovative services. When they are not tasked with directly supporting specific transactions, they can even explore completely new ways of thinking about problems and drive more profound innovations that are unrelated to existing problems and may open new opportunities for future services. In this sense, PSLs and other professionals in permanent, non-fee earning functions, such as of counsel, who are allowed to go "off the clock" can themselves constitute an important source of innovation. This is possible because these senior professionals combine strong technical expertise with several years' experience of working on client transactions. They work closely with lawyers on transactions, providing a mix of support and advice work which deals with the intricacies of particular problems. They therefore operate at the frontiers of professional know-how in using a combination of formal knowledge (in the UK, precedents and statute law) and firm-specific or practice-specific know-how to resolve particular client problems.

It can be argued that this may herald the introduction of an R&D capacity, akin to manufacturing firms, in PSFs. While we have shown that innovation has traditionally happened on the job as individual professionals respond to client demands, now innovation may become an independent function—importantly, one staffed by professionals who have the same credentials as those applying their expertise. Thus, the more firms invest in non-billable time by creating positions for those with expertise and experience to support the development of know-how, the more they are embedding exploration activities within the firm. Figure 7.2 summarizes how changes to the career model permeate the firm's organizing model and affect its capacity for innovation.

CONCLUSION AND FUTURE RESEARCH AGENDA

We started by arguing that innovation in professional service firms is distinctive in a number of ways that relate to its inputs (professional labor) and outputs (relatively customized solutions to complex problems). The common explore–exploit dichotomy is less applicable to innovation in professional service firms, because innovation is not delegated to a separate organizational unit but is embedded in the core of the firm—namely in the everyday production process by client-facing professionals.

Consequently, the career model by which highly mobile professionals are attracted, motivated and retained is central to the functioning of professional firms. The traditional up-or-out promotion system has been—and still is—undergoing significant change towards a new holistic career model. We found that, by introducing such change to their career model, law firms are generating options for significant innovations to their traditional organizing model, which, in turn, have implications for the source and process of service innovation.

The new leverage model and underpinning diamond-shaped team composition suggest that innovations will continue to be sourced from within the production process itself, albeit from new places. If business generating ability rather than technical excellence becomes the key characteristic of partners, then young associates will strive to acquire and demonstrate this particular skill. They receive increasing support from non-partnered technical experts with considerable transactional expertise. PSLs, for instance, specialize in capturing and recombining knowledge, and senior associates, of counsel or legal directors take more responsibility for service delivery while partners seek business. Therefore, it may be argued that, as a clearer division of labor between partners, associates and senior non-partnered professionals solidifies, entrepreneurial mind sets, focused on "getting the deal done" for the client, may govern practice lower down on the seniority ladder, making innovation more pervasive in the firm, rather than the prerogative of the upper echelons.

Beyond detailing the specific changes and their effects on innovation, the model in Figure 7.2 also highlights the three key mechanisms through which changes in the

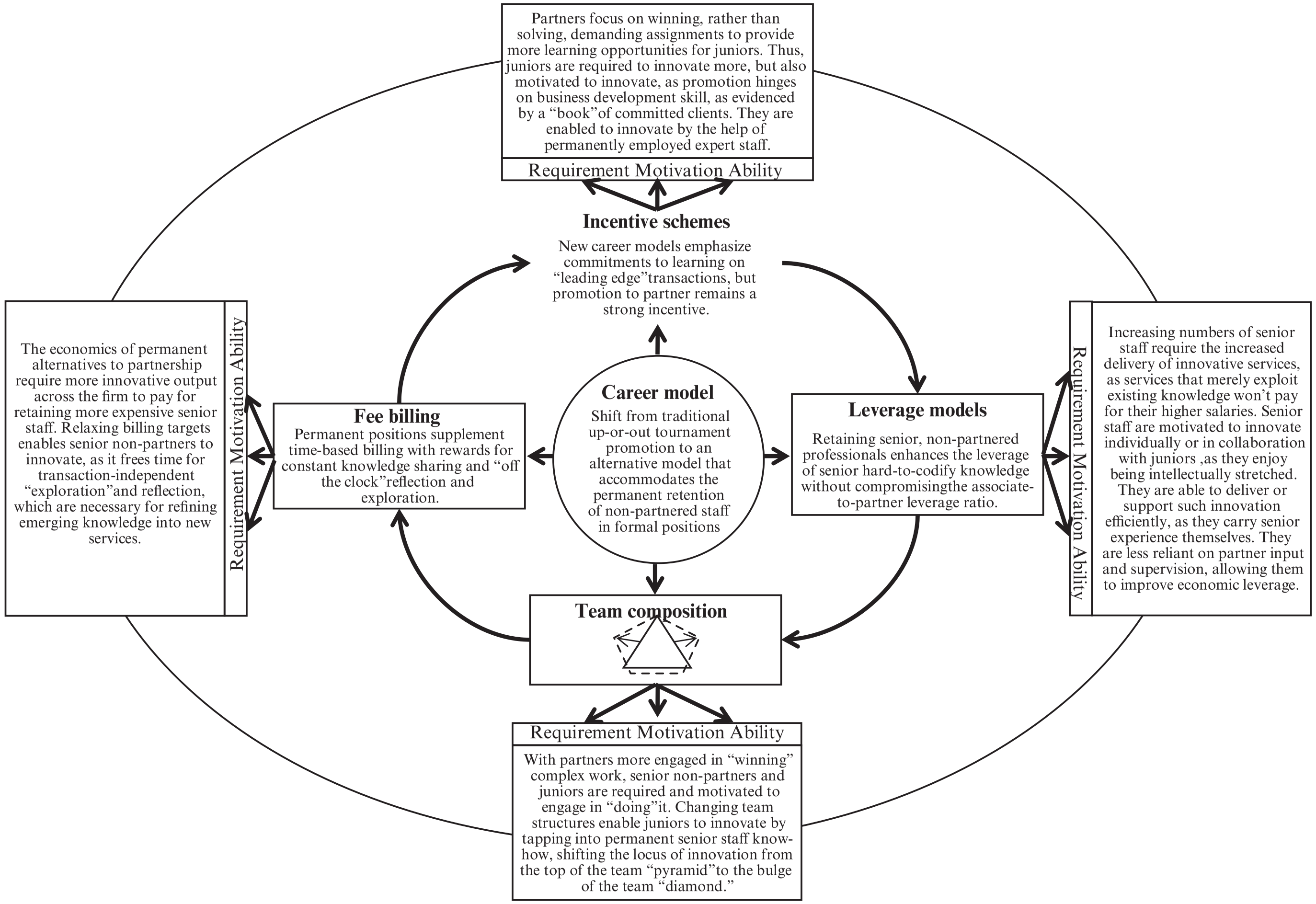

Figure 7.2 Changes in career model, organizing model and capacity for innovation

organizing model can effect changes in innovative capacity. Across all elements of the organizing model, innovative capacity is augmented where the change to the organizing model: requires increased innovative activity, for example to meet the economic demands of retaining a larger portion of senior, highly paid professionals; motivates innovative activity among members of the firm who were previously considered negligible in this regard, such as junior professionals aiming to distinguish themselves in the eyes of colleagues and clients; enables those newly motivated individuals to pursue their innovative ambition, for example by giving them access to senior professional know-what *and* know-how through the work of senior, non-partnered staff.

Importantly, it is the combination of all three elements—requirement, motivation and ability to innovate—that determines a firm's innovative capacity. Staff who are motivated and able to innovate, but not required to do so because of the nature of their clients and assignments, are just as unlikely to innovate as those who lack ability or motivation. Conversely, a favorable combination of requirement, motivation and ability in the wake of the changes in career model we described is likely not only to enhance capacity for innovation, but also to shift the locus of innovation, namely from the apex of the team "pyramid" to the middle or bottom of the emerging team "diamond."

These observable changes shed a first light on the link between career models and capacity for innovation in elite law firms and professional service firms more generally, but also indicate avenues for future research.

As our discussion of individual career ambitions and entrepreneurial predispositions as well as organizational incentives for innovation suggests, the link between career models and entrepreneurship should be studied at multiple levels, focusing on the individual, organizational or institutional level, or on a combination of all three. Studying the interaction of institutional conditions, organizational policies and individual ambitions will be particularly illuminating and help specific organizations, but also professions as a whole, to tap the innovative potential of their members.

Studies across different professional services should refine our understandings of the mechanisms by which changes to career models are translated into new capacity for innovation. As our analysis is based on law as an archetypical professional service, comparative studies that unpack the specifics of innovation in other, less regulated or more "creative" professional services will be illuminating.

Lastly, future research on careers and innovation should consider effects of internationalization on the level and locus of innovation in professional firms. As PSFs internationalize, they necessarily extend into client and labor markets of varying quality. Future research should examine how this increasing heterogeneity of staff, clients and learning opportunities affects the sustainability of established career models and the translation of local experiments into new and innovative services.

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