

THREE ESSAYS ON THE HUMAN CAPITAL AUGMENTATION STRATEGIES OF
BUILDING AND ACQUIRING

BY

AMIT JAIN CHAURADIA

DISSERTATION

Submitted in partial fulfillment of the requirements
for the degree of Doctor of Philosophy in Business Administration
in the Graduate College of the
University of Illinois at Urbana-Champaign, 2014

Urbana, Illinois

Doctoral Committee:

Associate Professor Deepak Somaya, Chair
Professor Joseph T. Mahoney
Professor Huseyin Leblebici
Associate Professor Rebecca L. Sandefur

Abstract

This dissertation examines firms' human capital (HC) augmentation strategies and under what conditions firms can generate competitive advantages from these strategies. I investigate the two main ways firms augment their HC: building and acquiring. I seek to advance this important, but understudied, area of research in the strategic HC literature by explaining how and when, as well as with what performance effects, firms engage in each of these strategies. The first question addresses how firms generate economic returns from building and acquiring strategies. The second question investigates the antecedents to firms' choices to invest in building rather than acquiring strategies. Finally, the third question examines the effects of the business cycle on firms' capabilities to generate economic returns from building and acquiring strategies. I find that firms can create value from their HC augmentation strategies if they can also use their capabilities to overcome the four classic problems across the business cycle, and can invest in long-term building strategies. To conduct my analyses, I use a longitudinal dataset that I constructed by combining several secondary data sources on the largest U.S. law firms over the last decade.

Dedicated to my late grandma, my parents, my wife, and my son, the lovable Ram...

Acknowledgments

I would like to acknowledge the invaluable assistance of the many people who were very generous with their patience, support, and time. First, I would like to thank my doctoral committee—Deepak Somaya (Chair), Joseph T. Mahoney, Huseyin Leblebici, and Rebecca L. Sandefur. My committee members provided me with critical feedback and guidance throughout the dissertation project. In addition, strategy faculty and doctoral students in the Department of Business Administration will forever have my gratitude for attending my presentations and providing me with invaluable comments, feedback, and ideas to improve my dissertation. I could not have completed my study or this project without the generous and abundant assistance of the department and library support staff. Last, but not least, my family has been both endlessly patient and supportive throughout this, at times, challenging process. I would especially like to thank my wife Ashli, and my son Ram, for their understanding and love during the past few years. I would like to give special thanks to my editors, John O'Connor and Margo Robbins.

Table of Contents

CHAPTER 1: INTRODUCTION	1
CHAPTER 2: HOW DO FIRMS AUGMENT THEIR TALENT? A COMPARATIVE PERFORMANCE ASSESSMENT OF BUILDING AND ACQUIRING.....	7
Introduction.....	7
Literature Review	10
Theory.....	14
<i>Quality uncertainty</i>	15
<i>Firm-specific HC</i>	16
<i>Team complementarities</i>	17
<i>Employee motivation</i>	17
Hypotheses.....	18
<i>Firm reputation</i>	18
<i>Promotion chances</i>	20
<i>External leadership</i>	22
<i>Augmentation experience</i>	23
Data and Variables	24
Results.....	30
Discussion and Conclusions	34
Tables and Figures	36
CHAPTER 3: WHEN DO FIRMS INVEST IN DEVELOPING ROOKIES? A FIRM-LEVEL ANALYSIS OF THE DECISION TO BUILD VERSUS ACQUIRE HUMAN CAPITAL ...	47
Introduction.....	47

Literature Review	50
Theory and Hypotheses	53
<i>Mentorship</i>	53
<i>Long-horizon investments</i>	55
<i>External leadership</i>	56
<i>Turnover shocks</i>	57
Data and Variables	58
Results.....	62
Discussion and Conclusions	64
Tables.....	67
 CHAPTER 4: HOW BUSINESS CYCLE-DRIVEN CHANGES IN EMPLOYEE SEARCH FRICTIONS IMPACT THE GENERATION OF VALUE FROM BUILDING AND ACQUIRING STRATEGIES	
Introduction.....	72
Literature Review	75
Theory and Hypotheses	79
<i>Building during early expansion and early contraction stages</i>	80
<i>Acquiring during expansion and contraction sets</i>	82
Data and Variables	84
Results.....	86
Discussion and Conclusions	88
Tables.....	92
CHAPTER 5: CONCLUSION	106

REFERENCES	110
APPENDIX A: AN ANALYSIS OF BUILDING AND ACQUIRING STRATEGIES IN THE LEGAL INDUSTRY	129
APPENDIX B: CONSTRUCTION OF DATASET.....	136

List of Tables and Figures

Table 2.1: Manifestation of 4 classic problems in each HC augmentation strategy.....	36
Table 2.2: Descriptive statistics	37
Table 2.3: Correlation table	38
Table 2.4: Fixed effects model of a building strategy on ROS (2004-2009).....	39
Table 2.5: Fixed effects model of a building strategy on ROS (2002-2009).....	40
Table 2.6: Fixed effects model of an acquiring strategy on ROS (2004-2009).....	41
Table 2.7: Fixed effects model of an acquiring strategy on ROS (2004-2010).....	42
Table 2.8: Fixed effects model of a building strategy on ROS (2002-2009) after one year.....	43
Figure 2.1: Firm reputation as a moderator for a building strategy on ROS	44
Figure 2.2: Promotion chances as a moderator for a building strategy on ROS.....	44
Figure 2.3: Building experience as a moderator for a building strategy on ROS.....	45
Figure 2.4: Promotion chances as a moderator for an acquiring strategy on ROS.....	45
Figure 2.5: External leadership as a moderator for an acquiring strategy on ROS	46
Figure 2.6: Acquiring experience as a moderator for an acquiring strategy on ROS.....	46
Table 3.1: Descriptive statistics	67
Table 3.2: Correlation table	68
Table 3.3: Fixed effects model of firm-level variables on investments in building (2003-2009)	69
Table 3.4: Fixed effects model of firm-level variables on investments in building (2003-2009) with a subsample of firms that have high leverage.....	70
Table 3.5: Fixed effects model of firm-level variables on investments in building (2003-2009) with a subsample of firms that have low leverage.....	71
Table 4.1: Problem levels for building	92

Table 4.2: Problem levels for acquiring.....	94
Table 4.3: Descriptive statistics	96
Table 4.4: Correlation table	97
Table 4.5: Fixed effects model of a building strategy on ROS during a business cycle (2002-2009), with early expansion years 2002 and 2003.....	98
Table 4.6: Fixed effects model of a building strategy on ROS during a business cycle (2002-2009), with early expansion year 2002 and continuing expansion year 2003	100
Table 4.7: Fixed effects model of an acquiring strategy on ROS during a business cycle (2004-2010).....	102
Table 4.8: Fixed effects model of an acquiring strategy on ROS during a business cycle (2003-2010).....	104
Figure A.1: The extent law firms practiced building and acquiring strategies.....	135
Figure B.1: Trends of law firms practicing each HC augmentation strategy	139
Figure B.2: Average revenue per lawyer and average number of associates per firm across a.. business cycle.....	140
Figure B.3: Augmentation strategies by law firm from 2002 to 2011	141

lockstep compensation system,³¹ lateral associates are paid even higher wages. In addition, law firms have to pay recruiting fees of as much as \$50k when bringing in a lateral associate (Kimball, 2006). However, hiring costs are only one part of a larger building strategy. Novice associates also have substantial training and development costs (Goldberg, 2007). Therefore, in looking at the total costs of these two HC strategies, both can be equally expensive.

In conclusion, the pursuit of building and acquiring strategies in the legal industry has changed over time. Initially, law firms only pursued building, then they gradually started to adopt acquiring to a limited degree, and now employ both building and acquiring strategies in relatively equal degrees. Drawing from the National Association for Legal Placement (NALP), as shown in Figure A.1, the hiring of novice and lateral associate lawyers from 1999-2008 has been relatively equal, barring a couple business cycle-related bumps. Past literature and research articles have unevenly explained current trends, and therefore, this dissertation is needed to shed light on these HC augmentation practices.

³¹ Under a lockstep compensation system that is characteristic of law firms, lawyer salaries are purely based on a lawyer's seniority in the law firm, since this reduces intra-firm competition and encourages teamwork among lawyers (Gilson & Mnookin, 1985).

