A FAREWELL TO TOURNAMENTS? THE NEED FOR AN ALTERNATIVE EXPLANATION OF LAW FIRM STRUCTURE AND GROWTH

George Rutherglen* and Kevin A. Kordana**

David Wilkins and Mitu Gulati have offered a revised version of tournament theory to explain the structure of large firms, changing the theory, however, from a "model" to a "metaphor."¹ Marc Galanter and Thomas Palay, in Tournament of Lawyers,² originally applied tournament theory to explain the exponential growth of large law firms over the period from 1922 to 1988. On their view, the tournament occurs among associates for the prize of partnership in these firms, and it solves the problem of compensation for employees whose work cannot easily be monitored to determine its marginal value to the firm. From the firm's perspective, the tournament provides an incentive for associates to work without being closely monitored. From the associates' perspective, a constant rate of promotion to partnership assures them that the firm is not exploiting them.

Wilkins and Gulati "do not advocate abandoning tournament theory altogether."³ We doubt, however, that they can save tournament theory from their own arguments, for many of the modifications that they offer in support of the theory can be turned against it. Even their defense of tournament theory as solving a monitoring problem rings hollow in light of their subsequent proposed modifications. With friends like Wilkins and Gulati, perhaps Galanter and Palay do not need enemies. This is not to say that they actually have enemies. No one has disputed the central finding of their book: that the law firms in their sample grew at an exponential rate, with an acceleration or "kink" in the rate around 1970.⁴ It is this finding, which extracts a measurable statistical pattern from a welter of data and anecdotal evidence, that requires

* O.M. Vicars Professor of Law and Earle K. Shawe Research Professor, University of Virginia.
** Associate Professor of Law, University of Virginia.

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³ Wilkins & Gulati, supra note 1, at 1587.
⁴ See Galanter & Palay, supra note 2, at 77-89.
an explanation. Without it, we would be far more ignorant about large law firms than we are. Yet, as it has been defined in the economic literature, tournament theory does not easily apply to the pattern of exponential growth that they discovered. Our difference with Galanter and Palay is what to make of their discovery. In terms of their title, it should have been replaced by the less memorable phrase, "The Kinked Exponential Growth of Large Law Firms." No doubt this would have made the book less popular, unless "kinked" somehow were confused with "kinky."

In any event, Wilkins and Gulati eventually appear to come to this position as well. Their modifications of tournament theory, in the end, transform it from a technical economic theory of compensation to a broader model that takes account of signaling and relational capital, as well as still more general cultural and political factors. In offering a broader version of the tournament, they accommodate objections to the original version of the theory, but at the cost of reduced precision and explanatory force. Tournament theory, in the version that they endorse, cannot easily yield falsifiable implications. And, in particular, it weakens the claim of Galanter and Palay that the promotion-to-partnership tournament constitutes the core of the large law firm as we now know it. What starts out as the dominant mechanism to explain the exponential growth of law firms becomes only one factor among many that contribute to the organizational structure of the large law firm.

We will start by considering Wilkins and Gulati’s defense of tournament theory and then turn to the suggestions they offer for modifying it. These modifications can be conveniently divided into those that concern the firm’s ability to monitor associates and those that concern the converse ability of associates to monitor the firm. In a brief concluding section, we will suggest how law firm structure might be explained without relying on tournament theory, for instance, by giving a more prominent role to the human capital of associates and by increasing the emphasis on competition between firms for the best associates.

I. THE DIFFICULTY OF MONITORING

Wilkins and Gulati begin by defending the central premise of tournament theory as applied to law firms: that it is difficult to monitor the productivity of individual lawyers within a law firm. The law firm therefore cannot accurately set the total compensation that should be paid to each associate in each
year and the associates cannot accurately determine whether they are being paid according to their productivity. In economic theory, a tournament solves both problems simultaneously. The firm can reduce the risk from inaccurate evaluation of associates by deferring selection of partners until the end of the tournament, when the errors in annual evaluations will tend to cancel each other out.\(^9\) Overvaluation in one year can be offset by undervaluation in another. Moreover, by selecting only the highest ranking associates as winners, the risk of any net undervaluation can be still further reduced; the firm can precommit to a certain level of compensation to be paid to an entering cohort of associates.\(^10\) Associates, for their part, can accurately assess their total compensation by determining how many associates in the classes hired each year are promoted to partnership (and by ensuring that they are paid a predetermined yearly wage unrelated to—and, in fact, less than—their productivity).\(^11\) Adding the value of promotion, discounted by the chance of being promoted, to their salary and fringe benefits, associates have an accurate means of determining their total level of compensation and comparing it to the compensation that they could earn elsewhere.

Wilkins and Gulati defend the difficulty of monitoring almost wholly from the law firm's perspective. Their evidence, however, is equivocal. They offer two main points against the claim that monitoring is relatively easy and costless: Associates do not accurately report the time that they spend working for the firm; and partners invest large amounts of time, not billed to clients, in evaluating senior associates for partnership.\(^12\) Neither of these points provides unequivocal evidence that monitoring is especially difficult and, as discussed in the next Part, both are undercut by the modifications proposed for the basic theory.

First, Wilkins and Gulati rely on anecdotal evidence that associates engage in widespread billing fraud, by inflating the hours that they report to the firm and that are ultimately billed to the client.\(^13\) Assuming that this form of fraud is widespread, it is either successful because it is undetected or condoned by the firm, or unsuccessful because it is detected by the firm or by the client. Only successful billing fraud supports the conclusion that monitoring is difficult.

\(^9\) And by promoting a fixed number of associates, any "common error" in associate evaluations will drop out of the comparison. See Lazear & Rosen, supra note 5, at 856.

\(^10\) See Malcolmson, supra note 5, at 493.

\(^11\) See id.

\(^12\) See Wilkins & Gulati, supra note 1, at 1594-95, 1600-01. They also suggest that billing by the hour rather than by work product indicates that monitoring is difficult. See id. at 1592. This suggestion, while interesting, is overbroad. House painters and massage therapists also charge by the hour, although their work seems easily monitored by the client. Hourly billing shifts the risk associated with the difficulty of completing the task to the client, which might be desirable in some circumstances.

\(^13\) See id. at 1594-97.
Unsuccessful fraud, on the contrary, presupposes that either the firm or the client can check up effectively on the hours billed by the associate, perhaps by comparing her billing records with those of other associates with similar experience and assignments. But even successful billing fraud does not work to the disadvantage of the firm, at least over the short term. The firm, not the associate, obtains the immediate return from inflated hourly billings, and the firm is more interested in associate productivity than in associate effort in the abstract. Inflated hourly billing by associates thus poses a problem for monitoring in the abstract, but not as it affects the immediate interest of the firm. Over the long term, of course, the firm might suffer from fraud that is later detected, but that again presupposes some form of monitoring that is eventually successful. Whatever that form of monitoring is—say audits of billing records by the firm or by clients, or discounted hours billed by the firm to clients—it is independent of any incentives postulated by tournament theory.

Second, Wilkins and Gulati emphasize the time, effort, and expense that the firm invests in annual associate evaluation and in choosing which senior associates to promote to partner. These costs are genuine according to Wilkins and Gulati because they are not usually passed on to clients. Not all of these costs, however, remain with the firm. Collecting the evaluations of individual partners and making final decisions about promotions may be time that cannot be billed to clients, but it will be based on the experience of partners in working with associates on matters that are billed to clients. Exactly what the division is between billed and unbilled time in the evaluation process may be difficult to determine. Moreover, to the extent that evaluation increases the productivity of the firm, time spent in this process may be billed indirectly through increased hourly rates for associates and partners. But even if evaluation time is not billed, either directly or indirectly, the very existence of extensive and costly evaluations (especially on an annual basis) provides as much evidence against tournament theory as in favor of it. The main advantage of tournaments for the firm is to avoid precisely these costs. If firms are incurring these costs anyway, then they are not relying on tournaments to the extent predicted by the theory. These doubts are amplified by the modifications proposed by Wilkins and Gulati to the theory itself.

14 See id. at 1600-01.
15 See id. at 1601.
16 Indeed, the formal documentation and the participation of committees inherent in the process might derive more from potential partner favoritism or infighting, see id. at 1617-19, than from any inherent difficulty in a supervisory partner's monitoring of subordinate associates. Conflicts among partners are discussed further infra Part II.
II. MODIFICATIONS THAT SUPPORT MONITORING BY THE FIRM

At several points, Wilkins and Gulati presuppose that firms can monitor associates, although they suggest that it is not the inherent difficulty of monitoring that prevents the firm from making use of this information, but rather conflicts of interest among partners in sharing this information.\textsuperscript{17} The existence of some form of effective monitoring is also supported by the lateral movement of associates between firms, a pattern of hiring candidly acknowledged by Galanter and Palay as accounting for twenty-two to twenty-four percent of the candidates for partnership.\textsuperscript{18} Wilkins and Gulati add three further qualifications to tournament theory involving the monitoring of associates: tracking of associates into assignments with more or less training; seeding of associates according to credentials acquired before they joined the firm; and favoritism among partners in selecting associates to work for them and in supporting them in the promotion process.

Wilkins and Gulati argue, first, that law firms track associates into paperwork and training assignments according to the level of performance expected of them.\textsuperscript{19} Performance in the earlier and simpler training assignments supports continued selection for more valuable assignments.\textsuperscript{20} And even as-sociates who are initially assigned to do only paperwork, with minimal chances for training, can elevate themselves to the training track by good performance.\textsuperscript{21} These methods of assigning work to associates plainly require close monitoring, as does the "reputational bond" posted by associates to induce them to perform their assigned tasks diligently.\textsuperscript{22} By contrast, the metaphor of a tennis tournament employed by Wilkins and Gulati requires little or no monitoring. It is obvious who wins and who loses at each stage of a tennis tournament.

Wilkins and Gulati's second point, that associates are seeded based on their credentials obtained before they are hired by the firm,\textsuperscript{23} does not directly support the existence of monitoring. But neither does it support the need for tournaments. As Wilkins and Gulati develop the significance of seeding, based on performance in college and law school, for instance, it becomes a self-fulfilling prophecy. Seeding is based on objective facts about an

\textsuperscript{17} See id.
\textsuperscript{18} See Galanter & Palay, supra note 2, at 54-55.
\textsuperscript{19} See Wilkins & Gulati, supra note 1, at 1644-47.
\textsuperscript{20} See id. at 1645-47.
\textsuperscript{21} See id. at 1648.
\textsuperscript{22} See id. at 1638-40. To the extent that the reputational bond depends on prior work done at the firm, it presupposes rather than dispenses with monitoring. Of course, not every assignment made to an associate will require close monitoring. Whether it does so depends on the importance of the assignment and the size of the reputational bond posted by associates.
\textsuperscript{23} See id. at 1651-53.
associate’s personal history that can be used to signal clients and future applicants for employment about the quality of the firm. To the extent that the tournament has a preordained outcome—because graduates of elite law schools and colleges are most likely to be promoted to partnership—it creates few incentives for other associates to perform well without monitoring. These other associates will be motivated by the tournament only if they believe that they have been moved onto the training track, which again presupposes that the firm has monitored their work and that they are aware of it.

Wilkins and Gulati argue, thirdly, that partners jealously guard and protect the associates who have performed well for them. This observation correctly calls attention to the incentives of individual partners, instead of the collective interest of the partnership as a whole. Yet the very success of the large law firm suggests that professional norms, institutional structure, and legal doctrine (such as the fiduciary duties among partners) constrain such opportunism. Again, this observation presupposes monitoring of the quality of associates’ work by individual partners, although as Wilkins and Gulati note, this form of monitoring may cause problems for the firm. The partner may inflate his evaluations of his associates in order to make the prospect of working for him attractive to other highly qualified associates. This distortion, however, may be offset by an individual partner’s desire to hide the contributions of the associates who work for him in order to monopolize their work within the firm. (This tendency might even persist into the partnership decision itself if associates are likely to remain with the firm as staff attorneys if they do not make partner.) In addition, to the extent that all partners inflate their evaluations of favored associates, the problem of overvaluation may largely solve itself.

And here again, even if the problem persists, it is a still greater problem for tournament theory than it is for monitoring. At the conclusion of the tournament, when the stakes are highest, Wilkins and Gulati find that the winners are as likely to be selected “on the basis of politics as on firm efficiency.” And, indeed, on their view, efficiency enters into the decision mostly as a prediction about future performance as a partner rather than past performance as an associate. Because partners are evaluated mainly on the basis of their ability to bring business to the firm, their work differs enor-

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24 See id. at 1654-57.
25 See id. at 1617-19.
26 See Henry Hansmann, The Ownership of Enterprise 97-98 (1996) (noting such forces may explain the low level of cycling and blatant exploitation in voting by employee owners).
27 See Wilkins & Gulati, supra note 1, at 1618-19.
28 See id. at 1598 n.67.
29 Id. at 1618.
30 See id. at 1620-24.
mously from that of associates, who are evaluated mainly on the basis of their ability to perform strictly legal work. For Wilkins and Gulati, the tournament among associates comes down to a contest for the most favorable opinion of the most influential partners about work the associates have not yet done in positions they do not yet occupy.

III. MODIFICATIONS THAT SUPPORT MONITORING BY ASSOCIATES

An economic tournament addresses the monitoring problems both of the firm and of its employees. In a law firm, the associates no longer need to rely on direct evaluations by partners of their productivity, which are difficult for them to verify. They can instead simply examine the rate at which associates are promoted to partnership. The tournament can provide this easily monitored signal only if the rates of promotion are constant, a condition that one of us has already challenged with contrary evidence in a previous article.

It is also undermined by the lateral hiring of partners and associates. If the rate of promotion of associates varies, if the number of prizes is reduced by the lateral hiring of partners, and if the number of associates seeking the prize is constantly changing, then the odds of obtaining the prize itself become highly variable. This makes the value of the prize both difficult to monitor and of less apparent worth to associates, especially if they are risk averse.

Wilkins and Gulati give us further reasons to doubt the importance of the tournament as an element in compensating and motivating associates. These reasons come in two forms: evidence of reductions in value of the tournament to associates and evidence of alternative forms of compensation to associates. As the value of the tournament decreases relative to other forms of compensation, its role in explaining the structure and growth of large law firms decreases as well.

Wilkins and Gulati identify several factors, some of them mentioned in the previous Part, that decrease the absolute value of the tournament. The role of firm politics in promotion decisions obscures the odds of actually being promoted as they appear to any one associate, who has little information about the relations among partners. Even more dramatically, Wilkins and Gulati emphasize that some of the rules and conditions of the tournament are

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31 See Galanter & Palay, supra note 2, at 101-02.
33 See Galanter & Palay, supra note 2, at 54-55.
34 See Wilkins & Gulati, supra note 1, at 1618.
kept secret from associates, further obscuring the signal sent by the promotion rate. Like other authors, they also point out that the promotion rates are inevitably "beholden to the business cycle" and that the prize of partnership is less valuable because of further competition among partners. The last of these factors may have become more prominent in recent years, so that it does not affect the growth of large law firms in the period studied by Galanter and Palay. The others, however, have no such increasing prominence attached to them. Collectively, they introduce considerably more noise into the promotion signal than it can bear as an alternative to other ways for associates to monitor the firm.

These other forms of monitoring, mentioned by Wilkins and Gulati, include increased pay as compared to other employment, and training and other improvements in general human capital. It is these factors that explain the lateral movement of associates, either out of the firm and any promotion tournament entirely or into another firm with a different tournament. These movements are explicable only if associates have some way to verify the firm's evaluation of their work. They may, consistently with tournament theory, move from one firm with longer odds or a smaller prize to one with a larger present value of promotion to partnership. If so, however, a pattern of lateral movement to firms with larger present value should emerge from the data. But as we have seen, the value of promotion is likely to be more diffi-

35 See id. at 1624-26, 1665-73.
36 Id. at 1623 (citing Robert Nelson, Of Tournaments and Transformations: Explaining the Growth of Large Law Firms, 1992 Wis. L. Rev. 733, 743; Frederick Lambert, An Academic Visit to the Modern Law Firm: Considering a Theory of Promotion-Driven Growth, 90 Mich. L. Rev. 1719, 1724-28 (1992)). Wilkins and Gulati also point out that both the location (in the sense of practice area) of partners and the number of promotions depend upon demand. See id. at 1623-24.
37 See id. at 1615-19. This observation seems to get tournament theory coming and going. One of us has argued that the absence of tournaments among partners in firms utilizing the Cravath lockstep compensation system demonstrates that the work of lawyers is not difficult to monitor, defeating the central presupposition of tournament theory. See Kordana, supra note 32, at 1917-18. Wilkins and Gulati argue that the existence of tournaments among partners in many firms today diminishes the value of the prize for winning the tournament among associates. The way out of this impasse is to recognize that there are other ways to monitor partners apart from tournaments. See, e.g., Ronald J. Gilson & Robert H. Mnookin, Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits, 37 Stan. L. Rev. 313, 339-53, 371-80 (1985); Hansmann, supra note 26, at 93-96.
38 Although partnership has not always meant an immediate increase in income, it has, at least under traditional lockstep compensation systems, increased the present value of an attorney's expected lifetime earnings. See Kordana, supra note 32, at 1913 n.30.
39 See Galanter & Palay, supra note 2, at 122.
40 See Wilkins & Gulati, supra note 1, at 1636-38.
41 See id. at 1641. They also discuss the harm to an associate's human capital from being fired for poor performance. See id. at 1638-41.
42 See id. at 1611-13, 1641-43.
cult for associates to ascertain than the firm's evaluation of them in the form of salary and training. Standing alone, lateral movement among associates provides further support for the conclusion that associates act on the basis of these other forms of compensation. It leads Wilkins and Gulati to move from tournament theory to mixed forms of compensation as the most plausible explanation for the patterns of hiring and promoting associates. Some modification of tournament theory is plainly necessary along these lines, but it inevitably subordinates the role of the tournament itself in determining the structure of large law firms. An appropriately discounted chance of obtaining partnership no doubt remains an element in associate compensation, but it does not play a central role in organizing the firm's internal labor market.

IV. ALTERNATIVE EXPLANATIONS

The immediate attraction of tournament theory is twofold: First, it explains the exponential growth of large law firms; and second, it explains the incentives of associates to remain with the firm despite the fact that the firm earns more from their employment than it pays them in salary. (The incentives of the firm to continue to employ associates already can be explained by the surplus human capital of partners deployed through the work of associates.) Tournament theory also has its limits, as Galanter and Palay carefully note: It does not account for the acceleration in the growth of large law firms after 1970, and, more generally, it does not address the increased demand for the services of large law firms, which must have accompanied their increase in size. Both of these phenomena are extrinsic to the tournament model.

It is hardly necessary for a theory to explain everything in order to explain anything. And, as we have already noted, we should be grateful to Galanter and Palay for giving us something that needs to be explained and then for offering an explanation at the high level of rigor and candor that they have. The two attractions of tournament theory can be accommodated by a more general class of theories: those that preserve the leverage, or ratio of associates to partners, for any single firm; and those that rely on other incentives to bind the associate to the law firm.

Tournament theory explains the exponential growth of law firms because every associate who is promoted must herself be replaced and also supplemented by enough additional associates to preserve the leverage of the firm. The leverage of the firm allows it to generate profits by having associates work with the surplus human capital of its partners. The source of new part-

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43 See id. at 1635.
44 See Galanter & Palay, supra note 2, at 98-108. Such profit-making from associates can also be understood as a return to the partners on the firm's brand-name capital.
45 See id. at 110-16.
ners makes no difference to the exponential effects of adding new partners. Whether they are promoted internally, or instead added laterally, they still must be supported by sufficient associates to preserve the leverage of the firm.46 Perhaps for this reason, Galanter and Palay were not too concerned about the trend to hire partners laterally in their original work.47

So, too, the prospect of winning the promotion tournament is only one factor binding associates to the firm. So long as the total compensation that they receive from the firm exceeds their alternative opportunities for employment, they have a strong incentive to remain as associates. Even if they receive only a fraction of the earnings from their use of the partners' surplus capital, and only a fraction of the training that they could receive in some alternative employment, their total compensation from the firm is likely to exceed what they can obtain elsewhere. The principal device that the firm can then use to assure their continued commitment to the firm need not be the uncertain and variable prospects for promotion to partner. It might consist of the delayed and carefully allocated training that Wilkins and Gulati emphasize in their paper.48 Further research is plainly necessary to explore these alternatives.

In order to come to a more satisfactory understanding of intra-firm structure, we need to turn to an analysis of inter-firm competition for top associates. Wilkins and Gulati rightly draw attention to the importance of the signals of quality possessed by associates (and partners).49 Yet the story they tell, if descriptively accurate, raises some interesting questions. Why, for example, don't we see more competition between firms for the best associates along the dimension of salary, especially given the central importance of salary to so many associates? Why does a lower prestige large firm in New York offer essentially the same salary as a higher prestige firm? It is possible, of course, that the lower prestige firm is offering a higher compensation package by offering greater partnership prospects, but this might not be true if high prestige associates are "seeded" and "tracked" at the high prestige firm.

In addition, Wilkins and Gulati seem to assume the existence of pressure within the firm to maintain associate salaries for a given cohort within a rela-

46 Cf. Sander & Williams, supra note 32, at 405 (noting that social and biological sciences recognize that economic, population, and organizational growth tend to be geometric, therefore geometric growth "is not particularly persuasive evidence for the tournament theory").

47 See Galanter & Palay, supra note 2, at 54-55, 111-12, 119.

48 See Wilkins & Gulati, supra note 1, at 1608-13. Other forms of deferred compensation might consist in the efforts of the firm to place associates who are not promoted to partner. Ronald J. Gilson & Robert H. Mnookin, Coming of Age in a Corporate Law Firm: The Economics of Associate Career Patterns, 41 Stan. L. Rev. 567, 582-83 (1989).

49 See Wilkins & Gulati, supra note 1, at 1652-53.
While there are well-known forces that tend to compress salaries in this manner, associates who are seeded and tracked in fact receive a more attractive compensation package, even if they receive the same nominal salary as other associates. This raises the question of why firms might not be able to pay higher wages to more desirable associates, especially since lower-prestige associates might be expected to internalize their lack of certain credentials valued by the legal profession.

As these alternative explanations for the structure of large law firms become stronger—and Wilkins and Gulati have given us good reasons to believe that they will—tournament theory must itself become weaker. No longer is it likely to be the single most important factor to explain the growth of large law firms. Galanter and Palay have made the inestimable contribution of raising these questions through a serious empirical investigation. Paradoxically, we now must go beyond tournament theory to answer them.

50 They suggest, for example, that a paperwork performing “flatliner” eventually costs the firm more in salary than he or she can bring in from billings. See id. at 1612.

51 This is particularly true if the chance of partnership is truly as high as 75% for well-seeded associates, as suggested by the sources cited by Wilkins and Gulati, id. at 1651 n.223.

52 Of course, a clerkship bonus might be seen as just such a device. And associate pay within a given cohort does vary at some large firms, at least after the first year. See Kordana, supra note 32, at 1929 n.112.