

# PROFESSIONAL SERVICES AND INTERNATIONAL STRATEGIC HUMAN RESOURCES: INTERFIRM TEAMS AND ONGOING RELATIONSHIPS WITH FREE AGENTS

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## ABSTRACT

This paper examines the strategic human resource problems of international professional service firms (IPSFs). The high degree of interaction and customization required of these firms suggests that network or intermediate forms of alternative governance structures may be needed to facilitate external fit in a multicultural, dynamic environment. We develop hypotheses regarding the factors that influence the choice of international professional service firms to use interfirm teams and ongoing relationships with free agents in place of hierarchy (internalized staff) or market transactions (one-time spot contracts). The paper concludes with a discussion of the implications.

## INTRODUCTION

Traditionally, many firms with international operations have relied on establishing wholly owned foreign subsidiaries and using internal staff to

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manage foreign operations. As a result, research on international human resource management often focuses on employee-oriented programs for improved selection, performance appraisal, training and development, and compensation (Dowling & Schuler, 1990). This paper takes a different position and suggests that International Professional Services Firms (IPSFs) need to consider alternate arrangements between the firm and its service providers. This expanded focus may be especially appropriate for smaller and midsize enterprises due to their restricted access to resources and the costs of increasing permanent employment levels (Crossick, 1990; Margolis, 1989). In addition, it may be especially relevant to professional service firms in operating in Europe that disproportionately experience the effects of European unification due to the human intensity of their businesses.

Although there are many possible forms of less traditional relationships (e.g., temporary employees and project teams, special task forces, fixed-term contract work, outsourcing, consultants, and strategic alliances), we focus on two particular types of relationships: interfirm teams and ongoing relationships with free agents. We choose these two because they are uniquely suitable to IPSFs given the knowledge intensity and dependence on remote access to strategic information of these firms (Rada, 1987). Interfirm teams and ongoing relationships with free agents offer flexibility as well as access to local know-how and tacit knowledge (Nelson & Winter, 1982) which are particularly important to IPSFs. Both interfirm teams and ongoing relationships with free agents are relationships that require nontraditional approaches to human resource management to increase a firm's competitive advantage (Bartlett & Ghoshal, 1989; Cascio, 1989).

A core strategic challenge for IPSFs is managing human resources and involves both the *people* and people-related *policies, procedures, and programs*. Traditionally, human resource policies and practices have tended toward standardization regardless of individual needs and preferences (Evans Lank, & Farquhar, 1990). With an increasingly diverse workforce organizations can tailor their network arrangements to maximize benefits for both parties while minimizing costs to both (Adler, 1991; Jackson & Alvarez 1992). Given the dynamic international arena, IPSFs need innovative forms of governance as well as more flexible policies, procedures, and programs for managing relationships with internalized employees and externalized labor in network relationships (Staber & Aldrich, 1989). This approach to human resources and governance, in turn, allows IPSFs access to information and information systems across national borders in an efficient manner which can serve as an additional strategic human resource basis for competitive advantage. Otherwise, IPSFs may lose out in the global marketplace.

The research question examined in this paper concerns governance structure. What are the boundaries of the international professional service team? As the international business environment becomes increasingly dynamic and

interdependent, the concept of the provider team must be reconsidered. We are specifically interested in exploring alternatives to the traditional approach of company-owned operations characterized by formal employment relationships with service providers (i.e., employees). We examine this issue at two different levels. First is the *organizational level*: Should IPSFs use wholly owned subsidiaries or some alternate form of organization such as an interfirm team for international expansion and accessing expertise across national borders? Second is the *individual level*: Should an IPSF use its own employees or an alternate form of ongoing relationships with free agents such as independent contractors or individuals on retainer to access expertise across national borders? This research is important because it suggests the critical need for international professional service firms to develop human resource management practices that facilitate the use of noninternalized arrangements such as free agents and interfirm professional service teams. The answers to these questions may suggest more effective governance structures for IPSFs in general, and for small and midsize IPSFs in particular.

This paper contains four major sections. First, we describe the domain and working definitions that are used. Second, we examine some of the international strategic human resource challenges that are unique to IPSFs. Third, we use Transaction Costs Analysis (TCA) as a framework to explore governance forms. The paper concludes with five propositions and a discussion of the potential implications of ongoing relationships with interfirm teams and free agents for the IPSFs.

## DOMAIN AND DEFINITIONS

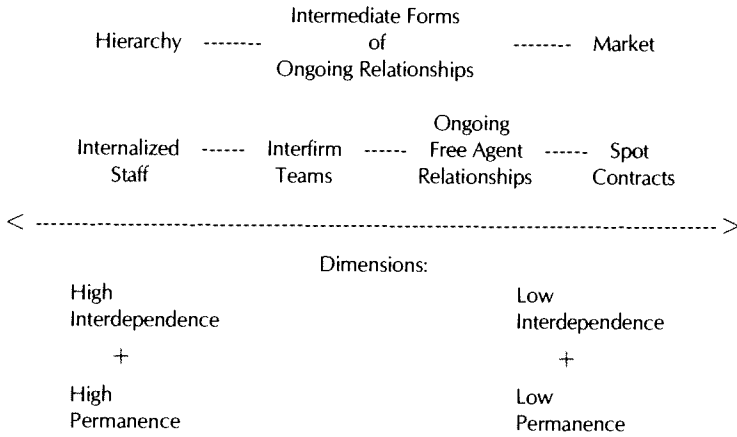
The focus of this paper is the International Professional Service Firm (IPSF). Professional services are a growing segment of the international service sector and include businesses that are often referred to as producer services (e.g., advertising, accounting, engineering) as opposed to consumer services (e.g., hotels, restaurants, and retail operations) (Richardson, 1987). Two key characteristics differentiate professional services from consumer services, the amount of *customization* of the service and the degree of client-provider *interaction* and interdependence in the creation of the service (Maister, 1982).

Professional services are services characterized by complexity, interdependence, specialization, and professionalism (Willman, 1989), and by extensive interaction and personal contact with the client over a long period of time (Richardson, 1987). The relationship often involves continual interaction because the provider and client often work cooperatively and make decisions jointly in a highly interactive mode (Mills, 1986). For example, the development of a new advertising program or the design of a new research facility building requires adjustments to plans and agreements during the service delivery

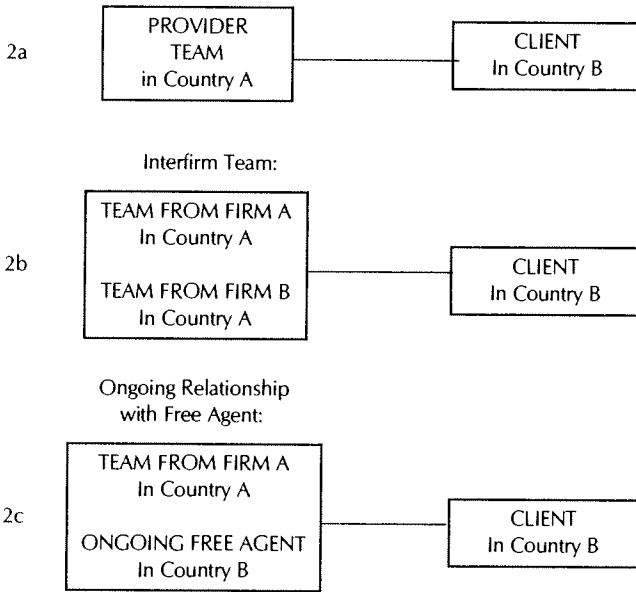
process in response to new information and changes in the external environment. This characteristic is particularly important for IPSFs, where changing economic and political conditions necessitate rapid competitive responses.

This paper also concentrates on relatively enduring relationships between IPSFs and their service providers. We suggest that traditional human resource approaches that typically emphasize internalizing employees within the firm are not necessarily the best governance structures for IPSFs. In fact internalization may be prohibitively expensive and unrealistic for small and midsize firms. In these cases, alternative service provider arrangements may be more effective in a multicultural and dynamic environment. The analysis presented in this paper can be compared to outsourcing arrangements (Prahalad & Hamel, 1990; Welch & Nayak, 1992). Some outsourcing, however involves one-time or very short-term relationships. In contrast, this paper focuses on relationships that endure over a longer period of time. Recent research indicates that network arrangements among firms are becoming increasingly common as a response to dynamic conditions (Acheson, 1985; Eccles, 1981; Johanson & Mattson, 1990). Additionally, professional service firms frequently use international partnerships and other contractual arrangements (Daniels, Thrift, & Leyshon, 1989; Dunning, 1989; UNCTC 1989).

We envision a continuum progressing from higher to lower interdependence as well as from higher to lower permanence, which suggests four general types of relationships between IPSFs and their service providers (See Figure 1). This continuum is based on Williamson's (1985) description of the difference between market and hierarchy. It also parallels Pfeffer and Baron's (1988) description of the continuum of employment relationships which range from long-term attachments under systems of bureaucratic control to arrangements in which workers are only weakly connected to the organization in terms of physical location, administrative control, or duration of employment. In this paper, we concentrate on the two intermediate relationships, interfirm team and ongoing relationships with free agents, which have moderate levels of interdependence and moderate levels of permanence. Unlike traditional approaches to vertical integration, neither the interfirm team nor the free agent is internalized as an "employee" of the IPSF. On the other hand, in both cases these network forms of governance involve moderately "permanent" relationships with potential benefits to the firm, the service providers, and the customers. These relationships are intermediate in terms of duration—more enduring than one-time market exchanges and less enduring than typical employment relationships. Thus, the paper focuses on innovative, intermediate approaches to ongoing relationships between service providers and IPSF rather than on hierarchy (i.e. internalized staff) or market (i.e., one-time specific transactions between two parties).



**Figure 1.** Continuum of service provider relationships.



**Figure 2.** Intermediate human resource arrangements for IPSFs.

Given this domain, it is also important to define our terms (see Figure 2 for an illustration of key terms and relationships). A *service provider team* (see Figure 2a) includes the entire group of individuals that is involved with the

creation and delivery of the service. For example, an architectural design team involves a wide range of providers such as engineers, rendering specialists, architects, and drafters. The architectural firm contracts with another firm or with a free agent for specific expertise regarding local laws or customs.

The first governance choice that we consider is the *interfirm team* (see Figure 2b). An interfirm team is a network arrangement which is typically defined as long-term relationships between two or more independent firms (Powell, 1990; Thorelli, 1986). An international interfirm team is an arrangement between two or more firms in two or more countries where the service providers from the affiliated firms cooperate to provide different components of an ongoing service to a client. Although our focus is on international teams, many of these same issues also apply to interfirm teams that operate within the same country but are located in different regions or political jurisdictions where local laws or customs differ.

The second governance choice examined is an *ongoing relationship with a free agent* (Figure 2c). This is also considered a network arrangement since such independent contractors typically set themselves up as legal entities for tax, legal, and insurance purposes. This type of free agent is an external source of labor, such as an independent contractor who engages in a long-term association with a particular firm. Although not an internalized employee of the firm, the free agent has a more interdependent and more permanent relationship with the firm than a short-term contractor who provides a specific one-time only service. A common example of an ongoing free agent relationship is an independent lawyer who is on retainer to a firm. Free agents may have relatively less permanence and interdependence than interfirm teams however.

## STRATEGIC HUMAN RESOURCES AND PROFESSIONAL SERVICES

A fundamental challenge of strategic management is to align the firm's strategy structure, and human resources (Lengnick-Hall & Lengnick-Hall, 1988; Tichy Fombrun, & DeVanna, 1982). Every activity of the professional service firm involves people and, thus, human resource management activities span the entire value chain of activities within the firm (Porter, 1986). This concept of alignment extends the function of human resource management beyond the traditional administration of recruitment and selection, performance appraisal training and development, and compensation. At the international level, firm must deal with the complexities of operating in different countries, in different cultural contexts, with an increasingly diverse workforce, and with different types of relationships between the firm and service providers (Dowling & Schuler, 1990). Decisions that are unstructured in domestic situations become

even more unstructured as firms interact across national borders and encounter unfamiliar sources of information, different cultural norms, and different human resource policies and procedures (Adler, 1991).

As a result, international strategic human resource management requires the simultaneous alignment of two fits: *external fit* and *internal fit* (Evans & Lorange, 1990; Milliman, Von Glinow, & Nathan, 1991). The purpose of external fit is to facilitate cross-cultural and cross-national interaction between the multinational corporation (MNC) and international as well as local forces. External environment fit is accomplished when the MNC involves host-country nationals to achieve a three-way congruence among management, societal values, and organization structure that is needed for effective cross-cultural management (Davis, Kerr, & Von Glinow, 1987). Internal fit refers to the congruence among the human resource policies and procedures and the internal organizational structure. In this paper, we focus on the external fit between provider and customer. We argue that external fit across national borders can be enhanced through the use of intermediate forms of governance such as interfirm teams and ongoing relationships with free agents. For example, use of a Spanish payroll service bureau, executive search firm, temporary help agency, contract programmers, or computer time-sharing service would enhance access to knowledge of local regulations and practices as well as minimize language barriers for an IPSF from the United States.

Traditional approaches to human resource management which tend to emphasize centralization or decentralization limit a professional service firm's ability to compete in global markets. In the international arena, client requirements for interaction and customization may fall outside the provider firm's past experiences and areas of expertise. To compete effectively across borders, IPSFs must view their *people* as strategic assets. In addition, their human resource *policies, procedures, and programs* must be significantly more flexible than traditional human resource approaches, which often emphasize standardization (Evans, Lank, & Farquhar, 1990).

Two characteristics of professional service firms are important for understanding strategic human resource issues: the degree of client-provider *interaction* and interdependence in the creation of the service and the amount of *customization* of the service (Maister, 1982). Professional service relationships involve extensive interaction, interdependence, and personal contact between the provider and the client over extended periods of time (Johanson & Mattson, 1990; Richardson, 1987). The provider and the client become mutually interdependent as projects proceed and the relationship develops. Boundaries between organizations in these interdependent relationships blur, and it becomes increasingly difficult for clients to detach themselves from the process in order to assess the quality of the provider's performance (Bressand, Dister, & Nicolaidis, 1989). At the international level, this interaction is an important element of external fit. It is essential to the

delivery of the service that the provider be able to fit within the cultural norms of the environment where he or she works. If there is a misfit, there may be a situation of the right service but the wrong delivery. For example, although most firms would agree that the concept of management development is important, the specific meaning of this phrase and the philosophy underlying the delivery of management development programs vary widely from country to country even within the European Community (Evans, Lank, & Farquhar 1990).

Second, professional services typically involve customization that results in an outcome which is unique to the relationship. Typically, professional services involve labor intensive activities (Casson, 1987) that explore and solve specific problems for particular clients (Gummesson, 1978). Examples of service customization include development of an advertising campaign or design of a new building. Customization, like extensive interaction and interdependence affects the ability of managers and clients to evaluate the quality or effectiveness of the service.

Furthermore, at the international level, customization requires a knowledge of local needs and constraints that affect the ultimate service. For example the advertising laws of Sweden are different from those of the United States. In order to create an acceptable and effective advertising campaign, a service provider must know both the laws and preferences of Swedish society.

The combination of interaction and customization creates two types of uncertainty regarding the management of human resources. The first uncertainty exists within the service provider firm. Supervising managers do not know and cannot easily evaluate the behaviors of individual members of the service provider team. This is a quality control issue which we refer to as *supervisor uncertainty* and results from the supervisor's inability to observe and monitor provider team member behaviors during interactions with clients (Casson, 1987; Stinchcombe, 1990). In addition, the supervisor may have difficulty evaluating subordinate performance due to the unique and dynamic nature of the service which is often negotiated jointly between client and immediate service provider in an informal and evolving sense.

The second type of uncertainty, *client uncertainty*, exists between the providing firm and the client. This results from the knowledge gap between client and provider (Kotler & Bloom, 1984). Given the interdependent, unique and dynamic nature of the service, clients can not easily or objectively evaluate the services that they receive (Bressand et al., 1989). This uncertainty exists before, during, and after contract execution.

Network and intermediate relationships such as interfirm teams and ongoing relationships with free agents are uniquely structured to deal with the above issues of supervisor uncertainty and client uncertainty. In contrast to many employment relationships, network relationships typically assess performance based on outcomes or results. Monitoring activity consequently focuses on the



final service or on the completion of a particular stage in the process. Accordingly, there is less need to monitor the detailed steps of the process or the specific behaviors of particular agents. Instead, traditional monitoring is replaced by self-management based on current and future reciprocal interdependence (Bartlett & Ghoshal, 1989). This ongoing interdependence is based on expectations that the relationship will continue and that self-interest will be best served through cooperation and the achievement of mutual goals of both entities. It is through reciprocal interdependence, trust, and collaboration (Powell, 1990) that these intermediate forms of governance add value, reduce supervisor uncertainty, and can increase the competitive advantage of both. Similarly, given the involvement of the client in service delivery, it is possible to conceptualize the client as a member of the IPSF team. This membership and consequent access to information demonstrates how network forms of governance can reduce both the knowledge gap and reduce client uncertainty.

## **TRANSACTION COST ANALYSIS AND GOVERNANCE FORMS OF IPSFs**

The management of IPSFs in rapidly changing economic and political environments involves problems of bounded rationality and opportunism under conditions of high uncertainty and moderate asset specificity (Reve, 1990). Broadly, TCA focuses on the costs of bargaining and negotiating and the resulting governance choices made by the firm (Casson, 1987; Williamson, 1985). The central issue in transaction cost analysis is whether a particular activity is more efficiently performed within an organization or by the marketplace. As a result, transaction cost analysis (TCA) provides a useful framework for examining two of the governance choices which confront IPSFs regarding boundaries of the service provider team. The first decision concerns the form of international expansion: wholly owned subsidiary versus network form. The second decision concerns the form of relationship between service provider resources and the firm: internalized employees versus network form.

Williamson (1985) describes three key determinants of the cost of a transaction: asset specificity, uncertainty, and frequency. Of these dimensions, asset specificity is considered the most important. The critical test of asset specificity is whether the assets involved in the transaction can be easily and costlessly shifted to alternate uses. Under conditions of high asset specificity, it is more efficient for a firm to internalize the activities. However, in an IPSF, much knowledge is tacit and therefore difficult to codify (Nelson & Winter, 1982). This strengthens the benefits from lateral forms of communication and mutual obligations (Powell, 1990) and results in moderate asset specificity. According to Reve (1990), moderate asset specificity cases are more suitable

for long-term contracts and bilateral or network arrangements. In fact, such bilateral governance structures are preferred when complementary rather than core skills are involved, thus increasing organizational and resource flexibility. Core skills are central to the competitive advantage of the firm and need to be governed internally. Complementary skills are related but peripheral to the strategic core and reflect medium asset specificity (Reve, 1990).

The second dimension, uncertainty, increases the costs of executing and monitoring well specified contracts. When uncertainty is high, it is more efficient to internalize the transactions in order to facilitate internal monitoring. In an IPSF, supervisor and client uncertainty cause uncertainty to be an important issue. Unspecified or incomplete contracts are common due to the knowledge gap between the provider and the client (Norman, 1984). Consequently, longer term relationships that rely on trust and anticipation of future interdependence (Powell, 1990) become more efficient. Frequency, the third dimension of TCA, involves the number of discrete transactions involved in a particular activity. Typically, as the number of transactions increases, IPSFs are more likely to internalize activities to reduce the number of nonstandard agreements and to reduce the costs associated with frequent negotiations. Clearly, long-term bilateral arrangements also serve to reduce the frequency with which agreements must be negotiated.

#### Interfirm Teams

For the IPSF, the choice of using an interfirm team through a network arrangement may result in lower transaction costs and increased flexibility compared with the expansion of an existing internalized system. A network form of interfirm human resources maximizes the ability to gather, process, and synthesize information leading to a more efficient provision of professional services across national borders. This occurs because network relationships allow firms access to greater staff diversity and expertise without having to incur the direct and continuing costs of staff internalization and human resource management. The costs of bargaining and negotiating are controlled because the IPSF negotiates with fewer parties while gaining access to a broader range of skills.

Interfirm arrangements can also create stable relationships. Since these agreements are typically between institutions, individual members of the team can change or leave and the basic relationship and agreement remains unaffected by the turnover. This stability should increase the ability of the IPSF to respond quickly and accurately to new clients and markets in unfamiliar national arenas. The cost of massive investment in internalized human resources required by a wholly owned subsidiary with "permanent" employees may not be recoverable and most likely would not be sufficiently flexible to meet the changing demands of both external and internal human resources fit.

### Ongoing Relationships with Free Agents

A similar argument holds at the individual level of analysis, that an ongoing relationship with free agents across national borders may result in lower transaction costs and increased flexibility for IPSFs. These intermediate relationships (e.g., long-term affiliate relationships or ongoing independent contractor arrangements) are based on interdependence and cooperation, and facilitate access to diverse sources of information and expertise without the high fixed costs associated with hiring a permanent employee (Powell, 1987). Similarly, this type of noninternalized but ongoing relationship allows both parties flexibility that greatly exceeds that of a typical employment relationship (Evans & Lorange, 1990). Furthermore, in the case of free agents, individualized agreements can be tailored to provide the forms of compensation or benefits most highly valued by particular individuals while at the same time allowing the firm to avoid the full costs of hiring permanent employees. This type of arrangement also provides the flexibility for the free agent to determine working hours for projects that can accommodate diverse and changing individual preferences and institutional needs.

Finally, it is possible that development of these network relationships themselves can become a distinctive competence (Porter, 1986) with strategic consequences as well as creating entry barriers (Harrigan, 1985). For example, the capability to coordinate and manage a geographically dispersed service provider team which operates in different countries could become a competitive advantage. Given the difficulty of replicating invisible assets and relationships, this organizational capability is likely to be particularly beneficial to IPSFs.

## **THEORETICAL EXTENSION**

This section extends the prior discussion of intermediate relationships and develops five propositions in a response to calls for more theory-grounded international research (Arvey, Bhagat, & Salas, 1991; Steers, 1989). Based on the transaction cost framework, we suggest one general proposition followed by four corollary propositions that cover four key human resource functions (i.e., recruitment and selection, performance appraisal, training and development, and compensation) that are particularly important for professional service firms. These propositions are based specifically on the international strategic human resource problems of IPSFs under conditions of uncertainty and rapid environmental change. Using the transaction cost framework, these propositions suggest that interfirm teams and ongoing relationships with free agents can potentially reduce the transaction costs associated with the international human resource management of service providers and simultaneously improve the firm's competitive position.

### Governance Costs

The development of interfirm teams and ongoing relationships with free agents allows IPSFs to shift some of the responsibility and costs for monitoring service provider professionals to organizations which are closer to the customers. The responsibility of monitoring the activities of providers can be shifted to another firm that is physically and perhaps culturally closer to the service site and, therefore, more aware of local customs and requirements. This may be of particular importance to small and midsize IPSFs that may not have either the human or financial resources to manage geographically dispersed operations. Thus, in bilateral relationships, the primary IPSF share responsibility for assuming external fit with a host country firm or free agent who possesses localized expertise.

Our first proposition is that the greater the costs of internalizing human resource functions, the more likely IPSFs will use interfirm teams and ongoing relationships with free agents across national borders. This is consistent with the issue of the strategic core discussed by Reve (1990). Unless the foreign operation constitutes a significant proportion of the total corporate competitive position, host country activities will be regarded as complementary rather than core skills. Under these conditions, it is more efficient for an IPSF, particularly a small or midsize firm, to use bilateral arrangements for handling its foreign interests.

### Recruitment and Selection

The recruitment and selection of professional service providers is always an essential human resource function. This function is becoming increasingly important in Europe as a result of the complexity resulting from unification and the scarcity of skilled labor and educated managers (Blanchard, 1992; Day 1990; Lilley, 1990). Furthermore, recruitment and selection are of central importance to IPSFs due to the high degree of task complexity and unique customer needs associated with professional services. Service providers must have the ability to deal with substantial amounts of discretion in the delivery of the service (Kotler & Bloom, 1984).

In many countries, the recruitment and selection of employees and expatriates is extensively regulated by the host government (Akhter & Gaidis, 1991; Rosenbaum, 1989). The acquisition of such information can be expensive and often has a time-limited value as the regulations change. As a result, it may become more efficient for firms to use interfirm teams and ongoing relationships with free agents when expertise is needed on a continuing basis outside their traditional domain. By using one of these arrangements, firms can avoid the process and expense of recruiting and can rely on local expertise to assure that governmental regulations are satisfied.

This leads to our second proposition, that the more regulated the recruitment and selection of employees by a host government, the more likely IPSFs will use interfirm teams and ongoing relationships with free agents across national borders. The interfirm team and, particularly, the free agent have local knowledge and expertise that the IPSF may need only occasionally unless it anticipates extensive activity in a particular country. The use of bilateral arrangements permits IPSFs to avoid incurring high asset specificity for complementary skills.

### Performance

Employee performance expectations and the performance appraisal process are strongly influenced by culture (Dowling & Schuler, 1990; Evans & Lorange, 1990; Laurent, 1986). Furthermore, the differential effects of culture on performance are stronger for professional service jobs due to the discretionary nature of much professional service work. Ultimately, the assessment of IPSF effectiveness is determined by the client and is partially dependent on the behavior of the client receiving the service. Thus, both supervisor and client uncertainty make performance evaluation problematic. Performance evaluation of the immediate service provider and of the professional service firm are both based primarily on perceptions, which again are culturally influenced (Gronroos, 1990; Richardson, 1987).

Our third proposition is that the greater the cultural differences in performance practices, the greater the likelihood of interfirm teams and ongoing relationships with free agents. This reduces the need to develop asset specific human resource routines concerning performance evaluation that may not be redeployable to other locations. The lack of transferability is a central concern to small and midsize IPSFs that must be able to achieve economies of scale and scope with limited resources. By externalizing labor in other countries through network relationships, firms can access local expertise without having to develop unique performance management programs. These governance arrangements also reduce the need to integrate host country employees into performance management programs which may be locally inappropriate.

### Training and Development

Most service firms rely heavily on socialization, training, management development, and professional norms to regulate the behavior of immediate service providers (Willman, 1989). The international environment, however, imposes requirements that may make managing service providers through socialization too costly and too slow (Fisher, 1986). Typically, training and development programs require substantial financial investment by the IPSF

in dedicated assets that cannot be easily shifted to other uses. In addition, many training programs are culturally bound and not particularly sensitive to differences in customs or values (Derr, 1987; Laurent, 1986). Attempts to implement training programs across national borders can result in clashes between home and host country norms and may adversely affect the firm. Research indicates that country effects are sometimes significantly stronger than company effects (Hofstede, Neuijen, Ohayv, & Sanders, 1990). This suggests that in some cases, the effects of training programs may be limited.

Fourth, we propose that the greater the cultural differences in training and development programs, the more likely it is that IPSFs will use interfirm team and ongoing relationships with free agents. This arrangement allows interfirm team members and free agents to be included in training programs that focus on a particular culture in a particular place. This can increase team members' understanding of local differences while simultaneously tapping into local expertise in another country.

### Compensation

Compensation arrangements (e.g., pay, perquisites, and benefits) and associated taxes are extensively regulated by many governments. Also, legislation and practices concerning issues such as equal pay for equal or comparable work vary across countries (Pantaleo & Miller, 1991). Finally, local norms regarding the dimensions of a competitive compensation package vary widely from country to country (Dowling & Schuler, 1990; Toyne & Kuhne, 1983). This creates a complex situation of high variability in compensation. For example, the definition of taxable income in Italy differs from that in England. Similarly, government required contributions to benefit programs such as pensions, and the costs associated with these vary significantly across countries (Day, 1990).

To understand and manage these differences effectively, multinational firms often develop extensive in-house compensation expertise. This knowledge, however, is expensive to acquire and even more expensive to maintain given the rapid and continuing changes in compensation and taxation practices. As a result, IPSFs may need to rely on network relationships to access existing expertise rather than developing in-house resources. For example, the establishment of an ongoing relationship with an international architectural firm with local expertise in architect compensation as well as in host country construction practices reduces the need to develop such expertise internally. This will be especially relevant given the unification of Europe and the anticipated changes in compensation programs (Brooks, Haller & Viguié, 1990). Bilateral arrangements are also appropriate when there is a time-limited opportunity in a country where the firm does not already have compensation expertise. The use of an intermediate arrangement eliminates the need for the

firm to develop a special compensation program for free agents located in another country where local requirements and practices might be substantially different.

Our fifth and final proposition suggests that the greater the differences in the components and regulation of the compensation package, the more likely interfirm teams and free agents will be used. Again, this governance choice is affected by the concept of complementary versus core skills. Unless the operation is proportionally large enough to be part of the strategic core of the firm, knowledge of compensation practices and requirements would, at best, constitute only a complementary skill. Under these conditions, bilateral governance provides a more efficient solution.

## **IMPLICATIONS AND CONCLUSIONS**

The most significant implication of our analysis is the critical importance of rethinking the concept of the international professional service team. Increasing complexity and competitive pressures suggest that it is no longer appropriate to expect that all team members will be located at one geographic site or be formal employees of the firm. Instead, we argue for a concept of the service provider team as a nexus of contracts (Coase, 1937; Reve, 1990) that allows for different governance forms at the firm and individual levels of analysis. We propose that the service provider team is not limited to firm employees but can include, for example, a team of employees in the United States, a team of network members in Spain, as well as the client who is also in Spain. The key characteristic of this approach to the IPSF provider team is that coordination is accomplished through the nexus of contracts, which is the sum of the individual agreements among the various provider team members.

At the firm level, we suggest that it will become increasingly important for IPSFs to use alternate forms of organizational governance such as interfirm teams as they expand their businesses beyond traditional geographic borders and as they attempt to enter new markets rapidly. These forms of governance which cross national borders are intermediate relationships and may be formal or informal. Formal relationships include joint ventures, strategic alliances, negotiated contracts, retainers, outsourcing, and subcontracting. Informal relationships at the firm level can include loose affiliations or relationships that develop gradually as firms become increasingly interdependent during the service creation process. These relationships are important to IPSFs because they enhance external fit with the local environment and permit access to greater expertise than can efficiently be developed internally.

At the individual level, we similarly suggest that intermediate forms of governance will be used increasingly to manage ongoing relationships between international professional service firms and free agents across national borders.

Again, these relationships can be either formal or informal. Formal intermediate relationships include written agent contracts, retainer arrangements, and subcontracting. Informal relationships include loose affiliations and links through professional organizations and associations. These individual level intermediate forms of governance are important because they provide IPSFs with mechanisms to retain flexibility while ensuring external fit with the customer and the host country.

We believe that it is important to reassess the definition of an international professional service provider team and expand it to include network forms of governance. Relationships need not be limited to traditional employment arrangements within the technical boundaries of the firm (Pfeffer & Baron, 1988). They can include a wide variety of formal and informal relationships contained within the broader conceptualization of the service provider team as a nexus of contracts (Reve, 1990). This paper applies the nexus of contracts definition of firm boundaries to the international professional service firm and recommends increased use of interfirm teams. The paper also extends the nexus of contracts analysis beyond the firm level to the individual level of analysis. Here, we recommend increased use of ongoing relationships with free agents in IPSFs.

The second implication of our analysis stresses the importance of human resources for the IPSF. This includes the importance of both the people and the human resource policies, procedures, and programs (Hossain & Davis 1989). For intermediate forms of governance to work effectively, human resource practices must become more flexible. Firms must be willing to invest time and effort to develop unique relationships that build on the particular strengths of a firm, team, or individual. The traditional and standardized approach to managing people does not allow maximum use of firm, team, or individual capabilities. Instead, flexibility and specialization should characterize recruiting and selection, performance appraisal, training and development, and compensation in intermediate forms of governance.

In many cases, interfirm teams and ongoing relationships with free agents may be somewhat novel forms of governance. In these instances, it will be important for the human resource function to educate team members, both employees and externalized agents, on the unique characteristics of these intermediate forms of governance (Hardy, 1990). It will be important for the human resource function to provide training on building and maintaining effective relationships that cross national borders (Howes & Jones, 1990). In addition, professional service firms must examine the implicit assumptions which lie behind many country specific human resource policies. In some cases managers may not be aware of the cultural differences (Adler, 1991; Schneider 1988), fundamental assumptions (Laurent, 1986), or deeply embedded belief structures (Sullivan, 1986) which form the basis of local human resource policies and procedures (Laurent, 1986). This increases the probability that home country developed programs may not succeed.



**Table 1.** Comparison of Internalized Employee and Ongoing Free Agent Characteristics

<i>Profile of Internalized Employee</i>	<i>Profile of Ongoing Free Agent</i>
Possesses Critical Core Skills	Possesses Important Skills
High Organization Commitment	Low Organizational Commitment
Moderate Professional Commitment	High Professional Commitment
Moderate Need for Autonomy	High Need for Autonomy
Moderate Need for Independence	High Need for Independence
Preference for <ul style="list-style-type: none"> <li>● continuity</li> <li>● security</li> <li>● traditional compensation</li> <li>● company training</li> </ul>	Preference for <ul style="list-style-type: none"> <li>● flexibility</li> <li>● variety</li> <li>● individualized compensation</li> <li>● self-directed development</li> </ul>
Experience—inside organizations	Experience—loosely coupled to organization
Company Specific Expertise	Country and Professional Expertise

The third implication of our analysis suggests that not all individuals are well-suited for intermediate employment relationships (see Table 1). Some people are more comfortable with the stability, security, and predictability that accompanies more traditional employment. Other individuals, perhaps those who value independence, flexibility, and variety, find being an interfirm team member or free agent rewarding both personally and professionally. It is important to acknowledge the potential stress and strain that can be experienced by individuals in boundary spanning roles such as those described in this paper (Adams, 1980). Not only are some people not well-suited to intermediate forms of employment, but it is possible that long-term relationships of this type might have long-term negative personal consequences.

The intermediate forms of governance explored in this paper (i.e., interfirm teams and ongoing relationships with free agents) are more complicated than traditional hierarchy or market approaches to providing client services. Nevertheless, we believe that the potential benefits to the IPSF of increased flexibility and more rapid access to information may offset the costs of these more individualized and unique relationships. Research on international human resource management should explore how improved selection, training and development, performance evaluation, and compensation packages can increase the success of these network relationships and lead to greater competitive advantage for the firm.

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