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# Globalization of Law Firms: A Survey of the Literature and a Research Agenda for Further Study

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# Globalization of Law Firms: A Survey of the Literature and a Research Agenda for Further Study

D. DANIEL SOKOL\*

## ABSTRACT

*The international expansion of law firms plays a critical role in understanding the business of law and the nature of globalization. This article responds to the articles by Carole Silver and Len Bierman and Michael Hitt on law firm expansion in this symposium issue on the Globalization of the Legal Profession. The essay utilizes management studies' theoretical work on internationalization and applies it to law firm expansion to explain law firm strategic decision-making. The author creates a six-part taxonomy for types of law firm expansion and provides a snapshot of the increasing U.S./U.K. dominance of capital markets, corporate and mergers & acquisitions legal work around the world. Finally, the article proposes an interdisciplinary research agenda that incorporates law, economics, sociology, economic geography, and management studies to more fully understand law firm expansion.*

## INTRODUCTION

The international expansion of law firms, which began in earnest in the 1980s, has transformed large law firms.<sup>1</sup> Law firm expansion plays a critical role in understanding the business of law and the nature of globalization. Law firms

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1. This article focuses on the expansion of large law firms for the reason that the practice of law is qualitatively different in large law firms than in other law firms. See John Flood, *The Growth of Large Law Firms and Its Effect on the Legal Profession and Legal Education: Megalaw in the U.K.: Professionalism or Corporatism? A Preliminary Report*, 64 IND. L.J. 569, 570 (1989); Marc Galanter, *Mega-Law and Mega-Lawying in the Contemporary United States*, in *THE SOCIOLOGY OF THE PROFESSIONS: LAWYERS, DOCTORS, AND OTHERS* 152, 153–55 (Robert Dingwall & Philip Lewis eds., 1983).

also provide a case study of how one industry within the professional services sector addresses global expansion. This case study may shed light more generally on how professional service firms respond to an increasingly global marketplace and the various strategies that such firms may use to meet these challenges.

This article begins the process of closing the gap in the existing literature on law firm expansion. It does so by utilizing management studies' theoretical work on internationalization and applying it to law firm expansion to explain law firm strategic decision-making. This article creates a six-part taxonomy for types of law firm expansion. It also provides a snapshot of the increasing U.S./U.K. dominance of capital markets, corporate and mergers and acquisitions legal work around the world. Moreover, this article responds to the articles by Carole Silver and Len Bierman and Michael Hitt on law firm expansion in this symposium issue on the Globalization of the Legal Profession. Finally, this article proposes a robust interdisciplinary research agenda that incorporates law, economics, sociology, economic geography, and management studies to more fully understand law firm expansion.

## I. THE BLACK BOX OF INTERNATIONAL LAW FIRM EXPANSION

### A. *The Tournament Model*

Global expansion of law firms must be understood within the larger context of the growth of the law firm as a business organization. Law firms do not have outside investors. Rather, the employees are also the owners of the firm.<sup>2</sup> Previous scholarship has developed a framework to understand law firm expansion. Galanter and Palay's seminal book, *Tournament of Lawyers*, argues that law firms operate within an up-or-out pyramid structure.<sup>3</sup> As an associate makes partner, to maintain firm leverage, the firm requires an additional number of associates. The purpose of the tournament is to create greater leverage for the firm's human capital and to prevent shirking by lawyers within the firm. In the tournament model, the most important factor in the transformation of law firms is size expansion of firms in terms of total number of lawyers. Other empirical work supports the tournament explanation.<sup>4</sup>

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2. HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 67 (1996). More accurately, a subset of employees (equity partners) own the firm.

3. MARC GALANTER & THOMAS PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM* 99-102 (1991).

4. John P. Heinz, Robert L. Nelson & Edward O. Laumann, *The Scale of Justice: Observations on the Transformation of Urban Law Practice*, 27 *ANN. REV. SOC.* 337, 338 (2001). The tournament theory has been further expanded upon by David Wilkins and Mitu Gulati, who add a number of

Recent empirical work provides additional explanation of law firm expansion and the tournament model. Using data from Martindale-Hubbell for U.S.-based law firms from the period 1998-2005, Baker and Parkin find that large U.S. law firms have grown over time. This growth has come about with an increase in the number of offices for firms. Increased leverage has accompanied the expansion in the size and geographic scope of large law firms. Similarly, an increasing number of attorneys have fallen from the two-tiered partnership track and have taken on non-partner designations at these firms.<sup>5</sup>

Another recent contribution to the literature is the work of William Henderson. Henderson's findings suggest that the tournament model has changed in that there are now at least two stages to the tournament in most large U.S. law firms. The first stage is to move from the ranks of an associate to that of partner. The second stage of the tournament occurs at the partner level in which non-equity (service) partners battle to join the ranks of equity partners. Henderson has studied the domestic effects of partnership tracks at American Lawyer ("Am Law") 200 large law firms. His findings explain why all but a small number of law firms have abandoned the single-tier partnership model for a two-tiered approach between equity and non-equity partners. The firms that remain single tier are those with fewer offices and higher levels of prestige. These findings support a conclusion that the tier structure of a firm is a function of a firm's relative standing in its ability to gain high-end corporate work.<sup>6</sup>

The works of Baker and Parkin and Henderson have not been extended to the study of international offices of U.S. law firms. It may be that the type of partnership structure varies across countries. Overhead costs may be different, the

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caveats to this tournament. They posit that (1) many within the associate ranks may not seek to participate in the tournament; (2) partners favor some associates over others in the tournament based on the type of assignments that they give; (3) firm interests and the interests of individual partners may not be aligned; (4) the tournament has more than two stages; (5) becoming a partner is not caused by past performance as an associate; and (6) the tournament process lacks transparency. David B. Wilkins & G. Mitu Gulati, *Reconceiving the Tournament of Lawyers: Tracking, Seeding, and Information Control in the Internal Labor Markets of Elite Law Firms*, 84 VA. L. REV. 1581, 1586-87 (1998). Though some scholars have shown limits to the tournament model, no alternative explanatory device seems to have emerged to overtake it as the basis for understanding law firm growth. See, e.g., Heinz, Nelson & Laumann, *supra*, at 344-46; Richard H. Sander & E. Douglass Williams, *A Little Theorizing About the Big Law Firm: Galanter, Palay, and the Economics of Growth*, 17 LAW & SOC. INQUIRY 391 (1992).

5. George P. Baker & Rachel Parkin, *The Changing Structure of the Legal Services Industry and the Careers of Lawyers*, 84 N.C. L. REV. 1635, 1677-78 (2006).

6. William D. Henderson, *An Empirical Study of Single-Tier Versus Two-Tier Partnerships in the Am Law 200*, 84 N.C. L. REV. 1691, 1748-1750 (2006).

prestige element may differ between local and international firms, and the amount that a firm may be willing to pay for international human capital may be different across markets. These and many other questions about the globalization of U.S. and foreign law firms remain unanswered. It is with these and other research questions in mind that we must approach the study of the growth in internationalization of law firms.

### B. *New Insights*

Much remains unknown about the mechanisms and dynamics of international law firm expansion. Two works from the 14<sup>th</sup> Annual Conference of the Indiana Journal of Global Legal Studies, “Globalization of the Legal Profession,” provide important insights into international expansion of law firms: Carole Silver’s “Local Matters: Internationalizing Strategies for U.S. Law Firms”<sup>7</sup> and Len Bierman and Michael Hitt’s “The Globalization of Legal Practice in the Internet Age.”<sup>8</sup> In her article, Silver has added an important work to her extensive research agenda into the globalization of law firms and the legal practice.<sup>9</sup> Silver’s current article expresses the tension and the transition of law firms as they act globally on both international and local matters.

Silver identifies an important trend among U.S.-based law firms. Firms that have expanded internationally nearly always have a major New York presence.<sup>10</sup> This suggests the importance of New York corporate law and that corporate international expansion seems to be the driver of international expansion. The nature of this corporate law-based global expansion remains somewhat of a mystery.

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7. Carole Silver, *Local Matters: Internationalizing Strategies for U.S. Law Firms*, 14 IND. J. GLOBAL LEGAL STUD. 67 (2007).

8. Leonard Bierman & Michael A. Hitt, *The Globalization of Legal Practice in the Internet Age*, 14 IND. J. GLOBAL LEGAL STUD. 29 (2007).

9. See, e.g., Carole Silver, *Winners and Losers in the Globalization of Legal Services: Situating the Market for Foreign Lawyers*, 45 VA. J. INT’L L. 897 (2005); Carole Silver, *Internationalizing U.S. Legal Education: A Report on the Education of Transnational Lawyers*, 14 CARDOZO J. INT’L & COMP. L. 143 (2006); Carole Silver, *Regulating International Lawyers: The Legal Consultant Rules*, 27 HOUS. J. INT’L L. 527 (2005); Carole Silver, *Regulatory Mismatch in the International Market for Legal Services*, 23 NW. J. INT’L L. & BUS. 487 (2003) [hereinafter Silver, *Regulatory Mismatch*]; Bryant G. Garth & Carole Silver, *The MDP Challenge in the Context of Globalization*, 52 CASE W. RES. L. REV. 903 (2002); Carole Silver, *The Case of the Foreign Lawyer: Internationalizing the U.S. Legal Profession*, 25 FORDHAM INT’L L.J. 1039 (2002).

10. Silver, *supra* note 7, at 72.

Lawyers in large firms specialize in specific practice areas of law.<sup>11</sup> When there is international expansion, do we find specialization in smaller satellite offices along practice area specializations? Can particular country markets handle such precise levels of specialization based on the cost of legal services by foreign firms? While U.S. firms traditionally have expanded into corporate practices abroad, Silver suggests that there is an increasing litigation and regulatory aspect to foreign expansion.<sup>12</sup> Silver examines the number of U.S. law firms with foreign offices. This is an important first step. However, questions remain as to how to account for the scale, scope, quality, and success of these offices.<sup>13</sup>

Silver's article focuses on the U.S. aspect of globalization. However, the globalization of law firms has increasingly significant London- and New York-based components. Chambers & Partners publishes a yearly guide of the best law firms in the various jurisdictions around the world.<sup>14</sup> I use their 2006 Chambers Global Guide as a source for data to illustrate the increasing supremacy of U.S.-based and London-based law firms in international capital markets and corporate/merger and acquisition deals in the capital markets of China/Hong Kong, France, Germany, Italy, Japan, the United Kingdom, and the United States.<sup>15</sup>

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11. See Luis Garicano & Thomas N. Hubbard, *Firms' Boundaries and the Division of Labor: Empirical Strategies*, 1 EURO. ECON. ASSOC. 495 (2003).

12. Silver, *supra* note 7.

13. Economic geographers suggest that most U.S. law firms with international offices have only a small international footprint. See J.V. Beaverstock, R.G. Smith & P.J. Taylor, *Geographies of Globalization: United States Law Firms in World Cities*, 21 URB. GEOGRAPHY 95, 115 (2000). Similar work has begun to explain the internationalization of London based law firms. See generally J.V. Beaverstock, P.J. Taylor & R.G. Smith, *The Long Arm of the Law: London's Law Firms in a Globalising World Economy*, 31 ENV'T & PLANNING 1857 (1999).

14. Chambers' description of its methodology is as follows: "[r]esearch into the strengths and reputations of lawyers in the Global Guide is carried out in the same way as the research for the Chambers 'UK' and 'USA' guides. The methodology has been approved by the British Market Research Bureau, which audits the research annually. In-depth interviews with clients and lawyers are done over the telephone, each one lasting about half an hour. . . . For the current Global directory, over 6,500 of these interviews were conducted covering 170 countries. They were carried out by a team of 30 full-time researchers over a period of 12 months." Chambers and Partners, *Global Guide, Research & Rankings Explained*, <http://www.chambersandpartners.com/global/research-ranking.aspx> (last visited Feb. 2, 2007). Chambers is in many ways the equivalent to law school rankings for the U.S. News & World Report. Firms monitor their Chambers rankings very carefully. Chambers has its flaws—it measures perceptions of the strength of firms and practitioners rather than the actual strength of such people and firms. However, based on the difficulty of more direct measurements, Chambers is the least bad current methodology to measure practice group and individual quality of lawyers and firms.

15. See Chambers and Partners, *Search Global Guide*, <http://www.chambersandpartners.com/global/search.aspx> (last visited Feb. 2, 2007).

Chart I: Ratio of Local Firms to All Top Firms

| Practice   | China             | France | Germany          |                  | Italy | Japan             |                  | UK                |                    | US    |
|--|-------------------|--------|------------------|------------------|-------|-------------------|------------------|-------------------|--------------------|-------|
| Corporate/M&A<br>Top 1 <sup>st</sup> -3 <sup>rd</sup> Tier<br>Practices <sup>1</sup>   | 3/17              | 7/19   | 3/9              |                  | 5/6   | 0/18              |                  | 6/6 <sup>a</sup>  | 5/8 <sup>b</sup>   | 16/16 |
| Corporate/M&A<br>Top 4 <sup>th</sup> -5 <sup>th</sup> Tier<br>Practices <sup>1</sup>   | 0/11 <sup>c</sup> | 2/10   | 2/11             |                  | 13/16 | N/A               |                  | N/A               | 4/12               | 11/11 |
| Capital Markets<br>Top 1 <sup>st</sup> -3 <sup>rd</sup> Tier<br>Practices <sup>1</sup> | 0/15              | 2/13   | 1/6 <sup>d</sup> | 1/8 <sup>e</sup> | 3/9   | 0/12 <sup>f</sup> | 6/9 <sup>g</sup> | 6/12 <sup>d</sup> | 7/7 <sup>e</sup>   | 10/10 |
| Capital Markets<br>Top 4 <sup>th</sup> -5 <sup>th</sup> Tier<br>Practices <sup>1</sup> | 2/8               | 2/4    | 0/4              | 0/1              | N/A   | N/A               | N/A              | 0/2 <sup>d</sup>  | 1/7 <sup>e,h</sup> | 5/5   |

Data from 2006 Chambers Global Guide

<sup>1</sup> These ratios reflect total corporate/m&a deals or international corporate/m&a deals, depending on the specifics of the country rankings.

<sup>a</sup> Larger Deals/Larger Resources

<sup>b</sup> Larger Deals/Medium Resources

<sup>c</sup> Two firms are non-US/UK

<sup>d</sup> Capital Markets Debt

<sup>e</sup> Capital Markets Equity

<sup>f</sup> Foreign Capital Markets

<sup>g</sup> Capital Markets

<sup>h</sup> Five of six foreign firms are US based, the other is French based

This chart provides important insights into the increasing dominance of Anglo-American law firms in capital markets. Within the China/Hong Kong market, only three of the top twenty-eight firms ranked are local firms. Within capital markets, none of the top fifteen practices in China are local firms and only two of the eight firms in the next tier in the ranking are local. In Japan, none of the top eighteen ranked firms for corporate/mergers and acquisitions (M&A) work are domestic. Within foreign capital markets work, none of the twelve top firms in foreign capital markets are local firms. Only six of nine local firms make the list for top firms in domestic capital markets work.

Examining the European markets, each of the capital markets shows increased penetration by non-local firms. This is most pronounced in Germany, where only five local firms make the top twenty corporate/M&A practices, one of ten in capital market debt practices, and one of nine among capital market equity practices. In France, local firms hold nine of the top nineteen corporate/M&A practice honors but only four of seventeen capital markets top practice honors. Italian local firms tend to have the strongest showing. They continue to dominate corporate/M&A work with eighteen of the top twenty-two corporate/M&A practices ranked. However, in capital markets work only a minority of Italian firms (three of nine) com-

pete at the top end in terms of ranking for best practices for this work.

The situation in the United Kingdom suggests that in its home market, U.K. firms are under attack by U.S.-based competitors, particularly for high-end deal work that requires medium rather than large resources. Among medium resourced deals, only nine of twenty top U.K. practices are London-based. U.S.-based firms take up the remainder of the spots. However, when deals require larger resources for staffing, U.K.-based firms hold all six top slots. Capital markets debt and equity work also suggests a shift toward a greater use of primarily U.S.-based firms. Within the debt capital markets practice in the United Kingdom, a minority of top firms are British (six of fourteen). Similarly, only eight of fourteen top equity capital markets practices are run by U.K. firms. This contrasts with the United States, where all twenty-seven top corporate/M&A practices and all fifteen capital markets practices are U.S.-based firms.

The provision of high-end legal services in Germany provides for a case study in the increased leverage of U.S. and U.K. dominance in high-end legal services. Ever since U.S. and U.K. law firm expansion into Germany began in earnest in the mid- to late-1990s, this has transformed the German legal market.<sup>16</sup> International law firms have become the new legal elite in Germany, as Chart I suggests.<sup>17</sup> Moreover, a number of international firms have developed critical mass for large scale work. For example, among U.S. firms, Shearman and Sterling has 105 attorneys listed as practicing in four German offices, Cleary Gottlieb has 53 attorneys in two offices, Latham & Watkins has 118 attorneys in four offices, and White & Case has 206 attorneys in six offices. Among U.K.-based firms, Clifford Chance has 360 attorneys in three offices, Freshfields has 561 attorneys in six offices, and Allen & Overy has 130 attorneys in two offices.<sup>18</sup>

## II. UNDERSTANDING INTERNATIONAL EXPANSION FROM THE MANAGEMENT LITERATURE

Within the field of business management, scholars have undertaken much research to understand the effectiveness of firms in their internationalization.<sup>19</sup> How

16. Martin Henssler & Laurel S. Terry, *Lawyers Without Frontiers—A View From Germany*, 19 DICK. J. INT'L L. 269, 272 (2001).

17. See Susanne Lace, *Mergers, Mergers Everywhere: Constructing the Global Law Firm in Germany*, in 3 SOCIOLOGY OF CRIME, LAW AND DEVIANCE: LEGAL PROFESSIONS: WORK, STRUCTURE AND ORGANIZATION 51 (Jerry Van Hoy ed., 2001).

18. These figures are based on visits to firm websites on September 15, 2006.

19. For literature reviews, see Madan Annavarjula & Sam Beldona, *Multinationality-Performance Relationship: A Review and Reconceptualization*, 8 INT'L J. ORG. ANALYSIS 48 (2000); Oded Shenkar, *One More Time: International Business in a Global Economy*, 35 J. INT'L BUS. STUD. 161 (2004).



this scholarship applies specifically to law firms remains under-developed. The application of this work is critical to understanding the strategic management of law firm expansion. Overall, the management literature explains that the internationalization of a firm comes with costs and benefits.<sup>20</sup> Firms perform well with either high or low levels of internationalization. They tend to perform less well at medium levels of internationalization.<sup>21</sup> At the medium level, international firms must reconfigure their internal systems to respond to the process of internationalization.<sup>22</sup>

Firm leadership plays a role in international expansion. When firm leadership has had international exposure, this increases the extent of internationalization of the firm.<sup>23</sup> Firms that expand internationally earlier have greater knowledge and experience greater international growth.<sup>24</sup> However, there are limits to the ability of firms to take in the knowledge they gain from their international experience. External knowledge must be assimilated by a firm for it to be utilized.<sup>25</sup> The absorptive capacity of the firm to internalize knowledge limits the ability of the firm to internationalize successfully.<sup>26</sup>

Law firms have two strategic choices for international expansion—greenfield expansion or expansion via merger or acquisition. Greenfield expansion occurs through new entry and organic growth, and allows for revenue capture by a single firm. It may lead to lower costs through reduced transaction costs.<sup>27</sup> With greenfield expansion, law firms can boast to their corporate clients that scale effects reduce the information costs of selecting law firms across jurisdictions. Creating critical mass allows for a firm to claim that it can coordinate legal work across jurisdictions.<sup>28</sup> The use of a single firm reduces the need to coordinate across firms because the information costs of learning the deal are lower.

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20. Winfried Ruigrok & Hardy Wagner, *Internationalization and Performance: An Organizational Learning Perspective*, 43 MGMT. INT'L REV. 63, 68 (2003).

21. *See id.*

22. *See id.* at 70–71.

23. Nicholas Athanassiou & Douglas Nigh, *The Impact of the Top Management Team's International Business Experience on the Firm's Internationalization: Social Networks at Work*, 42 MGMT. INT'L REV. 157, 173–74 (2002).

24. Erkkö Autio, Harry J. Sapienza & James G. Almeida, *Effects of Age at Entry, Knowledge Intensity, and Imitability on International Growth*, 43 ACAD. MGMT. J. 909, 919 (2000).

25. Wesley M. Cohen & Daniel A. Levinthal, *Absorptive Capacity: A New Perspective on Learning and Innovation*, 35 ADMIN. SCI. Q. (SPECIAL ISSUE) 128, 128 (1990).

26. Kent Eriksson & Sylvie Chetty, *The Effect of Experience and Absorptive Capacity on Foreign Market Knowledge*, 12 INT'L BUS. REV. 673, 674–75 (2003).

27. *See generally* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

28. Debora L. Spar, *Lawyers Abroad: The Internationalization of Legal Practice*, CAL. MGMT. REV., Spring 1997, at 8, 14.

In the greenfield scenario, a law firm opens a foreign office and staffs it with its own lawyers with J.D.s. The expatriates then select local lawyers to increase the size of the local office.<sup>29</sup> These local lawyers often have obtained their LL.M.s in the United States or elsewhere. Greenfield investment allows a firm to better control the cultural differences across offices than expansion through acquisition. It allows a firm's foreign expansion to build upon existing firm best practices.<sup>30</sup>

In the other scenario, a firm can expand through the acquisition of a preexisting firm or a group of lawyers from a preexisting firm. Firms learn through their experience. As a firm becomes more international, this increases the types of experiences that a firm has.<sup>31</sup> Firms experience learning "if through its processing of information, the range of its potential behaviors is changed."<sup>32</sup> Acquired firms behave differently than greenfield firms because they have a preexisting culture. An increasing body of literature demonstrates that acquisitions that do not create a common culture may lead to acquisition failures.<sup>33</sup>

Law firms may expand as a reaction to competitor expansion.<sup>34</sup> Some firm expansion may result from a herd mentality. That is, sociological imitation may be at play in the decision to internationalize a law firm.<sup>35</sup> Firm thinking in this scenario is that other firms must have better information as to a certain foreign market. If these firms are expanding into these markets, this is a signal that there are increased opportunities in this market.<sup>36</sup> Other firms also may see the lack of an office in a certain jurisdiction where the rival has an office as disadvantageous

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29. See generally David J. Teece, *Towards an Economic Theory of the Multiproduct Firm*, 3 J. ECON. BEHAV. & ORG. 39 (1982) (describing changes in the face of American business due to diversification).

30. See Harry G. Barkema & Freek Vermeulen, *International Expansion Through Start-up or Acquisition: A Learning Perspective*, 41 ACAD. MGMT. J. 7, 12 (1998); Jean-Francois Hennart & Yong-Ryeol Park, *Greenfield vs. Acquisition: The Strategy of Japanese Investors in the United States*, 39 MGMT. SCI. 1054, 1055 (1993).

31. See Barkema & Vermeulen, *supra* note 30, at 7–8; Roland Calori, Gerry Johnson & Philippe Sarnin, *CEOs' Cognitive Maps and the Scope of the Organization*, 15 STRATEGIC MGMT. J. 437, 452 (1994).

32. George P. Huber, *Organizational Learning: The Contributing Processes and the Literatures*, 2 ORG. SCI. (SPECIAL ISSUE) 88, 89 (1991) (emphasis removed).

33. Barkema & Vermeulen, *supra* note 30, at 9 (citing a number of studies).

34. See Richard L. Abel, *Transnational Law Practice*, 44 CASE W. RES. L. REV. 737, 741 (1994).

35. See generally THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS (Walter W. Powell & Paul J. DiMaggio eds., 1991) (discussing institutional theory and how individual choices are influenced by sociological context).

36. See Sushil Bikhchandani, David Hirshleifer & Ivo Welch, *Learning From the Behavior of Others: Conformity, Fads, and Informational Cascades*, J. ECON. PERSP., Summer 1998, at 151, 151–53.

in the competition to provide legal services to potential clients. This might create the incentive for a firm to follow and to open its own office in order to compete with its rivals.<sup>37</sup>

However, many law firms lose money in their foreign operations. In keeping these foreign offices open, law firm management at these firms believes that at some point these offices will make a profit.<sup>38</sup> U.S.-based law firms face particular challenges. International firms often cannot compete with local firms on price and have higher overhead than do local firms.<sup>39</sup> Consequently, law firm outposts have to differentiate themselves on the services that they provide. Firms will attempt to create a seamless common culture across their offices. This suggests that a law firm will try to sell its services internationally as part of the firm brand.<sup>40</sup> This branding includes quality of services, in which the same quality holds across offices.

The nature and size of foreign offices may play an important role in their potential profitability. Without critical mass, foreign offices may be less profitable. Overall, to hold expansion through greenfield or acquisition may make a foreign office too small to compete in the local market. When a firm does not have enough repeat business to send to a foreign office, this reduces the profitability of the foreign office. The smaller size of foreign offices also exposes such offices to increased fluctuations in terms of revenue and productivity because work and expertise tend to be concentrated across fewer practice groups.<sup>41</sup> Other risks abound. Foreign expansion may be risky where the client base of a firm may not be as easily transferable across foreign jurisdictions. There may be limits as to the size of the office or the needs of the existing client base.<sup>42</sup> Referrals may dry up across local firms if other players in the local market fear that referrals will not be reciprocated.<sup>43</sup>

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37. See David L. Deephouse, *To Be Different, or To Be the Same? It's a Question (and Theory) of Strategic Balance*, 20 STRATEGIC MGMT. J. 147, 147–48 (1999) (discussing the need for law firms to strike a balance between conforming with and differentiating from other firms); Spar, *supra* note 28, at 13.

38. Spar, *supra* note 28, at 13.

39. *Id.* at 15.

40. See generally Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981); John W. Meyer & Brian Rowan, *Institutionalized Organizations: Formal Structure as Myth and Ceremony*, 83 AM. J. SOC. 340 (1977).

41. See Carole Silver, *Globalization and the U.S. Market in Legal Service—Shifting Identities*, 31 LAW & POLY INT'L BUS. 1093, 1130–31 (2000).

42. *Id.* at 1131. Pay the foreign office too little, and the office may defect to a rival firm.

43. Abel, *supra* note 34, at 744–45.

### III. LAW FIRM EXPANSION MODELS

This article argues that there are at least six models of international expansion of law firms. The first five involve traditional law firms. These models include: the charmed circle, the alliance/best friends, the magic circle, the almost-charmed circle, and the not-so-charmed circle. The sixth model is the expansion of law practice by the Big Four accounting firms.

#### *A. Charmed Circle*

The first expansion model is that of the “charmed circle” of large New York-based law firms. These firms represent large, sophisticated investment banks and Fortune 500 clients in high-end corporate and litigation work, particularly in the United States but increasingly in other markets. The charmed circle firms lack large scale jurisdictional coverage because of a concern that per-partner profits may get diluted with large scale international expansion. Charmed circle expansion focuses almost exclusively in capital markets and in highly complex deal work. The foreign offices of charmed circle firms remain small relative to other foreign law firms or domestic firms.

#### *B. Alliance/Best Friends*

The second model is a more informal “alliance/best friends” model of a referral network across firms. This is a conscious effort not to expand into certain markets and instead create alliances with other firms in those jurisdictions. The reason for alliance is that it reduces the costs to individual law firms. It does not require setting up foreign offices where there will not be enough repeat work to justify such a relationship. There are coordination problems for such a model because of the informality of the arrangement and the increased monitoring cost to ensure high quality work when such work gets referred outside of a particular firm. Similarly, there are principal/agent problems to this model. These problems manifest themselves in ensuring the same quality of work and attention across jurisdictions and across firms.

There is an increasing prevalence of more formal alliances.<sup>44</sup> The largest formal network of firms belongs to Lex Mundi. Lex Mundi boasts coverage that

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44. See, e.g., Lex Mundi Home Page, <http://www.lexmundi.com> (last visited Feb. 3, 2007); Law Firm Alliance Home Page, <http://www.lawfirmalliance.org> (last visited Feb. 3, 2007); The Law Firm Network Home Page, <http://www.the-law-firm-network.com> (last visited Feb. 3, 2007);

spans across 99 countries with over 17,000 attorneys in 160 member firms with 560 offices.<sup>45</sup> Firms within the network get a half hour of free time with questions about doing business in their jurisdiction. Member firms meet on a regular basis to facilitate client referrals.

These formal alliances have their limits. What may work as an effective strategy at some point in organizational development may shift when clients demand that a foreign office be opened by a particular firm. It may put strains on an alliance relationship when members of an alliance compete for work with other members of the alliance in the same jurisdiction. Similarly, an alliance strategy is a function of available alliance partners given the strategies of competitors. If a firm chooses an alliance strategy, this limits the potential formal alliances for competitor firms. A lack of potential alliance partners may push competitor firms to try to expand across markets and across practice groups to keep all of the revenues of multi-jurisdictional work for themselves.

A less formal version of the alliance is the “best friends” model. Firms that purposely do not want to expand into certain markets or types of representation may pursue a best friends strategy of cross-referrals across jurisdictions to firms or individual partners within these firms. With the possible exception of Baker & McKenzie, all law firms lack global reach. Given this reality, law firms that pursue other models of law firm expansion also pursue a best friends model to a certain extent. Over time, repeated interactions between best friends increase the predictability of work relationship and work quality. However, the agency costs typically remain higher among best friends than within a single firm.

### *C. Magic Circle*

The third model is that of the top end London-based firms, the so-called “magic circle” that have jurisdictional capacity around the world in both developed and developing world countries. There are limits to this worldwide footprint. With the exception of Clifford Chance, the magic circle model lacks a significant U.S. capability. The inability of magic circle firms to cover the U.S. legal market adequately suggests that one-stop shopping is more difficult to sustain. By working with U.S.-based firms in large transatlantic transactions, magic

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State Capital Global Law Firm Group Home Page, <http://www.statecapitallaw.org> (last visited Feb. 3, 2007).

45. Lex Mundi, About Lex Mundi, [http://www.lexmundi.com/lexmundi/About\\_Lex\\_Mundi.asp?SnID=2137785878](http://www.lexmundi.com/lexmundi/About_Lex_Mundi.asp?SnID=2137785878) (last visited Feb. 3, 2007).

circle firms open themselves up to competition from these same U.S. firms in subsequent deals if these U.S. firms have offices in magic circle markets.

The further large scale expansion of British firms through greenfield or acquisition into the U.S. market seems unlikely given the Clifford Chance experience. The Clifford Chance expansion into the U.S. market, via its merger with New York-based firm Rogers & Wells, has been rather difficult. Some of the most profitable partners from Rogers & Wells have left the firm due to differences of management style, compensation, and structure.<sup>46</sup> These problems are not unique to Clifford Chance. Rather, issues of cultural fit, management style, firm structure, and compensation remain significant between U.S.- and U.K.-based firms.<sup>47</sup>

#### *D. Almost-Charmed Circle*

The fourth model is a modified charmed circle. These firms can be termed “almost-charmed circle” in that their main competition includes members of the charmed circle.<sup>48</sup> Many of the firms in this category are not traditionally based in New York. In such cases, the almost-charmed circle of firms lack the extensive ties to New York-based investment bank clients and have regional roots in other major U.S. cities. These firms tend to have become national through expansion into other markets (e.g., Kirkland & Ellis, Latham & Watkins, Gibson Dunn) or “second tier” New York firms (e.g., Shearman & Sterling, Milbank Tweed). Almost-charmed firms have a significant presence in both New York City for transactional work and Washington, D.C. for regulatory work. Almost-charmed firms charge rates similar to those of charmed circle firms.

Almost-charmed firms seek to compete with the charmed circle for high-end work. The lack of a large footprint of foreign offices (because of fears of profit dilution) from charmed circle firms provides almost-charmed firms an opportunity to create a single firm network abroad. Almost-charmed firms can pitch one-stop shopping to investment banks and Fortune 500 clients that might otherwise engage a charmed circle firm. This creates strategic opportunities and choices for almost-charmed firms. These firms may have a somewhat different strategy of international expansion than charmed firms. That is, these firms may have more

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46. See Anthony Lin, *Clifford Chance Turns to Partner From London to Halt U.S. Slide*, N.Y. L.J., Mar. 21, 2005, at 1.

47. John Flood, *Lawyers As Sanctifiers: The Role of Elite Law Firms In International Business Transactions*, 14 IND. J. GLOBAL LEGAL STUD. 35 (2007).

48. *Am Law 100*, A.M. LAW. (2006).

international offices or more heavily staffed international offices, the better to distinguish themselves vis-à-vis charmed circle firms to sell economies of scale and scope abroad across a number of different markets. Because they lack the deep and historic long-term relationships with investment bank clientele of charmed circle firms that gives charmed circle firms access to many of the largest international deals, almost-charmed firms open up more offices than charmed circle firms to address a demand-side need to provide for seamless legal service across jurisdictions.<sup>49</sup>

### *E. Not-So-Charmed Circle*

The fifth international strategy may be termed the “not-so-charmed circle” expansion model. Firms outside of the charmed and almost-charmed circles in the Am Law 100 focus more on midcap market work. These firms tend to have many offices across the United States, lower per-partner profits, and prestige levels lower than those of charmed and almost-charmed firms (e.g., Greenberg Traurig, K&L Gates, Bryan Cave, Squire Sanders, Holland & Knight). Some of these firms may pursue an international strategy that allows them to provide greater scope vis-à-vis other similar not-so-charmed circle firms. Not-so-charmed firms may want an international presence in as many cities as possible to overtake dominant local firms for international work for midcap clients, much like their U.S. expansion strategy.

### *F. Multidiscipline Practices (MDPs)*

In a number of jurisdictions, accounting firms have made increasing inroads into legal services. These firms have a larger platform in most countries around the world and can provide one-stop shopping for a number of areas of service—law, accounting, and consulting. However, the threat to firms in the U.S. legal market may be theoretical so far.<sup>50</sup> In the United States, because of regulatory barriers, the accounting firms have not been able to move into the general practice of law.<sup>51</sup> Post-Enron discussion has chilled further expansion of these firms into tra-

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49. Examples of historic ties include Sullivan & Cromwell’s relationship with Goldman Sachs or Davis Polk’s relationship with J.P. Morgan.

50. See Garth & Silver, *supra* note 9, at 903–04. Rather than an economic threat, these firms may threaten the legitimacy of lawyers. Yves Dezalay & Bryant G. Garth, *The Confrontation Between the Big Five and Big Law: Turf Battles and Ethical Debates as Contests for Professional Credibility*, 29 *LAW & SOC. INQ.* 615, 616 (2004).

51. See Garth & Silver, *supra* note 9, at 910–18.

ditional U.S. legal services. However, these remain formidable potential threats to traditional U.S. law firms should the regulatory barriers be removed.<sup>52</sup>

What constitutes legal services varies across countries.<sup>53</sup> This variation provides opportunities for accounting firms to operate law practices that might allow them to leverage existing relationships on the accounting or consulting side. MDPs present a particular problem for traditional law firms because accounting firms are better capitalized than U.S. law firms and have a high leverage.<sup>54</sup> This allows MDPs to bill less than many law firms for similar services.

MDPs may be a particular threat to U.S. law firm expansion abroad. The leading international law firms can hold their own against MDPs with highly complex, high-stakes type work.<sup>55</sup> However, there is increasing competition for commodity legal work.<sup>56</sup> Merely in terms of size, the accounting firms remain significant players in legal services, particularly in the area of tax.<sup>57</sup> MDPs threaten not-so-privileged firms the most, as these firms are the most likely to compete for international commodity work and lack the scope of the network of the big four. As the regulatory environment shifts to allow for greater penetration by MDPs around the world, the threat of MDPs may grow over time.

#### IV. THE GROWING IMPORTANCE OF THE LL.M. DEGREE

Part of Silver's article focuses on the increasingly important LL.M. degree for foreign lawyers. She notes that LL.M.s may serve as a bridge to an increasingly U.S. (or U.K.) style of lawyering.<sup>58</sup> Because of their U.S. legal education and potential year of work with a U.S.-based firm upon graduation, lawyers with LL.M.s and

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52. This threat has been realized in the United States in the realm of business counseling on tax issues.

53. Herbert M. Kritzer, *The Professions Are Dead, Long Live the Professions: Legal Practice in a Postprofessional World*, 33 *LAW & SOC'Y REV.* 713, 734 (1999); Mary C. Daly, *Choosing Wise Men Wisely: The Risks and Rewards of Purchasing Legal Services from Lawyers in a Multidisciplinary Partnership*, 13 *GEO. J. LEGAL ETHICS* 217, 227 (2000); Mary C. Daly, *Monopolist, Aristocrat, or Entrepreneur?: A Comparative Perspective on the Future of Multidisciplinary Partnerships in the United States, France, Germany, and the United Kingdom After the Disintegration of Andersen Legal*, 80 *WASH. U. L.Q.* 589, 625–28 (2002).

54. Heinz, Nelson & Laumann, *supra* note 4, at 356–59.

55. See Garth & Silver, *supra* note 9, at 928.

56. See Wendy M. Becker, Miriam F. Herman, Peter A. Samuelson & Allen P. Webb, *Lawyers Get Down to Business*, *McKINSEY Q.*, 2001(2), at 44, 48.

57. Randall S. Thomas, Stewart J. Schwab & Robert G. Hansen, *Megafirms*, 80 *N.C. L. REV.* 115, 171–79 (2001).

58. Silver, *supra* note 7, at 82–83.



U.S.-based experience may sell themselves as premium lawyers. Silver's empirical work into LL.M. degree recipients shows that it is difficult for LL.M. graduates to find work in major U.S. law firms.<sup>59</sup> Indeed, nearly a quarter work for local firms in their home countries that lack any foreign presence.<sup>60</sup> For U.S.-based law firms in their initial greenfield phase of expansion, foreign lawyers with LL.M. degrees seem to return to their local firms after spending a year working in the United States. This may serve to strengthen the alliance/best friends policy of the U.S. firm with its foreign alliance partner.<sup>61</sup>

As U.S. firms have expanded into foreign jurisdictions and have moved beyond the initial greenfield phase of international offices staffed exclusively by J.D. lawyers, the LL.M. dynamic changes. As foreign offices shift from primarily a J.D. transplant model to an office structure primarily staffed with locally trained lawyers who also hold an LL.M., an understanding of the importance of an LL.M. degree, what it entails, and the opportunities that it provides (in terms of a one year work permit in the United States) needs to be explored further. Gaps remain in a larger understanding of how many foreign lawyers for U.S. or U.K. firms have LL.M.s, and how many of these LL.M.s come from the U.S./U.K. legal academe versus other, lower cost, academic LL.M. programs (Australia, Canada or Continental Europe). A further research question is whether there is a sense that the quality of LL.M. institutions explains placement in foreign offices of U.S.- or U.K.-based law firms. Similarly, what types of firms do specific LL.M. programs feed? Is there a difference in LL.M. placement in both local and international firms based on the LL.M. granting institution? Within the U.S. law firm domestic structure, recruiting favors graduates from elite law schools. Whether this holds for general LL.M.s and specialized LL.M. programs (e.g., banking, tax) makes for an interesting research question. An article by Garicano and Hubbard that examines the role of lawyers with elite law school qualifications suggests that there is a strong relationship between the quality of the J.D. law school institution (as a proxy for cognitive ability) and sorting mechanisms for knowledge within a law firm and a weak relationship between cognitive ability and experience.<sup>62</sup> This work has not been extended to LL.M. graduates.

Silver's observation on Frankfurt offices of international law firms shows that

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59. *Id.* at 83.

60. *Id.*

61. *Id.* at 74.

62. Luis Garicano & Thomas N. Hubbard, *Hierarchical Sorting and Learning Costs: Theory and Evidence from the Law*, 58 J. ECON. BEHAV. & ORG. 349, 350–51 (2005).

a quarter of lawyers in these offices possess LL.M. degrees from U.S. institutions.<sup>63</sup> Over time, based on theory supplied by management literature, we should expect to see that these LL.M.s will make up an even greater percentage of international law firm lawyers in these offices. A related research question is whether the depth of LL.M.s in local firms makes them more attractive to international law firms. Silver suggests that buying out local competition allows foreign law firms to offer increased one-stop shopping.<sup>64</sup> The more specific further research question is, when U.S. firms hire locally—either through cherry picking or via acquisition of an existing local firm at the partner level—are they more likely to hire those with LL.M. credentials? Does this hold true for entry-level hires in international offices?

#### V. TRANSITION IN FOREIGN EXPANSION IN U.S. LAW FIRM GLOBALIZATION

International law firm expansion has proceeded more slowly than domestic expansion. This may be due in part to the practice of law itself. Law has been a predominantly local enterprise. Countries have placed restrictions on the ability of foreign nationals to provide legal services in their countries.<sup>65</sup> In countries where these barriers have been reduced or eliminated, this has changed the nature of legal representation by U.S.-based firms. However, lawyers are no longer practicing purely domestic law. Transactions and litigation increasingly involve multiple jurisdictions.<sup>66</sup>

Silver provides an important explanation of the transition of foreign expansion of U.S. law firms. In the pre-internet/communications revolution era, the purpose of foreign offices was to sell U.S. law to foreign clients.<sup>67</sup> The communications revolution made a physical presence less important for international work but more important for local work in other jurisdictions. The typical U.S. firm now serves both local and foreign clients in its foreign offices.<sup>68</sup> Traditionally, the U.S. firms would start with greenfield investment into new markets.<sup>69</sup> In the second phase of expansion, U.S. firms acquired local capabilities, just as the management literature would suggest. Silver provides a case study of the London legal

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63. Silver, *supra* note 7, at 88.

64. See *id.* at 89.

65. Spar, *supra* note 28, at 11.

66. Silver, *Regulatory Mismatch*, *supra* note 9, at 489.

67. Silver, *supra* note 7, at 77.

68. *Id.* at 78.

69. *Id.* at 79–80.

market, where U.S.-based solicitors and barristers now advise on local law issues.<sup>70</sup> Due to increasingly lower regulatory barriers to the practice of law, an office in that country might perform the kind of work no different than the type of work done in a U.S. office such as Chicago, New York City, Washington, D.C., or Los Angeles. Clients may be pushing for their incumbent law firms to expand when there are issues of comfort and quality. This may suggest a demand-side theory of law firm expansion. This demand-side theory may augment the supply-side tournament explanation. In the demand-side model, law firms may be growing and functioning based on the demands of its clients.<sup>71</sup> That is, law firm clients have begun to demand legal capabilities across jurisdictions.<sup>72</sup> In this explanation, U.S. law firms may be responding to client pressure by hiring local talent to protect their client relationships around the world.<sup>73</sup> This may be particularly important in the most profitable and largest jurisdictions, such as in U.S. and EU markets, and less in other foreign markets. This is a claim that intuitively seems true. However, there is a lack of empirical evidence of whether or not this holds.

Bierman and Hitt pick up on one theme that Silver touches upon: the transformation of the practice of law in the internet age. The internet has reduced the response time to redraft documents.<sup>74</sup> Moreover, Bierman and Hitt provide the critical insight that law has become more of a business, with a move away from true partnerships to a more corporate business structure.<sup>75</sup> These observations suggest a number of potential research questions. Does the move to a more corporate structure affect turnover rates in firms? Law firm productivity? Law firm happiness? Is this of particular concern to firms with a global presence in which partners and associates must be available at all hours to address client concerns from around the world? Initial analysis from Bill Henderson suggests that there is a statistically significant negative relationship between per partner profit and factors that affect associate happiness (except money). There is also a geographic effect—associates in New York are statistically less happy than associates in other large markets. Similarly, associates in Washington, D.C., Chicago, San Francisco,

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70. *Id.* at 78–79.

71. See Sherwin Rosen, *The Market for Lawyers*, 35 J.L. & ECON. 215, 242 (1992); Thomas, Schwab & Hansen, *supra* note 57, at 137.

72. See Thomas, Schwab & Hansen, *supra* note 57, at 138–39.

73. See, e.g., Silver, *supra* note 7, at 80.

74. Bierman & Hitt, *supra* note 8, at 30.

75. *Id.* at 31–32. For a recent example of how this plays out among large U.S. law firms, see Equal Employment Opportunity Comm'n v. Sidley Austin Brown & Wood, 315 F.3d 696 (7th Cir. 2002).

and Los Angeles are statistically less happy than Am Law associates in the remaining markets.<sup>76</sup> What remains unexplored is whether associate and partner happiness decreases as the firm expands internationally.

Just as the practice of law has become more corporate in its approach, there has been a shift in the provision of legal services. That is, law has become more of a commodity business.<sup>77</sup> Clients have become less loyal to their preexisting law firms and are more likely to seek counsel for specific transactions or litigations.<sup>78</sup> This competition among law firms allows clients to obtain legal services at lower prices, as clients can play law firms against each other. The information technology revolution has only increased competition and pricing pressure for legal services. Bierman and Hitt provide the example of GE's efforts at creating a priceline.com-type system for commodity legal work.<sup>79</sup> This has potentially profound implications on other Fortune 500 firms and the outsourcing of commodity legal work. We may be witnessing the beginning of a larger trend. Other companies may follow the lead of GE because as GE adopts cost-cutting measures for law firms, this may legitimate the decision of other Fortune 500 companies to take a similar approach.<sup>80</sup>

## VI. NEXT STEPS IN A LAW FIRM GLOBALIZATION RESEARCH AGENDA

More interdisciplinary work needs to be undertaken to understand international business.<sup>81</sup> Too often scholars across law, sociology, economic geography, management studies, and economics do not communicate with each other in their overlapping work in the study of law firms. Many scholars do not cite work outside of their field. This is a serious shortcoming to a better understanding of the globalization of law firms. Below I provide suggestions for future avenues of research into the globalization of law firms that allow for more interdisciplinary approaches to law firm expansion.

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76. Posting of Bill Henderson to Empirical Legal Studies Blog, [http://www.elsblog.org/the\\_empirical\\_legal\\_studi/2006/12/associate\\_satis.html](http://www.elsblog.org/the_empirical_legal_studi/2006/12/associate_satis.html) (Dec. 16, 2006, 10:33 EST) (containing a chart with data compiled by Henderson and David Zaring on attorney satisfaction).

77. Bierman & Hitt, *supra* note 8, at 32.

78. Kritzer, *supra* note 53, at 740; *see also* Baker & Parkin, *supra* note 5, at 1678 (discussing the decline of relationship lawyering).

79. Bierman & Hitt, *supra* note 8, at 33.

80. Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOC. REV. 147 (1983); David S. Scharfstein & Jeremy C. Stein, *Herd Behavior and Investment*, 80 AM. ECON. REV. 465 (1990).

81. Oded Shenkar, *One More Time: International Business in a Global Economy*, 35 J. INT'L BUS. STUD. 161, 168 (2004).

### *A. Understanding the Dynamics of Foreign Expansion*

One topic that remains unexplored is whether there is a different compensation structure for local work than international work. Are the U.S. firms' foreign offices paying more for their local lawyers than local firms? This would suggest that there would be greater prestige to work for a foreign firm and greater financial rewards. International competition for the best lawyers may change the local tournament model for lawyers. Lawyers with specialized skills who are younger partners may be the most in demand for foreign expansion. Young partners may be at the forefront of the battleground for talent because they know the contours of the local market well but do not have the financial incentives based on seniority to be as highly compensated as the more senior partners in local firms. These young partners may excel in a pre-existing international legal platform in which technical skills, rather than rainmaking skills, are at a premium.

The structure of international offices is in need of further study. What is the difference in cost structure across international offices? Are per-partner profits the same? Do these offices lose money or do they have enough deal flow, and if so, can they charge premium rates? Is there a difference between the rates charged on local matters between foreign and U.S.-based firms for local law in other countries? Does this contrast become exacerbated when the level of international work is low and does it reach a potential tipping point in which too much local work makes an international outpost unviable given the cost structure of an international office? What role do international partners play in firm management? An additional issue of the structure of international offices that has not been addressed is the decision by law firms to exit markets.

### *B. In-house Expansion*

Due to increased globalization, issues of integration and sourcing for goods and services for multinational firms has grown more complex than ever before.<sup>82</sup> These issues impact the in-house legal departments of multinational corporations ("MNCs") just as it does other functions of MNCs. The increased legalization of business adds to the importance of the in-house counsel to the corporation. This is due in part to the increased regulatory complexity under which companies operate. Likewise, an increase in litigation has increased the exposure of legal is-

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82. Elhanan Helpman, *Trade, FDI, and the Organization of Firms 2* (Nat'l Bureau of Econ. Research, Working Paper No. 12091, 2006), available at <http://papers.nber.org/papers/w12091.pdf>.

sues.<sup>83</sup> In-house counsels play an increasingly large number of roles in terms of how their legal advice may be used.<sup>84</sup>

The economics literature provides a start for additional avenues of research into the in-house practice of global law.<sup>85</sup> Outsourcing involves tradeoffs between two types of costs.<sup>86</sup> On the one hand, outsourcing of legal work outside of an MNC involves issues of agency costs.<sup>87</sup> On the other hand, outsourcing implicates organizational costs.<sup>88</sup> Available datasets do not provide a way to test patterns of outsourcing versus integration of legal services both domestically and abroad. Moreover, we lack an understanding of when in-house counsel should expand in-house versus outsource the work to international or local firms.

Adding to the complexity of empirical work in this area is how to define the provision of legal services. Do such service providers only exist with the general counsel's office of a corporation? One could make an argument that both lawyers and non-lawyers in regulatory, government affairs, tax, and compliance groups in a corporation perform "legal" services. The structure of who may get included within the general counsel's office versus other corporate offices is critical to understanding issues of outsourcing work to law firms or other professional service firms.

### C. *Reduced Transaction Costs and General Counsel Decision-making*

Silver provides some important examples of U.S. law firms that sell services in a number of different jurisdictions. How does selling firm services change across jurisdictions? In critical front page *Financial Times* or *Wall Street Journal* transactions, do savvy corporate clients partake in the cost savings of one-stop shopping with lower coordination costs, or do they choose the best firm in each jurisdiction? Sometimes it may be regulatory issues that drive a deal. In such cases, it may be more likely that a general counsel will hire the best practitioner in each jurisdiction

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83. Robert L. Nelson & Laura Beth Nielsen, *Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations*, 34 *LAW & SOC'Y REV.* 457, 459 (2000).

84. *Id.* at 462–73.

85. For a general analytical framework in this area, see Gene M. Grossman & Elhanan Helpman, *Integration Versus Outsourcing in Industry Equilibrium*, 117 *Q. J. ECON.* 85 (2002).

86. See generally Pol Antràs & Elhanan Helpman, *Global Sourcing*, 112 *J. POL. ECON.* 552 (2004) (discussing the costs and benefits firms must weigh when deciding whether and how to outsource).

87. Agency problems may reflect problems of managerial incentives. Gene M. Grossman & Elhanan Helpman, *Managerial Incentives and the International Organization of Production*, 63 *J. INT'L ECON.* 237, 240–46 (2004).

88. See R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 390–92 (1937).

rather than pursue cost savings based on one-stop shopping. When regulatory issues are ancillary and/or the complexity of the deal and its structure does not drive the deal regardless of deal size, this may encourage one-stop shopping for law firms globally. Work that could test this hypothesis could provide valuable insights into a global understanding of Gilson's lawyer as "transaction cost engineer" in his or her ability to create value in a transaction because of expert skills.<sup>89</sup>

#### *D. Understanding Law Firm Expansion*

Elite law firms sell their high-end repeat work experience to potential clients. In this sense, high-end lawyers are "transaction cost engineers."<sup>90</sup> For work critical to a company, this allows elite law firms to price at a high level, where price is inelastic. How far can such firms grow in terms of total numbers of lawyers? Growth of these firms requires labor-intensive, high-end work to justify the cost of growth in their home markets. In the alternative, these firms would need to increase their share of the pie in the other capital markets where price would be equally inelastic. Increasingly, this is the case, as Chart I illustrates. Over time, it is possible that U.S. firms will try to gain scale in the U.K. legal market to offer high-end legal services to dominate large deals in the London market.<sup>91</sup>

U.S.-based international firms sell their services based on lowering of transaction costs. U.S. firms keep specialized knowledge of previous international deals and litigations that provides them with an informational advantage over other firms who may be only occasional players in multi-country complex transactions or litigations. This institutional knowledge allows firms to reap the rewards of their information. Because of the primacy of New York to corporate law matters, this exposes U.S.-based law firms to multiple iterations of big deals. These firms can draw on these experiences to sell their services to multinational clients across jurisdictions.<sup>92</sup> Similarly, London firms shape legalization in a number of jurisdictions.<sup>93</sup>

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89. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 *YALE L.J.* 239, 255 (1984).

90. *Id.*

91. In the investment banking world, the complexity of a deal has a positive correlation to the size of the transaction. Henri Servaes & Marc Zenner, *The Role of Investment Banks in Acquisitions*, 9 *REV. FIN. STUD.* 787, 791 (1996). It remains to be tested empirically if this holds within law firms.

92. U.S. lawyers may be more willing to think outside the box than other lawyers. Silver, *supra* note 41, at 1095-97.

93. Flood, *supra* note 47, at 36.

Such firms can offer a type of informal insurance to a potential client. If an important and complex transaction or litigation does not go well, directors, the CEO, and others in a corporation will be less likely to second guess the decision of the general counsel to retain a charmed circle firm. Empirical work in the banking literature suggests that the investment banking equivalent of charmed circle firms serve a similar insurance purpose. The involvement of a high-end investment bank in an IPO signals the quality of the offering.<sup>94</sup> Initial research into law firms in the mergers and acquisitions practice suggests that there may be a signaling effect for the use of such law firms, in the sense that larger and more prestigious law firms work for the more prominent investment banks and corporate clients.<sup>95</sup>

Because of the cost of these offices, a hypothesis would be that charmed and almost-charmed firms lose work to others (e.g., local firms, not-so-charmed firms) for more routine projects. Certainly, this hypothesis may offer a partial explanation for the size of offices of global law firms. Only MNCs are willing and able to pay such high fees. Such MNCs may only be willing to engage premier international law firms for high-end corporate work. One area for further study is whether non-U.S.- and European-based MNCs are willing to pay the high prices that U.S.- and European-based MNCs pay for legal work and the particular kinds of such work.

The explanatory value of demand- and supply-side models of law firm expansion need to be tested based on data that measures the international expansion of law firms. The first study to do this suggests that human capital and relational capital have a positive effect on internationalization.<sup>96</sup> However, this study overlooks both country variables for expansion as well as human capital quality of practice groups in a particular country setting. Specifically, what remains under-explored is the decision to expand into particular markets and not to expand into other markets. Is this expansion practice group driven and/or sector driven? For example, why has there been greater expansion into some capital markets and not others? Why the choice of specific non-capital market offices in certain countries but not others?

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94. See Roni Michaely & Wayne H. Shaw, *The Pricing of Initial Public Offerings: Tests of Adverse Selection and Signaling Theories*, 7 REV. FIN. STUD. 279, 282 (1994).

95. C.N.V. Krishnan & Paul A. Laux, *Legal Advisors: Popularity Versus Economic Performance in Acquisitions 4–5* (Sept. 19, 2003) (unpublished manuscript, on file with authors), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=520343#PaperDownload](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=520343#PaperDownload).

96. Michael A. Hitt, Leonard Bierman, Klaus Uhlenbruck & Katsuhiko Shimizu, *The Importance of Resources in the Internationalization of Professional Services Firms: The Good, the Bad and the Ugly*, 49 ACAD. MGMT. J. 1137, 1148 (2006).



*E. Maximizing Firm Resources*

If Bierman and Hitt are correct, there will be an increasing trend on the part of corporate clients to lower the cost of legal services provided by law firms. If so, why have law firms not anticipated this by shifting their commodity legal work outside of the New York offices to lower-cost partners and associates in other jurisdictions, including other U.S. offices? As part of an empirical research agenda, at least two hypotheses can be tested to answer this question. Hypothesis 1: Principal/agent problem within a law firm; there may be principal/agent problems where there is a concern about consistent quality of work across offices. Hypothesis 2: Compensation Structure; it may be a function of the “eat what you kill” pay model that shapes internal firm decision-making in many law firms. Compensation may create different incentives for individual partners or practice groups than firm profit maximization.

## CONCLUSION

The explanation for law firm global expansion is complex. Much remains under-explored. The works by Silver and Bierman and Hitt provide an important first step to a richer understanding. As part of a larger law firm research agenda, more cross country quantitative work should be undertaken to provide aggregate level explanations. This work needs to be augmented by case studies of particular firms and/or regions to fill out our understanding of the global expansion of law firms. Further work can provide a much more detailed assessment of the country-level expansion decisions for firms as part of a global strategy. To gain a greater understanding of the forces that define law firm expansion, we require an understanding of the goals, outputs, structure, and limitations of law firm expansion across countries. Such research will provide a better understanding of how law firms, as professional services firms, conduct their increasingly global business. This may have implications for the study of professional services firms more generally and for corporate strategy in international expansion.