

INTERNATIONAL DIVERSIFICATION AND PROFESSIONAL SERVICE FIRMS

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ABSTRACT

This research considers factors related to the propensity of professional service firms to open foreign offices, and explores relationships between patterns in international diversification and firm performance. This is one of the first studies to consider how a firm's home location relates to patterns in diversification, and also contributes by relating specific strategic motives to operational definitions, and theorized links between diversification and performance. The results suggest that firm prestige, or status, is positively related to the ratio of foreign to total offices maintained, and home location is associated with patterns in diversification. Additionally, results suggest that international diversification to exploit existing firm resources, or diversification to pursue and develop new resources, are both associated with positive performance. However, the results also suggest that the simultaneous pursuit of both types of diversification may be associated with negative performance.

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CHAPTER 1: Introduction

International Business scholars have made impressive contributions to our understanding of the multinational enterprise. In particular, researchers have made distinctions between foreign direct investment (FDI) and portfolio investment (Hymer, 1976), offered motives behind FDI and location decisions (Buckley & Casson, 1976; Dunning, 1979; Hymer, 1976; Vernon, 1966), and examined the process of internationalization (Aharoni, 1966; Johanson & Vahlne, 1977). In addition, International Business scholars have looked at the relationship between international diversification and performance (Bartlett & Ghoshal, 1989; Contractor, Kundu, & Hsu, 2003; Ghoshal, 1987; Grant, 1987; Hitt, Hoskisson, & Kim, 1997; Hout, Porter, & Rudden, 1982; Kim, Hwang, & Burgers, 1993; Kogut, 1983; Levitt, 1983; Lu & Beamish, 2001; Ronstadt & Krammer, 1982). This dissertation seeks to contribute to both the literatures that consider the antecedents and the consequences of international diversification.

To begin with, this dissertation seeks to contribute to the literature on internationalization by looking at how firm status, firm home location, and differences in business model might be related to the propensity towards international diversification and patterns in investment. Firms status, or prestige, has become a rich and diverse area of study in Organizational Theory literature (e.g., Phillips & Zuckerman, 2001; Podolny, 2005), but has been less common in IB literature. This dissertation will argue that firm status, or prestige, may be a factor in the internationalization of organizations.

Additionally, a rich body of IB literature has focused on location advantages of foreign

markets (e.g., Dunning, 1977, 1993, & 1998) and economic geographers have contributed greatly to our understanding of the agglomeration of industries in specific locations (e.g., Krugman, 1991; Nachum, 2000), but less research has looked at how a firm's home region might influence location decisions. This research seeks to contribute by helping to fill these gaps. In particular, by focusing on home location as a factor that may influence patterns in foreign investment, this study offers a unique contribution to the international business literature stream.

Second, this dissertation seeks to contribute to the literature stream on relationships between international diversification and financial performance. In particular, research has tended to treat international diversification as an accumulation of homogenous resources (Verbeke, Li, & Goerzen, 2009) and has often argued for a general positive (Grant, 1989; Han, Lee, & Suk, 1998) or curvilinear (Contractor, Kundu, & Hsu, 2003; Hitt, Hoskisson, & Kim, 1997) relationship between diversification and performance. However, the theoretical arguments behind these hypothesized general relationships may only be valid in specific contexts (Hennart, 2007). As a result, hypothesized relationships between international diversification and financial performance may need to consider context-specific firm resources and motives for diversification. This dissertation seeks to use context-specific resources and motives to make theoretically valid hypotheses on relationships between diversification and performance.

In order to contribute to the literature streams on internationalization and the consequences of internationalization, this study focuses on a unique empirical context, professional service firms, and specifically large US law firms. While a number of

researchers have made significant contributions to the literature by focusing on service firms (e.g., Erramilli, 1991; Krishna, 1987; Li & Guisinger, 1992), much of the existing literature in these areas deals with the empirical context of manufacturing firms (e.g., Dunning, 1979; Kindleberger, 1969). Professional service firms are well suited for exploring the relationships of interest in this dissertation. For instance, firm status is an important market mechanism in services. A firm's status can serve as an indication of quality where there are no opportunities to directly observe quality in products (Podolny, 2005 pg.38). In addition, professional service firms, and particularly law firms, often grow as their clients grow and initially their clients are often those in the same geographic location (Driver, 2004; Hyman, 1998; Lipartito & Pratt, 1991). As a result, these firms may follow home-town clients as they expand to foreign markets, and patterns in internationalization in professional service firms may be related to their home locations. And finally, international diversification in professional service firms can occur to exploit a variety of existing resources or develop a variety of new resources (e.g., human resources, status/prestige, or client relationships). By focusing on the empirical context of law firms, this study deals with one of the most heavily regulated industries in the world, and looking at this unique context is a contribution in itself.

To further develop the arguments in this study, and empirically test hypotheses, this dissertation is divided into several chapters. Following this introduction, chapter 2 will develop theoretical arguments on several factors that may influence the propensity towards international diversification in large US law firms, and will empirically test specific hypotheses using a unique hand-collected database including observations from 1984 through 2008. Next, chapter 3 will offer an approach to developing context-specific

predictions for relationships between international diversification and performance, and empirically test specific hypotheses. This approach will consider motives for international diversification and as a result, it will offer some direction for appropriate operational definitions of diversification and performance. Following the empirical analyses in chapters 2 and 3, chapter 4 will offer five brief law firm histories, and will attempt to highlight examples where firms seem to follow the relationships identified in previous chapters, as well as examples where firms have deviated for the relationships identified in the earlier empirical analyses. Finally, chapter 5 will include a brief summary of results and contributions, and will also offer some limitations and directions for future research.

CHAPTER 2: Status, home location, and international diversification

2.1 INTRODUCTION

The objective of this chapter is to explore the associations between status and home location, and the international diversification of professional service firms. More specifically, this analysis asks three separate questions. First, how does the prestige or status of a professional service firm influence the number of foreign markets that it operates in, or the ratio of foreign to total offices maintained? One potential argument views status as an intangible asset that clients use as a sign of quality or ability. If firms enter foreign markets to overcome client uncertainty about a firm's ability to operate in the host environment, higher status may supplement the need to open foreign offices by reducing uncertainty. On the other hand, more prestigious firms may wish to open foreign offices as a method of quality control, which would allow them to better protect their status.

The second question asks, how are the propensity of professional service firms to open foreign offices and the actual location patterns of such investments influenced by firm home location? For example, large US law firms that were founded in New York have often been at the forefront of innovations in the industry (Galanter & Palay, 1993; Smigel, 1969). Hence, these firms may have a head start in the trend towards entering foreign markets in the last three plus decades. Additionally, professional service firms in

different home locations may grow with their local clients and make geographic expansion decisions to serve their existing client base. Furthermore, economic geography studies (Krugman, 1991; Nachum, 2000) have highlighted the phenomenon of agglomeration of firms in the same industry in specific locations. As a result, the foreign investment patterns of professional service firms may be partially dependent upon the location advantages that are important to industries that are prevalent in their home locations. For example, firms from Texas may be more likely to enter foreign oil producing regions and markets, because their local domestic clients are more likely to enter these locations.

Finally, the third question asks, how does the use of a more business-like management model in professional service firms influence their propensity to open offices in foreign markets? In a traditional partnership model, practicing partners make decisions and split their time between billing hours and management. More recently, an alternative model has emerged, where firms are increasingly hiring professional managers, centralizing decision making powers, and focusing on firm-wide strategies and measures of performance. As a result, with this more “businesslike” approach, the key performance variables used by decision makers may change. Hence, with this new governance structure, in addition to the ability to better serve existing clients in their foreign locations, international diversification has the added benefits of potentially improving firm-wide performance and stability.

In order to address these questions and to make a substantive contribution to existing literature, this chapter is organized into several sections. First, a review of selected literature is used to describe relevant theories and offer specific hypotheses.

Second, a description of the specific empirical context of this analysis, large US law firms, is offered. Next, a methodology section describes how data was collected, how key variables were operationalized, and how analyses were conducted. Fourth, a findings section presents the models used to test hypotheses and discusses results. And finally, a conclusions and discussion section summarizes arguments and findings, and also looks at theoretical implications and potential future research directions.

2.2 LITERATURE & HYPOTHESES

2.2.1 FDI Theory and Services

One type of foreign direct investment (FDI) seeks to establish international operations (Hymer, 1976). This form of investment seeks to gain management control over a foreign operation and may be made to take advantage of certain skills and abilities. In this chapter, the degree of international diversification, or extent of FDI to establish international operations, is the key outcome of interest.

A number of researchers have noted that after the Second World War (WWII), FDI became more prevalent as it entered a period of significant growth (Buckley & Casson, 1976; Dunning, 1979). In particular, these authors rightfully singled out the importance of FDI in manufacturing and especially focused on FDI flows from the US (Dunning, 1979; Kindleberger, 1969). Given its growth at the time, FDI in manufacturing was a particularly urgent phenomenon and topic of study. Additionally, the theories which were born out of this post WWII era have offered a rich set of ideas and concepts that help to explain investment patterns and motives (Buckley & Casson, 1976; Dunning,

1979; Hymer, 1976; Vernon, 1966), and the process of internationalization (Aharoni, 1966; Johanson & Vahlne, 1977).

Even as research began to bear fruitful offerings in the area of FDI theory, the importance of service industries in developed countries was growing. As an example, in the context of the US, the percentage of the country's gross domestic product generated by services has been steadily rising for decades. On the other hand, the percentage of America's GDP generated through manufacturing has been steadily decreasing (UNCTAD, 2004). As a result, America, like other developed countries, and even developing countries, has become more dependent upon services as a source of growth.

Additionally, as service industries became more important to the domestic environments of developed nations, they also began to play an increasingly important role in international business. Again, as an example in the US context, receipts from cross-border trade and operations in service industries grew by a factor of more than six from 1986 to 2007, and payments increased by a factor of more than five in the same time period (Koncz-Bruner & Flatness, 2009).

Today, the international exchange of services is important to both developed and developing nations (UNCTAD, 2004), as illustrated by the robust growth in the export of technology services by countries such as India. Furthermore, beyond cross-border exchanges, services are also becoming an important source of FDI flows. This trend is illustrated in the context of Japan's major general trading companies, or "Sogo Shosha." In 2002, the five largest Sogo Shosha combined had approximately 1,500 foreign affiliates, and of the 139 foreign affiliates established between 2000 and 2002, 82% were

in services (UNCTAD, 2004 pg.133-134), which represents a shift from the past focus on manufacturing.

This increased importance of services as a source of FDI, coupled with the historical anchoring of FDI theory and investigation in manufacturing industries, means that it became important to evaluate the utility of existing FDI theories in the context of service industries. To begin with, past research has asked why the internationalization of professional services might be different from manufacturing. Services, by definition, involve simultaneous production and consumption (Capar & Kotabe, 2003; Krishna, 1987), leading to interesting questions on ability to trade across borders. For example, computer and data processing services produced in India can be simultaneously consumed by clients in Tokyo or New York with little inconvenience; however, litigation in an international court may require counsel to be present at a specific location or venue. This issue of “location-boundedness” versus “tradability” (Boddewyn, Halbrich, & Perry, 1986; Krishna, 1987) has important implications for investment decisions, beyond the considerations confronting manufacturing firms. In addition, the increased importance of intangibles in services is an interesting difference.

Additionally, some authors have offered that professional service firms are often more harshly restricted by host governments (Capar & Kotabe, 2003; Li & Guisinger, 1992; White, 2001 pg.18-21). The issue of restrictions on professional service industries by host governments is highlighted by Gaedeke’s (1973) research, in which 26.7% of US-based international law firms surveyed reported that overcoming national hostilities was a major problem encountered in internationalization, and 60% reported host government laws and industry rules as major problems. The fact that professional service

firms are knowledge based may also play into this issue, where host-governments restrict the entrance of foreign workers. In her history of the New York law firm, Coudert Brothers, Veenswijk (1994) notes that opening an office in Indonesia required no fewer than three government signatures for foreign personnel and up to 37 signatures to bring a piece of office equipment into the country.

In many cases, professional service firms are entering foreign markets to follow existing clients or pursue potential clients from the same home country (Gaedeke, 1973; Hitt, Bierman, & Collins, 2007; Li & Guisinger, 1992; Miller & Parkhe, 1998). This may change the dynamic of host-market uncertainty (Krishna, 1987) and could potentially change the nature of host-government restrictiveness. On the other hand, if a professional service firm is entering a foreign market as a means to access new local clients, Capar and Kotabe (2003) suggest that the nature of professional services may require even greater levels of local adaptation than would be required in other sectors.

Although, this is not an exhaustive list of the reasons why there is the potential for differences in the internationalization of professional services versus manufacturing firms, it does highlight some of the key points mentioned in existing literature.

Furthermore, it is important to note that researchers have already applied existing FDI theory to service industries and incorporated the unique characteristics of the service sector (Boddewyn, et al., 1986; Contractor, Kundu, & Hsu, 2003; Erramilli, 1991; Krishna, 1987; Li & Guisinger, 1992).

2.2.2 Firm Status and Internationalization

The Resource-Based View (RBV) of the firm offers that firms with valuable strategic resources can create barriers which allow them to maintain an advantage relative to competitors (Wernerfelt, 1984). In order to be a source of sustained competitive advantage, these resources should be intangible, valuable, rare and difficult or impossible to substitute (Barney, 1991). Additionally, some of these assets cannot be purchased or traded, and they must be developed internally (Barney, 1986; Dierickx & Cool, 1989).

One such asset that could potentially influence a firm's propensity towards internationalization is the firm's domestic status. Intangible assets such as the information that consumers already have about a firm, brand name, and prestige can be a powerful source of competitive advantage (Itami & Roehl, 1987). Additionally, a firm's status may play a role in overcoming client uncertainty about quality (Podolny, 2005 pg.38). This is important in the context of the current research because client uncertainty about a firm's abilities in foreign markets represents a transaction cost, and this market imperfection can lead to the internalization of operations abroad (Boddewyn et al., 1986; Casson, 1982). However, if a firm's positive reputation or status reduces or eliminates client uncertainty, the firm does not face the same market imperfection and may be less likely to internalize operations abroad. This concept leads to the following hypothesis.

Hypothesis 1: Firms which are more prestigious will exhibit a lower propensity towards internationalization.

2.2.3 Firm Home Location and Internationalization

The regional or home-city location of professional service firms may also influence the propensity towards international diversification. For example, large law firms in New

York have often been at the forefront of developments in the industry (Hoffman, 1973). For example, the firm Cravath, Swaine and Moore pioneered the use of a model where associates who do not get promoted to partner must leave the firm, and the firm Davis, Polk and Wardell pioneered the use of permanent salaried positions for associates that did not make partner (Sherer & Lee, 2002). Both of these firms are headquartered in New York and new trends, such as non-equity partner positions, often originate in New York (Galanter & Palay, 1993; Smigel, 1969). Similarly, many of the early trends among management consulting firms were instituted by firms from Chicago and Boston. As an example, as early as 1953, the Chicago firm McKinsey and Company began to consider expansion into the European market to serve American foreign subsidiaries and local firms (McKenna, 2006 pg.172). Hence, one could expect that firms in particular locations, such as firms in New York for the legal industry, have a head start in innovations or changes and may have a greater presence abroad (Hitt, Bierman, Uhlenbruck, & Shimizu, 2006). Consistent with this idea, the second hypothesis in this study seeks to corroborate past expectations and findings, and is as follows.

Hypothesis 2: Firms headquartered in trend-setting markets, such as New York for the legal industry, will exhibit a higher propensity towards internationalization.

Beyond simply affecting the propensity of a firm to become more internationally diversified, the home city, or region, of a firm may also influence the types of foreign markets the firm decides to operate in. Specifically, one reason firms open foreign offices is to better serve their existing clients (Hitt et al., 2007; Smigel, 1969 pg.360-361;

Stevens, 1981 pg.39; Stevens, 1985 pg.20; White, 2001 pg.13). Additionally, firms often grow with a client base that has roots in their home-city. For example, the Atlanta firm King and Spalding grew with, and opened offices in new locations at the request of their home-town client, Coca-cola (Driver, 2004). In the same way, the Houston firm Vinson and Elkins has consistently made decisions on geographic expansion based upon the business of its home-town clients in the oil industry (Hyman, 1998 pg.460 & 484), and the same is true of another Houston firm, Baker and Botts (Lipartito & Pratt, 1991). Additionally, accounting firms have expanded overseas in an attempt to serve existing clients, as these clients often want to use the same accounting firms across all of their international operations (Stevens, 1981 pg.69-73; Stevens 1985 pg.20; White, 2001 pg.13). As a result, professional service firms might be more apt to establish offices in foreign markets that are attractive to firms in dominant industries in their home cities or regions.

Past research in the area of economic geography offers some insights into why firms' multinational clients may select specific geographic locations with a high concentration of other firms in the same industry (Krugman, 1991). The economic geography perspective focuses on actors in economic space and often highlights the intersections of "place, space, and scale" (Coe, Kelly & Yeung, 2007 pg.223-253). When those actors are multinational enterprises, competing across an international field is not effortless and requires careful spatial configuration and organization of functions and activities to compete and survive. The spatial configuration of such organizations may focus on places that allow them to plug into networks of other organizations and alliances. These places, or clusters, can allow for economies of agglomeration, where

multiple organizations in the same industry or sector occupy a dense space and attract more customers or even support industries. In particular, with a higher concentration of firms in the same industry, there may be opportunities to leverage complementary know-how, activities, and abilities as a collective (Nachum, 2000). Additionally, this agglomeration of economies can be connected to the location advantages of a specific geographic location (Arthur, 1989; Nachum, 2000), such as low labor costs and the costs of available transportation (Chen, 1996). For example, comparatively lower labor costs have made China an attractive location for technology manufacturers, and the natural occurrence of large oil reserves has made the Middle East into a key location for the oil industry.

This line of thought leads to the idea that location patterns for FDI of professional service firms can be framed with reference to their home cities or regions, and the dominant industries of local clients in those home locations. For example, because of the abundance of local home-location clients in the banking and investment industries, firms with their roots in New York will be more likely to open foreign offices in the world's financial capitals, such as Frankfurt, Hong Kong, London, and Tokyo. Similarly, Texas firms will be more likely to open offices in oil-rich regions, and California firms will be more likely to open offices in centers of technology development and manufacturing. Following this idea, the next set of hypotheses is offered.

Hypothesis 3a: Firms headquartered in New York will maintain more offices in the world's financial capitals.

Hypothesis 3b: Firms headquartered in Texas will maintain more offices in foreign markets and regions that are known for oil production.

Hypothesis 3c: Firms headquartered in California will maintain more offices in foreign markets where high tech manufacturers are prevalent.

2.2.4 Internationalization and Business Model

For organizations, the decision to establish a presence abroad can be viewed as a function of the interaction between the characteristics of the firm and the characteristics of decision makers (Reid, 1981). A number of commentators have noted a change in governance mode from a traditional professional partnership model to a more businesslike model (Cooper et al., 1996; Galanter & Palay, 1993; Hitt et al., 2007; Pinnington & Morris, 2003).

As firms are changing, the locus of control and decision making becomes more centralized and focuses on organization-wide strategies, organization-wide efficiency, and identification of new markets (Aquila & Marcus, 2004 pg.171-172; Cooper et al., 1996). This requires partners to shift from being actively practicing managers, to firm leaders who reduce their personal billing hours and devote their energy to the strategic management of the firm as a whole (Freeman, 2001; McPherson, 2000). In particular, these partners may focus on the appropriate alignment of activities, people, and processes (McPherson, 2000). As a result, in addition to the net income of each partner, or profits per partner (PPP), overall gross revenue and net profit also become valid measures of performance for decision makers in these firms.

Some authors (Cooper et al., 1996) describe the transformation from the law practice business model to the more businesslike corporate model as a transformation from a Professional Partnership (P2) to a Managerial Professional Business (MPB). The

MPB model often involves the introduction of human resources and marketing management roles, which are not prevalent in the P2 model (Cooper et al., 1996; Curriden, 2001b). Under the MPB model the system changes to one where partners are compensated based upon their perceived contribution to the firm. Aquila and Marcus (2004 pg.9) describe a parallel shift from a traditional partnership model to a more business-like model in accounting firms and professional service firms in other industries. These authors note that as accounting firms have grown over the years, the sheer number of internal complexities make it imperative to move towards a professional management model.

Under the P2 model, firms also open and operate foreign offices. The common explanation for this growth is that professional service firms must expand into new geographic areas to better serve their existing corporate clients as they become more geographically diversified (Driver, 2004; Grenier, 2007; Hitt et al., 2007; Hyman, 1998; Langill, 1992; Lipartito & Pratt, 1991; Smigel, 1969 pg.360-361; Stevens, 1985 pg.19-21; Veenswijk, 1994 pg.63; Winston & Strawn, 2004). For example, in 1963, the Chicago law firm, Winston and Strawn, established their first foreign office in Paris in order to better represent one of their key clients, Beatrice Foods (Winston & Strawn, 2004). Similarly, in 2003, King and Spalding opened an office in London to facilitate the needs of clients' European operations (Driver, 2004), and Vinson and Elkins opened an office in Moscow in the early 1990's to better represent clients in the oil industry (Hyman, 1998). In addition, firms in other professional services industries, such as accounting firms, also expanded across borders to better serve clients as they become

increasingly multinational (Aquila & Marcus, 2004 pg21; Stevens 1981, pg.39; Stevens, 1985 pg.19-21).

Alternatively, under the MPB model, decision makers may be even more motivated to expand their firms by opening offices in foreign markets. These firms have a more centralized view that focuses on organization-wide strategies, organization-wide efficiency, and identification of new markets (Aquila & Marcus, 2004 pg.230; Cooper et al., 1996), and like P2 firms, one benefit of geographic diversification is the ability to better serve existing clients. However, from the MPB perspective, international diversification also potentially offers opportunities to tap new markets, increase earnings stability, and improve firm-level measures of performance such as gross revenues and net profits. It is suggested that this more long-term and strategic view of geographic expansion is a consequence of the “new profit-driven reality” of professional service organizations such as law firms (Zeughauser, 2001). Hence, the benefits of international diversification, beyond the ability to better serve existing clients, leads to the following hypothesis.

Hypothesis 4: The use of a MPB model in firms is positively related to the propensity toward international diversification.

2.3 METHODOLOGY

2.3.1 Empirical Context: Large US Law Firms

While the theoretical arguments in this chapter are being generalized to professional service firms, it is necessary to select an appropriate empirical context to test the previously developed hypotheses. Large US law firms offer an appropriate empirical

context to test these hypotheses because of the importance of prestige and status in the industry, and the importance of close ties and long relationships with home-town or home-region clients and industries.

The tradition of the multi-lawyer firm and the partner system can be traced back to the pre-Civil War days of the United States (Hazard & Dondi, 2004). Smigel (1969) notes that these firms, even large firms, are not allowed to incorporate, and partnership agreements are the formal aspects of law firm structures. The guiding logic behind this restriction is to avoid conflicts of interest and protect clients.

In the years following the US Civil War, law partnerships remained relatively small. Then, in the late 1880's Paul Cravath, a partner in the New York law firm Cravath, Swaine and Moore, instituted the "up-or-out" model (Sherer & Lee, 2002). Under this model, firms hired newly minted lawyers directly out of university and offered them work as associates, with the prospect of making partner after a number of years, but not the guarantee of making partner (Galanter & Palay, 1993). Under the Cravath model, an associate who fails to make partner must leave the firm. This development in the structure of law firms allows less experienced associates to be managed by more experienced partners who have a greater vested interest in the firm and who are better equipped to deal with the complex relational work required to manage legal teams (Hitt, Bierman, Shimizu, & Kocchar, 2001).

Having associates allocated to the cases of partners not only allows firms to train, and observe associates in order to make promotion decisions, but it also offers the opportunity to leverage the firm's work force to increase the profits of partners (Galanter & Palay, 1993; Sherer, 1995). As US law firms grew larger through the adoption of Paul

Cravath's model, there was also the restriction that those associates that did not get promoted to partner were required to leave the firm, meaning that substantial growth also meant growth in the number of equity partners. This use of profits per partner as the basis of performance was formalized by David Maister in his "law practice business model" which uses net income per partner as the key dependent performance variable (Ward, 1991).

More recently, a number of developments have lead law firms to question the wisdom of this traditional law firm model, and in particular the up-or-out system (Sherer & Lee, 2002). As US corporations have grown over the last 50 plus years, there has been a proliferation of in-house legal departments to deal with routine legal issues (Caplan, 1993 pg.70-73; Galanter & Palay, 1993). Simultaneously, the work of law firms has become more specialized as the requirements of corporate clients have become more complex and their need for general legal support has been redirected to in-house counsel (Caplan, 1993 pg.70-73; Galanter & Palay, 1993; Hyman, 1998 pg.149). As a result of these developments, large law firms must now compete against the very corporations that they serve for an increasingly specialized and scarce pool of legal talent leaving elite universities with law degrees (Hitt, Bierman, & Collins, 2007; Sherer & Lee, 2002). In addition, corporate clients have become less dependent upon specific law firms for legal counsel and have become increasingly nomadic in their allocation of work, opting to select firms based upon current needs and firm specializations (Caplan, 1993 pg.70-73).

Within this more competitive legal landscape, there has been a growing trend towards professional management in large law firms and a more traditional corporate model of operation and performance (Cooper, Hinings, Greenwood, Brown, 1996;

Galanter & Palay, 1993; Hitt et al., 2007; Pinnington & Morris, 2003). In particular, this drive towards professional management, coupled with a more pronounced focus on overall firm performance and competition for talent has resulted in a proliferation in two-tiered partner systems with permanent salaried positions for associates who do not get promoted to equity-partner positions (Curriden, 2001a). As a result, growth does not necessarily mean that there is consistency in the number of lawyers employed for each equity partner, a ratio referred to as law firm leverage. It follows that as firms have grown in recent years, they have also become more leveraged as the ratio of total lawyers to partners continues to rise (Galanter & Palay, 1993). Additionally, this shift in the legal industry has led to many firms hiring MBAs and CPAs as upper management (Hitt et al., 2007). It is also worth noting that this trend towards a new structure has been viewed negatively by some, who suggest that the industry has descended from an “honorable profession,” to something more “businesslike” (Hitt et al., 2007).

Along with growth in the overall number of lawyers in large US law firms, there has also been parallel growth in their international operations. The earliest US law firm to open an international office was the now defunct New York firm Coudert Brothers, with their Paris office opening in the 1880's (Veenswijk, 1994). However, at the turn of the century, in 1900, Coudert Brothers was still the only US firm to have an international office and the practice of opening overseas locations did not become common place until the 1960's (Smigel, 1969). The driving force behind opening these international offices was to better serve domestic US clients by following them abroad (Gaedeke, 1973). However, the number of firms with foreign offices, and the rate of overall international expansion, remained relatively low until the 1980's, when the rate of international

expansion began to quickly accelerate (Galanter & Palay, 1993). While these firms have often entered foreign markets to better serve existing domestic clients, US (and UK) law firms also have the advantage of language (Caplan, 1993 pg. 286). More specifically, English is one of the main languages of international business and the legal documents used in many international business transactions are in English, even if the parties in the transactions are not from English speaking countries.

2.3.2 Data

Data for this analysis were collected from a number of different sources and combined to create a unique longitudinal database including observations over 25 years, from 1984 through 2008. *American Lawyer's* annual ranking of America's 100 largest law firms by gross revenues was used to collect data on firm performance and size. This annual ranking was first published in 1985 and lists firm information from the previous year. Next, firm websites, published histories, articles, and timelines were consulted to gather data on the founding dates of firms. Finally, in order to build an accurate yearly representation of each firm's geographic locations that includes divested offices as well as offices in operation, a number of different sources were used. Specifically, published firm histories were consulted along with firm websites, the yearly *American Bar Reference Handbook*, and *Chamber's USA* to derive an accurate yearly list of each firm's domestic and international office locations. These yearly lists were further confirmed and checked through LexisNexis searches, searches of past issues of the *American Lawyer*, *Of Counsel*, and the *National Law Journal*. Additionally, in some cases, where firm documents and letters were available on official letterhead in specific years, the office

locations listed on the letterhead were compared to the list of office locations for that firm in the corresponding year. And finally, the *National Law Journal's* annual list of *Who Represents Corporate America* was used to identify the clients of firms and calculate levels of practice concentration based upon the industries served. As a result, the final sample included an unbalanced panel with 155 different US law firms and 2,418 firm-year observations.

2.3.3 Dependent Variables

For Hypotheses 1, 2 and 4, the level of internationalization was of interest. This dependent variable was operationalized in two ways. First, the total number of foreign offices that a firm operated in was used. This variable captures how extensively a firm has pursued foreign operations. Second, the ratio of a firm's foreign offices to its total offices was used. This variable represents foreign operations as an overall portion of a firm's structure. Unfortunately, data was not available on the number of employees at each foreign office, so while these measures represent the breadth of a law firm's international operations, they do not necessarily capture the depth of international operations through the commitment of human capital.

In order to test Hypotheses 3a, 3b, and 3c, three different count variables were used. First, to represent a firm's presence in oil producing countries or regions, the total number of countries the firm operates in among the Organization of Petroleum Exporting Countries (OPEC), Russia, Kazakhstan, Bahrain, Azerbaijan, and Egypt was used. Egypt was included because of its close proximity to oil producing nations. Second, to represent a firm's presence in the banking centers of the world, the total number of cities a firm

operated in among Tokyo, Frankfurt, Hong Kong, and London was used. However, for the sample used to test the relationship between a firm's home location and a presence in banking centers, the sample only included the years from 1988 through 2007, because prior to this time period, access to Tokyo and the Japanese market was more tightly restricted. Finally, to represent a presence in markets where high-tech manufactures produce, the total number of offices in the People's Republic of China was used. However, the sample including the total number of offices in China was limited to 1992 through 2007, because prior to this time period, foreign law firms were largely barred from operating in mainland China.

2.3.4 Independent Variables

The MPB model can be associated with a more centralized approach to decision making and overall management, and an increase in the number of permanent salaried associate positions, as a result, this analysis expects that firms more actively employing the MPB model will be more leveraged, or have more lawyers per equity partner. Hence, as a proxy for use of the MPB model, law firm *leverage* is used. This independent variable is the ratio of total lawyers to equity partners and Hypothesis 4 predicts a positive relationship between this variable and internationalization. Next, to test Hypotheses 2, 3a, 3b, and 3c, dummy variables were created to represent a firm's home location being either *New York*, *Texas*, or *California*.

Operationalizing law firm prestige or status is a challenge given the subjective nature of such assessments. As a result, a dummy variable was created for law firms commonly referred to as "*white shoe*" law firms, which are prestigious firms that

traditionally recruit graduates from top schools. To test the construct validity of this variable, firm prestige scores were used from the *Vault prestige rankings* in 2007, the last year in the sample. These scores come from the *Vault Career Intelligence* website and publishing company, which asks associates to rate their peer firms from 1 to 10, based upon perceived prestige or status, with higher ratings indicating higher perceived prestige or status. The mean prestige rating for white shoe firms in the ranking is 6.9, while the mean score for all other firms is 5.8, and a *t*-test suggests that the means of the two groups are significantly different ($p < 0.001$). As a result, this analysis uses a dummy variable representing firms commonly referred to as white shoe law firms to operationalize more prestigious or higher status firms. Interestingly, we might also think of this categorization as a distinction between firms handling different types of transactions, with white shoe firms handling more transactions in bread-and-butter industries such as investment banking. The white shoe law firms in this sample included Arnold and Porter; Cadwalader, Wickersham and Taft; Cravath, Swaine & Moore; Chadbourne and Parke; Covington and Burling; Davis, Polk and Wardell; Devoise and Plimpton; Dewey and LeBoeuf; Goodwin Proctor; Hogan and Hartson; Hughes, Hubbard and Reed; Milbank, Tweed, Hadley and McCloy; Ropes and Gray; Shearman and Sterling; Simpson, Thatcher and Bartlett; Sullivan and Cromwell; White and Case; Willkie, Farr and Gallagher; and Wilmer, Cutler, Pickering, Hale and Dorr.

2.3.5 Control Variables

One firm-level factor that may contribute to the propensity to open and maintain foreign offices is the *size* of a law firm (Hitt et al., 2006). Potentially, as firms become larger,

they have more resources to dedicate to international expansion and they may begin to seek new markets to continue to facilitate their growth. Hence, the natural log of the total number of lawyers that a law firm had each year was incorporated. The log transformation of the total number of lawyers was used to adjust for a skewed distribution in this variable. Similarly, the *age* of a law firm may contribute to its propensity towards international diversification, as a law firm gains more experience and grows with its clients who may expand into international markets. Hence, the natural log of the number of years since a firm was founded was included as a control variable and the log transformation was used because of a skewed distribution. Additionally, once firms do gain knowledge abroad through *experience*, this may increase resource commitments to opening foreign offices (Johanson & Vahlne, 1977), leading to the expectation that the total amount of time elapsed since a firm's initial foray into international markets may be positively related to that firm's level of international diversification. Hence, the natural log of the total number of years since a firm's first expansion into a foreign market plus one was used as a control variable. Finally, the degree to which a firm's practice is concentrated on certain industries may influence the degree of internationalization, as well as specific patterns of internationalization. To control for this factor, available issues of the annual list *Who Represents Corporate America*, from 1986 through 2007, were used. The top two SIC codes represented by each firm were identified and the ratio of firms represented by these two SIC codes to the total number of firms represented between 1986 and 2007 was used as a measure of *practice concentration*.

2.3.6 Analysis

The correlation matrix presented in Table 1 shows that there are relatively large correlations between firm leverage and firm size, and between the dummy variables for white shoe firms and firms headquartered in New York. In order to assess the threat of multicollinearity, Variance Inflation Factors (VIFs) were calculated using each of the independent variables. As a result, the largest VIF calculated was 2.00 for firm size, and all other VIFs came out at less than 2. These results suggest that multicollinearity is not a serious threat in this analysis.

Next, the Breusch and Pagan (1980) version of a Lagrange Multiplier (LM) test was used to test the presence of individual effects. The results of the LM tests suggest significant effects. Furthermore, Hausman tests (Hausman, 1978) suggest that a random effects approach may be more appropriate than a fixed effects approach in the models that use the ratio of foreign offices to total offices as the dependent variable. Therefore, for testing Hypotheses 1, 2 and 4, a Feasible Generalized Least Squares types (FGLS) approach was taken. The advantage of using FGLS in this case is that FGLS offers robust results to heteroskedasticity and serial correlation within multiple observations of the same law firm.

To identify the most appropriate way to model dependent variables that use count data, over-dispersion tests (Wetherill & Brown, 1991) were used and the results were significant for the total number of foreign offices, oil countries, banking cities, and Chinese cities operated in. Hence, negative binomial distribution models were used instead of Poisson distribution models where appropriate. To assess the appropriateness of pooling data for the models used to test Hypotheses 3a, 3b, and 3c, a standard F-test

was employed to compare the models using the full sample and models estimated for each law firm based upon the equation. As a result, none of these F tests was significant, leading to the conclusion that pooling the data in these models is appropriate.

Table 1: Pearson Correlation Matrix (1)

	Mean	SD	1	2	3	4	5	6	7	8	9	10	11
<i>Dependent variables:</i>													
1. Foreign Offices	2.89	5.74	-										
2. Foreign to Total Offices	0.24	0.25	0.65	-									
<i>Independent variables:</i>													
3. ln.Size	6.02	0.53	0.56	0.40	-								
4. ln.Age	4.37	0.53	0.04	0.17	0.20	-							
5. ln.Experience	1.68	1.47	0.52	0.83	0.46	0.22	-						
6. Leverage	3.44	1.11	0.24	0.28	0.41	0.07	0.24	-					
7. White Shoe	0.13	0.34	0.11	0.35	-0.04	0.29	0.22	0.20	-				
8. Practice concentration	0.64	0.18	-0.20	-0.21	-0.38	-0.13	-0.24	-0.03	0.01	-			
9. New York	0.31	0.46	0.13	0.44	-0.13	0.03	0.33	0.25	0.52	0.09	-		
10. Texas	0.06	0.24	-0.05	-0.04	0.05	-0.04	0.02	-0.15	-0.10	0.11	-0.17	-	
11. California	0.14	0.35	-0.05	-0.12	0.03	-0.01	-0.04	-0.02	-0.16	0.02	-0.28	-0.10	-
12. Domestic Offices	5.59	3.53	0.16	-0.12	0.55	0.06	0.11	0.11	-0.29	-0.21	-0.29	-0.03	0.14

n = 2,418

Correlations of 0.04 and above are significant (p<0.05)

2.4 RESULTS

To test Hypotheses 1, 2, and 4, Table 2 presents two models that look at different internationalization outcome variables. In models 1 and 2, which are negative binomial models that take group specific heteroskedasticity and serial correlation within multiple observations of the same law firm into account, the total number of foreign offices that a firm operates is the dependent variable.

As expected, the control variables for firm size, firm age, and total years of international experience do result in positive estimates that are significant ($p < 0.001$). However, in models 3 and 4, which use the ratio of foreign offices to total offices, only international experience is positive and significant ($p < 0.001$) and surprisingly, firm age results in negative and significant coefficients ($p < 0.001$). These findings suggest that older firms may be more likely to operate a greater number of foreign offices, but they are less likely to maintain structures with larger ratios of foreign to total offices. Practice concentration also results in different findings depending upon which dependent variable is used. In models 1 and 2, this control variable results in positive and significant coefficients ($p < 0.001$ and $p < 0.001$ respectively), but in models 3 and 4 this variable results in negative and significant coefficients ($p < 0.05$ and $p < 0.001$ respectively).

In addition, negative and significant estimates in model 2 and 4 suggest that firms in the sample from Texas are likely to operate fewer foreign offices and are likely to maintain a smaller portion of their overall operation abroad ($p < 0.01$). Similarly, the dummy variable for California firms results in a negative and significant coefficient in model 4, which uses the ratio of foreign to total offices as the dependent variable.

Table 2: The Propensity to Go Abroad

	Y=Total Host Countries		Y=Foreign to Total Offices	
	Negative Binomial		Random Effects	
	1	2	3	4
Constant	-6.277*** (0.352)	-7.009*** (0.376)	0.167*** (0.029)	0.137*** (0.031)
<i>Firm Factors:</i>				
ln.Size	0.274*** (0.001)	0.115*** (0.001)	-0.001 (0.001)	-0.004* (0.002)
ln.Age	0.399*** (0.071)	0.501*** (0.074)	-0.033*** (0.006)	-0.023*** (0.006)
ln.Experience	1.319*** (0.027)	1.155*** (0.023)	0.132*** (0.002)	0.127*** (0.002)
Leverage	0.015 (0.027)	0.475*** (0.026)	0.001 (0.001)	0.002 (0.002)
Practice Concentration	0.548** (0.206)	0.681*** (0.205)	-0.036* (0.015)	-0.051*** (0.014)
White Shoe	0.269** (0.083)	0.065 (0.095)	0.145*** (0.008)	0.095*** (0.010)
<i>Home:</i>				
New York		0.056 (0.068)		0.061*** (0.009)
Texas		-0.510** (0.169)		-0.029** (0.010)
California		-0.083 (0.095)		-0.031*** (0.007)
Log-Likelihood	-4,061	-4,137		
χ^2	11,411	11,559		
n=2,418				

Notes: 1) *, **, *** significant at 0.05, 0.01, and 0.001, respectively, 2) Standard errors in parentheses

These findings suggest that in this sample, relative to firms from other locations, Texas and California firms have a lower propensity towards internationalization.

The first set of hypotheses in this analysis looks at how a law firm's status, or prestige, may influence the propensity to open and maintain offices in foreign markets. First, in model 1, the estimate for white shoe law firms is positive and significant ($p < 0.01$), but in model 2, this coefficient is no longer significant. This finding suggests that when internationalization is viewed as the total number of foreign offices abroad, status may not be an important factor in this sample. However, in models 3 and 4 the coefficient for this variable is positive and significant ($p < 0.001$), suggesting that prestigious firms in this sample tend to have a larger ratio of foreign offices to domestic offices. An explanation for this apparent inconsistency is that white shoe firms tend to have fewer domestic offices, as suggested by the negative correlation between white shoe firms and the total number of domestic offices in the correlation matrix in Table 1. Hence, the prestigious firms in this sample appear to have fewer foreign offices, but the overall portion of their offices located abroad is greater. For instance, the white-shoe New York law firm, Cravath, Swaine and Moore, has only one domestic office in New York and one international office in London, resulting in a ratio of foreign to total offices of 0.50, which is greater than the sample mean of 0.24. As a result, when internationalization is viewed in terms of expansion abroad as a proportion of a firm's overall operations or offices, these findings suggest that prestigious firms will show a greater propensity towards internationalization. This finding is counter to the expectation of Hypothesis 1.

The second hypothesis in this analysis predicts that firms from New York would be more likely to internationalize their operations. In model 2, the estimate for the New York dummy variable in this analysis does not result in a significant coefficient, suggesting that firms from New York are no more or less likely to operate a greater number of foreign offices than firms in the sample from other states. However, in model 4 the estimate for this dummy variable is positive and significant ($p < 0.001$), suggesting that firms from New York are more likely to have a geographic structure with a higher portion of its offices located in foreign markets. In the same way as the above findings on firm status, the correlation matrix in table 1 may offer some insight into the differences between models 2 and 4. Specifically, there is a negative correlation between the variable for New York and the total number of domestic offices. As a result, firms may have fewer foreign offices, but the foreign offices that they do operate represent a greater portion of their total offices. Hence, when internationalization is viewed as the proportion of a firm's total offices or operations represented by foreign offices, these results offer support for Hypothesis 2.

With regards to the fourth hypothesis in this analysis, the estimate for firm leverage is significant and positive in model 2 ($p < 0.001$), but the estimate for this variable is not significant in any of the other models. This finding suggests that when firms use the MPB model, as estimated by firm leverage, they are more likely to have a greater number of foreign offices. However, given that this coefficient is not significant in model 1, caution should be taken in interpretation. Additionally, given the overall lack of evidence for a relationship between leverage and the measures of internationalization Hypothesis 4 is not strongly supported in this analysis.

In Table 3, pooled negative binomial regressions are used to test Hypotheses 3a, 3b and 3c. Likelihood ratio tests were also used to compare fits between those models listed in table 3 and in all cases the inclusion of location dummies results in improvements. The results confirm that there are significant differences depending upon home location of law firms, as reported in these models. First in model 6, which uses the number of major financial markets or banking centers that firms maintained offices in as the dependent variable, the coefficient for firms from New York is positive and significant ($p < 0.001$). In addition, the coefficient for firms from California was also positive and significant ($p < 0.001$), while the estimate for firms from Texas is not significant. While Hypothesis 3a specifically focused on firms from New York, it is not surprising that the estimate for California firms is also positive and significant in model 6, given that there is also a large number of banks and financial institutions located in California (e.g., Wells Fargo, Charles Schwab, and VISA). Hence, this finding is consistent with the theoretical argument behind this set of hypotheses and supports Hypothesis 3a.

In model 8, which uses the number of offices in countries that produce oil as the dependent variable, the estimate for firms from Texas is positive and significant as expected ($p < 0.001$). This findings offers support for Hypothesis 3b. In addition, the coefficient for firms from California is negative and significant ($p < 0.001$). These findings suggest that California firms have a lower propensity to establish offices in the markets used to represent oil-rich markets or regions in this analysis.

Table 3: Home Region and Patterns of Internationalization

	Banking (1988-2007)		Oil (1984-2007)		China Offices (1992-2007)	
	5	6	7	8	9	10
Constant	-3.555*** (0.228)	-4.031*** (0.229)	-15.025*** (0.995)	-13.930*** (0.959)	-11.503*** (0.568)	-12.634*** (0.568)
<i>Firm Factors:</i>						
Size	0.321*** (0.004)	0.395*** (0.004)	1.660*** (0.099)	1.533*** (0.099)	0.951*** (0.012)	1.103*** (0.011)
Age	0.012 (0.047)	0.041 (0.049)	-0.330** (0.122)	-0.186 (0.118)	0.184 (0.117)	0.268* (0.122)
Experience	0.685*** (0.021)	0.650*** (0.022)	0.986*** (0.060)	0.876*** (0.062)	0.729*** (0.055)	0.663*** (0.056)
Leverage	0.029*** (0.004)	0.003 (0.004)	-0.004 (0.002)	0.001 (0.009)	0.155*** (0.012)	0.115*** (0.011)
Practice Concentration	-360** (0.135)	-0.465** (0.147)	3.066*** (0.373)	2.031*** (0.393)	1.253*** (0.308)	1.050** (0.341)
White Shoe	0.195*** (0.052)	0.083 (0.066)	0.015 (0.147)	-0.227 (0.170)	-0.491*** (0.144)	-0.731*** (0.172)
<i>Home:</i>						
New York		0.287*** (0.063)		0.275 (0.151)		0.515*** (0.139)
Texas		-0.109 (0.107)		0.835*** (0.174)		0.088 (0.233)
California		0.333*** (0.063)		-0.992*** (0.225)		0.436** (0.141)
Log-Likelihood	-2,089	-2,068	-1,071	-1,037	-795	-787
χ^2	2,142	2,183	1,558	1,628	556	572
n	2,092	2,092	2,418	2,418	1,699	1,699

Notes: 1) *, **, *** significant at 0.05, 0.01, and 0.001, respectively, 2) Standard errors in parentheses, 3) all models are pooled negative binomial

Finally, in model 10, which uses the total number of mainland China offices as the dependent variable, the regression coefficient for firms from California is positive and significant as expected ($p < 0.001$). This finding offers support for Hypothesis 3c in this research. In addition, the coefficient for firms from New York is also positive and significant. Overall, the results in table 3 offer support for Hypotheses 3a, 3b and 3c and present some interesting patterns.

Another interesting finding from the models in table 3 is for the estimates on firms considered to be white shoe firms. In particular, the coefficient in model 10 is negative and significant ($p < 0.001$). This result implies that prestigious firms are less likely to enter the Chinese market. This finding leads to interesting questions on how status is related to industries served and markets entered, or how industries served is related to status.

2.5 DISCUSSION & CONCLUSIONS

This analysis considers a number of different factors that are hypothesized to influence the propensity of professional service firms to expand internationally. In particular, findings on the relationship between a firm's status and the ratio of foreign offices maintained to total offices offers interesting insights. Specifically, this analysis suggests that higher status is associated with an increased propensity towards internationalization. Similarly, Riahi-Belkaoui (2001, pg.42-54) also suggests that positive corporate reputations will be associated with greater levels of international diversification.

One explanation for this association is that the motivation for internalizing foreign operations in the face of client uncertainty may be strict quality control and improved

communications with clients (Boddewyn et al., 1986), and as prestigious law firms actively seek to manage their reputations, this motivation becomes even more pronounced. This is the same as firms attempting to protect and nurture their competencies so they do not diminish (Prahalad & Hamel, 1990). This motivation for opening international offices is echoed in Hyman's (1998 pg.460) history of the Houston law firm, Vinson and Elkins, where a managing partner is quoted as saying that firms should use local offices in foreign markets as a visible symbol of their commitments, and as a signal to clients that they understand local issues and can deal with the complexities of local deals. This statement is reflected in Hennart's (2001) suggestion that when interdependencies require a specific reputation, they may lend themselves to internalization across borders and the creation of a multinational enterprise. The idea that firms go abroad to protect their reputations by improving client communications and engaging in quality control is also consistent with the findings of Kotha, Rindova, and Rotheamel (2001), who found that a good reputation was positively related to the degree of internationalization of US internet firms. Hence, client uncertainty about a firm's abilities abroad represents a transaction cost and market imperfection that could encourage internalization (Boddewyn et al., 1986; Casson, 1982).

While these findings do not support Hypothesis 1 and the idea that prestigious high-status firms may be less likely to maintain a greater portion of their overall operations abroad as their status may help them to overcome client uncertainties about their abilities to serve in markets where they do not maintain offices, they do raise a question. More specifically, are there some cases in which Hypothesis 1 is supported? Given that there is likely to be at least some level of heterogeneity in the motives and

decision making processes of firms in this sample one might ask if there are cases when individual firms depart from the overall pattern of the sample. While the theoretical argument behind Hypothesis 1 offers an explanation why these firms would not have to open more foreign offices, there is also another purely speculative argument for why they would not want to. Specifically, some firms may see opening a large number of offices as a sort of “McDonaldization” of their practice, which could hurt their prestige. By replicating their practice through opening more foreign offices, these firms could reduce the uniqueness upon which their prestige and status is built. However, investigating this possibility will require further research, and in particular, research that poses this question directly to managing partners and uses a case study approach.

Next, this study considers the role of a firm’s home location as a factor that influences both the propensity towards internationalization, and the actual patterns of international expansion. In particular, support was found for the idea that firms from New York have a higher propensity towards entering foreign markets, where there is agglomeration of companies in the banking or financial sector. Additionally, firms from Texas show a strong propensity towards markets in oil producing regions, but not necessarily other markets. And finally, California firms were less likely to enter oil producing markets but more likely to open more offices in China. The explanation for these findings is that firms are following their local home-location clients abroad, so they enter markets where there is an agglomeration of firms in the dominant industries of their home locations. Firms in New York may have access to a less concentrated set of local industries leading them to invest in different types of makes, such as banking markets and

China, whereas firms in Texas may have access to a more concentrated set of industries leading to a preference for a specific type of foreign market.

These results reinforce work on economic geography (e.g. Krugman, 1991; Nachum, 2000) in the context of professional services, and offer that where there is an agglomeration of firms in an industry, there may be a secondary buildup of professional service firms who specialize in serving that industry. Additionally, these findings on home location and foreign expansion, and expansion patterns, may be viewed through resource dependence and new institutional theory perspectives. From the resource dependence perspective, the behavior of firms is dependent upon transactions or exchanges with outside actors or organizations (Pfeffer & Salancik, 1978). Over the course of their relationships with particular clients and industries, firms become embedded and dependent upon transactions with external organizations, so they adjust to maintain relationships and continue exchanges. In this case, the adjustments are following clients abroad. From the new institutional perspective, internationalization can be viewed as a coercive isomorphic process (DiMaggio & Powell, 1983; Meyer & Rowan, 1977), by which structural changes occur because without them there is the threat of losing clients, even for “knowledge intensive” firms that have stronger firm-specific resources. Additionally, entering specific markets may be a result of mimetic isomorphic pressures, where the actions of other home-location firms are a factor (DiMaggio & Powell, 1983; Knickerbocker, 1973). Again, the findings in this analysis lead to questions on the role of firm status in moderating these relationships.

Finally, this analysis considers the role of a firm’s business model in determining the level of internationalization. In particular, support was not found for the argument

that firms using an MPB model would be more likely to enter more foreign markets. This could potentially be a result of how the use of the MPB model is operationalized. It could be that firms are becoming more leveraged, regardless of which management approach they use. If this is the case, future research may wish to use another approach to operationalizing this variable. An alternative explanation may be that the MPB is not a significant factor. However, this question will certainly benefit from further consideration and research.

The implications of this research should have broad appeal to researchers in a number of different areas. In particular, researchers in International Business and FDI theory may find this analysis relevant because of the findings on status and home location, as well as the unique professional services context. Status as a factor that is negatively related to the propensity to enter a larger number of foreign markets is promising as a firm-level factor. Further, findings on home-location suggest that host-country location advantages (Dunning, 1998) may be viewed with reference to “home town” complementarities. Additionally, the potential to relate this research to resources dependency theory and new institutional theory may be of interest to organizational theory researchers, and findings on FDI patterns may be of interest to economic geography researchers. Finally, organizations such as the United Nations Conference on Trade and Development (UNCTAD) may find this research relevant to their work, and host country governments may be interested in the idea that where there is an agglomeration of firms in an industry, this may also involve professional service firms that focus on the industry.

Of course, no research is perfect and this study is no exception. Further research can improve on this analysis by further exploring the effects of the MPB model through alternative approaches to operationalization. Additionally, these findings should be replicated in additional professional services industries, and future analyses could benefit from including a larger number of home-locations.

CHAPTER 3: Exploitive and explorative international diversification, and firm performance

3.1 INTRODUCTION

In the context of professional service firms, the objective of this chapter is to assess the performance implications of international geographic diversification patterns as they are related to firm-specific resources and motives. More specifically, this chapter asks three questions. How do investment patterns that suggest an attempt to exploit existing firm resources relate to firm performance? How do exploratory investment patterns that suggest an attempt to develop new firm resources relate to firm performance? And, how does the simultaneous use of investment patterns that suggest attempts to exploit existing firm resources and exploratory investment patterns that suggest attempts to develop new resources relate to firm performance? Additionally, this analysis integrates research on multinationality and performance (Hennart, 2007; Sullivan, 1994; Thomas & Eden, 2004; Verbeke & Goerzen, 2009), the resource-based perspective (Barney, 1986; Penrose, 1959; Peteraf, 1993; Wernerfelt, 1984), and organizational learning (Denrell & March, 2001; March, 1991) and ambidexterity (Duncan, 1976; He & Wong, 2004; O'Reilly & Tushman, 2004) to offer an approach that treats international diversification as a diverse set of resource commitments with differing motivations.

Existing research has often viewed international geographic diversification, or multinationality, as a collection of identical resource commitments (Li & Goerzen, 2009),

while simultaneously drawing upon internalization and resource-based perspectives (Hennart, 2007). However, firm resources and motives are not necessarily homogeneous and can vary greatly by industry and individual firm. As a result, it becomes difficult to offer a theoretically valid argument for a general link between international geographic diversification and performance (Hennart, 2007; Verbeke, Li, & Goerzen, 2009). Hence, this research is important because it looks at international geographic diversification in terms of firm-specific resources and motives, offering an approach that can result in context and firm-specific arguments for an international geographic diversification and performance link that are theoretically sound.

This chapter argues that the foreign offices of professional service firms can be viewed as attempts to either exploit ownership advantages anchored in existing firm resources, or attempts to develop new firm resources. Existing relationships with domestic clients and knowledge embedded in human capital are firm resources and foreign offices in markets where domestic clients are likely to maintain a presence are viewed as attempts to exploit these resources, resulting in superior and efficient performance. Alternatively, foreign offices in markets where domestic clients are less likely to maintain a presence are viewed as attempts to explore new possibilities and develop new firm resources, such as new client relationships and experiential knowledge, resulting in superior and effective performance. Additionally, the simultaneous pursuit of geographic diversification strategies that maintain foreign offices inside and outside of markets where domestic clients are likely to maintain a presence is argued to have a synergistic interaction effect that results in superior performance. This prediction is consistent with recent research that has found that organizational ambidexterity can result

in positive outcomes beyond the additive effects of both exploitation and exploration (Cao, Gedajlovic, & Zhang, 2009; He & Wong, 2004; Schilling, Vidal, Polyhart, & Marangoni, 2003).

In order to achieve the objectives stated above, and to test the arguments put forth here, this chapter is divided into several different sections. First, relevant literature on international diversification and performance, the resource-based view of the firm (RBV), and organizational ambidexterity is reviewed and a conceptual model along with hypotheses is presented. Second, a methodology section describes how data is collected and analyzed as well as how key variables are operationalized. Third, a findings section highlights empirical results. And finally, a discussion and conclusions section summarizes key findings and highlights the contributions of this research.

3.2 LITERATURE & HYPOTHESES

3.2.1 International Diversification and Performance

Past literature has used a number of different labels to refer to the international geographic diversification of organizations. These have included multinationality (Grant, 1987; Hennart, 2007; Thomas & Eden, 2004; Verbeke & Goerzen, 2009), geographic scope (Goerzen & Beamish, 2003), diversification (Grant, Jammine, & Thomas, 1988), international diversification (Hitt, Hoskisson, & Kim, 1997; Tallman & Li, 1996), global diversification (Kim, Hwang, & Burgers, 1989), degree of internationalization (Sullivan, 1994), and more. In the current analysis, the terms international diversification or international geographic diversification will be used.

It is not surprising that so many different labels have been applied to the concept of international diversification, given the myriad different approaches to operationalization that have been used by various researchers (Sullivan, 1994). For example, research often used the ratio of an organization's foreign sales to their total sales as a measure of how international they are (Grant, Jammine, & Thomas, 1988; Rugman, 1976; Siddharthan & Lall, 1982). In addition, researchers have used composite measures that incorporate different factors in international diversification (Contractor, Kundu, Hsu, 2003; Sullivan, 1994), measures of geographic scope, or asset dispersion (Goerzen & Beamish, 2003; Thomas & Eden, 2004), and the intensity or depth of investments in markets (Thomas & Eden, 2004), among other measures.

Research that has incorporated measures of international diversification has tended to fall within two categories, studies considering the antecedents to internationalization and studies considering the consequences of international geographic diversification (Hitt, Tihanyi, Miller, & Connelly, 2006). The current chapter deals with the latter and it focuses specifically on the performance consequences of international diversification.

In his critique of the literature stream on the relationship between multinationality and performance in multinational enterprises, Hennart (2007) offers that researchers have tended to rely on three separate theoretical arguments to predict a positive association. First, some research has suggested that international diversification allows firms to exploit economies of scale (Bartlett & Ghoshal, 1989; Contractor, Kundu, & Hsu, 2003; Grant, 1987; Hitt, Hoskisson, & Kim, 1997; Hout, Porter, & Rudden, 1982; Kogut, 1983; Levitt, 1983). Second, researchers have offered that international diversification may

allow MNEs to secure flexible access to resources (Kim, Hwang, & Burgers, 1993; Kogut, 1983; Lu & Beamish, 2001). And finally, the third major theoretical argument used to link international diversification and performance in past research is a learning argument (Contractor, Kundu, & Hsu, 2003; Ghoshal, 1987; Hitt, Hoskisson, & Kim, 1997; Kogut, 1983; Ronstadt & Krammer, 1982).

In terms of actual empirical results, some researchers have found a positive relationship between international diversification and financial performance (Grant, 1987; Grant, Jammine, & Thomas, 1988; Han, Lee, & Suk, 1998; Kim, Hwang, & Burgers, 1989). For example, Grant (1987) found a positive association between the ratio of foreign sales to total sales and a number of economic performance outcome variables. However, some researchers have also failed to find a relationship in either direction (Collins, 1990; Gomez-Mejia & Palich, 1997), or have only found very weak inconclusive correlations (Tallman & Li, 1996). For instance, Collins (1990) did not find any relationship between the ratio of foreign sales to total sales and a number of performance outcomes in the context of Fortune 500 companies operating in developing or developed countries. Additionally, some authors have even identified a negative correlation between international diversification and financial performance (Michel & Shaked, 1986; Shaked, 1986; Siddharthan & Lall, 1982). One such analysis, conducted early in the literature stream by Siddharthan and Lall (1982), found a negative association between multinationality and sales revenue in large US manufacturing firms in the 1970's.

Some researchers have suggested that as firms become increasingly internationalized and operate in more foreign markets, costs also increase (Gomes &

Ramaswamy, 1999; Geringer, Beamish, & daCosta, 1989; Daniels & Bracker, 1989; Hitt, Hoskisson, & Kim, 1997). These cost increases result from factors such as increases in coordination and control costs, cultural differences that change the context of administrative systems, and differences in human resources. As a result, these authors argue that international diversification will result in performance increases up to a point, and then as costs increase, performance will decrease and the benefits of international diversification will vanish.

Consistent with the idea that there is a nonlinear relationship between international diversification and performance, Contractor, Kundu and Hsu (2003) include ratios of foreign to total employees and ratios of foreign subsidiaries to total subsidiaries in a composite index of international diversification and find an sigmoid-shaped relationship. The authors explain these findings by suggesting that at early stages of international diversification, firms are hindered by a liability of foreignness, but then overcome these limitations as further international diversification allows them to exploit this expansion. However, as these firms become highly internationalized and dispersed, the costs of coordinating and operating in distant markets limit or decrease performance. In contrast, Tallman and Li (1996) offer that a curvilinear relationship between international geographic diversification and performance, or any relationship at all, may only exist in certain contexts. Furthermore, one reason for divergent findings in past research may be the multitude of different operational definitions of international geographic diversity (Sullivan, 1994; Thomas & Eden, 2004).

In an attempt to clarify the relationship between international diversification and performance in light of findings suggesting a curvilinear association, Goerzen and

Beamish (2003) offer that international geographic diversification, or what they refer to as geographic scope, may contain additional latent subcomponents. Specifically, geographic dispersion can be viewed as encompassing both international asset dispersion and country environment diversity. As mentioned above, authors have suggested that highly internationalized firms may experience a decrease in performance because operating in increasingly dissimilar markets means experiencing dissimilar transactions and an increased likelihood of mistakes and inefficiencies (Contractor, Kundu, & Hsu, 2003; Gomes & Ramaswamy, 1999). However, Goerzen and Beamish (2003) separate the ideas of dispersion of assets and differences in markets operated in, suggesting that a high level of international asset dispersion by itself will not necessarily result in decreases in economic performance. This is because if firms elect to operate in a relatively homogenous or similar set of international environments, transactions are more likely to be similar and there is not necessarily a risk of mistakes and inefficiencies. However, when country-environment diversity alone is considered, if multinationals underestimate the challenges posed by operating across a diverse set of market contexts, their performance may suffer. Consistent with this idea, Goerzen and Beamish (2003) do find a positive relationship between international asset dispersion and firm performance. Similarly, Thomas and Eden (2004) find evidence that breadth of international diversification, or asset dispersion, is positively associated with firm performance.

Finally, some researchers have suggested that there may not be a theoretical rationale that offers a general link between international diversification and performance. For example, Hennart (2007) offers that researchers have focused on the ability to exploit scale economies to predict a positive link, but this argument fails to recognize that

exploiting scale economies does not necessarily require international expansion. Similarly, he notes that arguments suggesting that international diversification results in better and more flexible access to resources ignore the potential for efficient access to resources on markets. Furthermore, Hennart suggests that learning arguments used to predict a positive link between international diversification and performance do not fully appreciate the possibility that knowledge can be accessed without owning a foreign subsidiary. However, Hennart is also careful to highlight that these are reasons why there may not be a general theoretical rationale for the international diversification-performance link, but in specific contexts, exploiting scale economies, accessing resources, and learning may be valid for predicting a positive link.

Additionally, Verbeke, Li, and Goerzen (2009) suggest that research has often viewed international diversification as the accumulation of homogenous resource commitments. However, these resource commitments are not necessarily homogenous and are more likely to reflect a diverse set of strategic motives. As a result, these authors offer that much of the research has tended to “examine the forest, but not the trees.” This view seems to offer some insights into why research on the international diversification-performance link has resulted in a range of different findings. Additionally, this view suggests that in empirical studies, theoretical discussions and operational definitions related to an international diversification-performance link need to take the resources and strategic motives of the specific setting into account.

As a result of this brief review of the literature stream on the relationship between international geographic diversification and performance, it becomes clear that empirical results will vary depending upon operational definitions of both international geographic

diversification and performance (Thomas & Eden, 2004). As a result, recent literature in this area has focused on how international geographic diversification is conceptualized and operationalized (Ramaswamy, Kroeck, & Renforth, 1996; Sullivan, 1994; Sullivan, 1996; Verbeke, Li, & Goerzen, 2009). Furthermore, some authors have argued that in a broad and generalizable sense, an international diversification and performance relationship lacks theoretical validity (Hennart, 2007; Verbeke, Li, & Goerzen, 2009). More specifically, much of the literature in this area depends upon internalization and resource-based perspectives, but the resources and motives of firms vary greatly depending upon context and setting (Verbeke, Li, & Goerzen, 2009). Hence, to offer a theoretically valid argument for a relationship between international diversification and performance, context specific resources and motives need to be considered.

3.2.2 Resources and Professional Service Firms

As noted above, a review of past literature suggests that there are problems with finding a sound general theory on the international diversification-performance link given the importance of setting-specific motives and resources. However, the conclusions of Hennart (2007) and Verbeke, Li, and Goerzen (2009) do suggest that when theories and operational definitions take context-specific factors into account, it is possible to generate theoretically sound predictions.

This chapter focuses on the link between international diversification and performance in the context of professional service firms. In order to offer a valid theory for an international diversification-performance link, the general resource profiles of professional service firms need to be considered (Hymer, 1976; Wernerfelt, 1984). In his article outlining a resource-based view (RBV) of the firm, Wernerfelt (1984) suggested

that if firms can develop resources that lead to high profits, and create resource positions which are difficult for competitors to achieve, they can enjoy competitive advantages. This sentiment is echoed by Prahalad and Hamel (1990) and Peteraf (1993), who identify superior resources as a cornerstone of competitive advantage. While some of these resources can be acquired on markets, other resources cannot, and must be internally developed and accumulated (Barney, 1986; Dierickx & Cool, 1989). Additionally, for resources to result in sustainable competitive advantages, they must be difficult for competitors to imitate (Barney, 1991) and may need to be causally ambiguous (Reed & DeFillippi, 1990). Identifying the resources that lead to competitive advantages in professional service firms may lead to insights on motives for international expansion and highlight foundations for the appropriate theoretical links between international diversification and performance. In addition, this exercise will aid in constructing an appropriate operational definition for international geographic diversification.

In professional service firms, human resources and the knowledge and capabilities that they carry are a precious resource (Hitt, Bierman, Shimizu, & Kochhar, 2001; Hitt, Bierman, Uhlenbruck, & Shimizu, 2006; Prahalad & Hamel, 1990; Sherer, 1995). An example of the importance of securing and retaining a steady stream of quality trained employees can be seen in the case of the New York law firm, Davis, Polk, and Wardell, which created permanent salaries positions for associates who failed to get promoted to partner (Sherer & Lee, 2002). Under the previous system, associates who did not get promoted were forced out of the firm and this represented a possible loss of a valuable and scarce resource. Additionally, the importance of attracting the right attorneys can be seen in the enduring preference of large US law firms for graduates of prestigious schools

(Smigel, 1960; Galanter & Palay, 1991 pg.110-111). More recently, competition for these resources has resulted in increased hiring of legal graduates in demographic groups that have been historically overlooked as potential associates (Abel, 1989 pg.90; Chambliss, 1997). And finally, as illustrated through comments made by a former managing partner of a large New York law firm, one motive for internationalization is to attract and retain quality candidates from top schools with the opportunity to gain international experience and develop new skills (Veenswijk, 1994 pg. 305).

Given that the human resources are a key resource for professional service firms, it is possible to see how this resource base may translate into motives for international expansion. First, having advantageous experience with and knowledge of their home-country legal systems and administrative and cultural norms represents an advantage (Caplan, 1993 pg.286; Veenswijk, 1994 pg.372) when clients include the foreign offices of corporations from the same country as a professional service firm, or foreign corporations doing business with the professional service firm's home country. Furthermore, experiential learning from working in offices abroad represents a potential opportunity to continuously develop and improve the human capital within a firm and further create resource positions that competitors would find difficult to follow. As a result, we can expect that advantageously utilizing, retaining, and further developing human resources are motives for the internationalization of professional service firms.

In addition to human capital, the reputations of firms also represent a potential resource (Riahi-Belkaoui, 2001). In particular, prestigious firms have enjoyed a number of benefits including the ability to attract competitive human capital (Phillips & Zuckerman, 2001; Smigel, 1960; Stevens, 1981 pg.171-195), and lucrative long-term

relationships with prestigious clients in bread-and-butter industries (Abel, 1989; Heinz, Nelson, Laumann, & Michelson, 1998; Phillips & Zuckerman, 2001; Pinnington & Gray, 2007; Smigel, 1969 pg. 186; Stevens, 1981 pg.39-41 & 66). As a result, a prestigious status may translate into advantages and greater revenues (Phillips & Zuckerman, 2001). Consistent with the idea of status as an advantage that can be used abroad, Pinnington and Gray (2007), have noted that some US and UK firms in the legal industry have been very successful at using their elite statuses to gain advantages over competitors in foreign markets. Part of this is that the reputations of these law firms are known to their home-region clients who have operations abroad.

Finally, professional service firms have often grown with their existing clients and these relationships are valuable resources. More specifically, firms often expand geographically and offer increasingly complex services as their clients become more geographically diversified (Driver, 2004; Grenier, 2007; Hitt, Bierman, & Collins, 2007; Hitt, Bierman, Uhlenbruck, Shimizu, 2006; Hyman, 1998 pg.152; Langill, 1992 pg.185; McKenna, 2006 pg.166; Stevens, 1985; Winston & Strawn, 2004 pg.216-217) and develop increasingly sophisticated and specific needs (Driver, 2004; Galanter & Palay, 1993 pg.30; Langill, 1992 pg.37; Smigel, 1969 pg.150-151; Winston & Strawn, 2004 pg.216-217). This trend reflects the need to better serve clients in an attempt to maintain long relationships that form a large portion of the revenues generated by firms (Aquila & Marcus, 2004 pg.28-29; Galanter & Palay, 1993 pg.21; Hoffman, 1973 pg.43-45; Liparito & Pratt, 1991 pg.15; Stevens, 1981 & 1985). As a result, as businesses expand their operations beyond the borders of their home country, professional service firms which offer them services have followed (Gaedeke, 1973; McKenna, 2006 pg.166).

Furthermore, previously existing relationships with domestic corporations operating abroad may offer advantages over host-country competitors, depending upon the nature of required services. These relationships represent a key resource for firms, and as a result, maintenance and expansion of these relationships, as well as the potential to enter into new relationships, should represent a motive for international geographic diversification.

3.2.3 Exploitation, Exploration, and Ambidexterity

A number of researchers have noted that firms can increase and refine existing knowledge stocks, or they can pursue new knowledge (March, 1991; Miles & Snow, 1978; Penrose, 1959; Wernerfelt, 1984). The refinement of existing knowledge has been called “exploitation,” and is associated with increasing efficiency and pursuing perfection in what is known (Auh & Menguc, 2005; Carmeli & Halevi, 2009; March, 1991). When decisions are viewed as a sequential selection between alternatives, the continuous and repetitious selection of the same choice is exploitation and this allows firms to continuously improve upon their ability to execute that choice efficiently (Brenner & Tushman, 2003; Holmqvist, 2004; March, 1991). This means that even though firms are essentially making the same choice, they do make incremental adaptive changes in order to learn from their experiences with that choice, and this is closely aligned with single-loop learning (Auh & Menguc, 2005). This behavior can be seen in organizations fitting the description of “defenders” in Miles and Snows’ (1978) typology. More specifically, defenders defend and further pursue existing markets, have stable processes and structures, do not seek new opportunities in new areas, initiate cautious incremental change, and focus on efficiency (Miles & Snow, 1978).

While exploitive activities may result in efficiency gains and a mastery of what is known, they can also result in negative outcomes. In particular, a preoccupation with exploitation at the detriment of activities which may offer innovations and competitive abilities for the future can have a negative impact in the long term (Brenner & Tushman, 2003; Denrell & March, 2001; March, 1991). In essence, a single minded strategy of exploitation might be the organizational version of the old adage, “live today, and die tomorrow.”

Alternatively, the term “exploration” describes the pursuit of the unknown, or a search for new ideas, innovations, and approaches (Birkinshaw & Gibson, 2004; Carmeli & Halevi, 2009; Denrell & March, 2001; Gupta, Smith, & Shalley, 2006; Holmqvist, 2004; March, 1991). If exploitive activities are closely aligned with single-loop and production-oriented learning, explorative activities are closely aligned with innovative, generative, and double-loop learning (Auh & Menguc, 2005). In the case of exploration, firms are not continuously making the same selection of options. Rather, exploration is non-incremental and characterized by searching for new opportunities and new domains (Auh & Menguc, 2005; Brenner & Tushman, 2003; March, 1991) and as a result, the benefits of exploration are learning from experimentation or exploration and innovation (March, 1991). This behavior can be seen in organizations fitting the description of “prospectors” in Miles and Snows’ (1978) typology. Prospectors tend to closely monitor environmental trends and conditions, continuously search for fresh opportunities, experiment with new areas, and focus less on efficiency (Miles & Snow, 1978).

In a similar way to exploitation, a single-minded pursuit of exploration can have negative consequences (March, 1991; Volberda & Lewin, 2003; Gibson & Birkinshaw,

2004). Specifically, if firms are constantly seeking new opportunities and innovations, they may not reproduce and refine their innovations and discoveries enough to optimize the potential benefits (March, 1991). The fault in this “make small, sell small” mentality is highlighted in a quote borrowed from an ancient Greek tragedian, which says “you must not look into the future at the cost of our immediate needs” (Euripides, C.435 BC line 482).

So far this discussion suggests that both exploitation and exploration can have attractive consequences. In particular, exploitation of existing capabilities allows organizations to increase efficiency and reduce uncertainty, and exploring new possibilities may help to secure future capabilities and avoid eventual decline into sub-optimal performance (Denrell & March, 2001; March, 1991). As a result, there are potential benefits to pursuing both exploration and exploitation. Additionally, much of the research suggests that exploration and exploitation can be pursued simultaneously (Birkinshaw & Gibson, 2004; Brenner & Tushman, 2003; Duncan, 1976; Jansen, Van den Bosch, & Volberda, 2006a; Luo & Rui, 2009; O’Reilly & Tushman, 2004), while fewer researchers wonder if these activities might take place at different times with exploration coming at periods of punctuated equilibrium (Gupta, Smith, & Shalley, 2006). Penrose (1959) touched upon the potential for both exploitation and exploration when she illustrated that a firm’s history with both integration and taking new paths matters in the cumulative growth of a firm’s collective knowledge. Similarly, Rubin (1973) offers that the experiences of firms constitute resources that can be used to both generate output and generate new experiences or resources. Additionally, Reed and DeFillippi (1990) suggest that superior causally ambiguous resources can result in competitive advantages, but

competition can result in the decay of these resource positions, so firms must reinvest in maintenance and the development of new resources. Wernerfelt (1984) sums this notion up nicely below.

“Strategy for a bigger firm involves striking a balance between the exploitation of existing resources and the development of new ones.”-pg.172

This idea that exploration and exploitation can be pursued simultaneously results in a further question. Specifically, what makes some organizations successful at balancing exploitation and exploration, while other organizations are less successful? Ito and Rose offer that in the Japanese context, creating spinoffs from promising new business units is one way to encourage innovation through structural separation, while simultaneously allowing for the transfer of resources (Ito & Rose, 1994; Ito, 1995). However, these authors are also careful to note that the use of informal and personal links in Japanese business makes this relationship between a spinoff and its genealogical parent possible, which is not necessarily the case in other national contexts. Using examples based on *USA Today* and *Ciba Vision*, O’Reilly and Tushman (2004) offer that companies that successfully exploit existing capabilities while exploring future possibilities often employ structurally independent business units. These authors argue that by separating units that exploit existing capabilities from units that explore new innovations to establish key capabilities for the future, firms can avoid cross-contamination, or the transfer of existing practices that may stifle innovation and out-of-the-box thinking. At the same time, companies which successfully use these structurally independent units weave them together at upper levels of management, allowing for

cross-fertilization, and the result is an “ambidextrous” organization (Brenner & Tushman, 2003; Duncan, 1976; O’Reilly & Tushman, 2004). Additionally, researchers have suggested that units characterized by centralization and formalization will be more effective in exploitation, while units characterized by informal connectedness will be more effective in exploration (Duncan, 1976; Jansen, Van den Bosch, & Volberda, 2006b).

Beyond structural separation of activities, it is also important to highlight the importance of contextual aspects of exploration and exploitation (Birkinshaw & Gibson, 2004; Carmeli & Halevi, 2009; Gibson & Birkinshaw, 2004). In their research, Birkinshaw and Gibson (2004) offer that successful organizations master both alignment and adaptability. Alignment refers to an explicit idea of where and how short-term value is efficiently created, and adaptability is the ability to see and act upon new opportunities (Birkinshaw & Gibson, 2004). Additionally, Andriopoulos and Lewis (2009) suggest that there are benefits to combining elements of structural and contextual approaches to exploitation-exploration. This dual pursuit of both exploration and exploitation can be seen in organizations fitting the description of “analyzers” in the Miles and Snow typology (1978). Analyzers have a foot in both worlds, as they are structurally separated into units pursuing exploitation and efficiency like defenders, and units looking for new opportunities and innovations like prospectors (Miles & Snow, 1978).

More recently, some researchers have looked at the simultaneous pursuit of both exploitation and exploration as having more than an additive effect (Cao, Gedajlovic, & Zhang, 2009; He & Wong, 2004; Schilling, Vidal, Polyhart, & Marangoni, 2003). For example, Cao, Gedajlovic, and Zhang (2009) viewed the simultaneous pursuit of

exploitation and exploration as being either an act of balancing two approaches, or combining two approaches. In particular, where organizations were not heavily constrained by the availability of resources, greater levels of both exploitation and exploration had a positive interaction effect. Similarly, He and Wong (2004) found that in a sample of 206 manufacturing firms, there was a positive interaction, beyond additive effects, between explorative and exploitative innovation strategies and their association with sales growth. Schilling, Vidal, Polyhart, and Marangoni (2003) came to a similar conclusion, noting that in their experiment, groups assigned to various related tasks tended to learn at greater rates than groups that repeated the same task, or groups that were assigned to various unrelated tasks. In commenting on the mutually enabling relationship between exploration and exploitation, Farjoun (2010) offered what he termed the “duality view,” offering that stability and change may be interdependent.

3.2.4 Conceptual Model and Hypotheses

So far, this chapter has reviewed literature streams related to the relationship between international diversification and performance, the resources of professional service firms, and exploitive and explorative activities. First, the review of literature on international diversification and performance has highlighted the need to identify the resources and motives of firms in particular settings, in order to come up with a theoretically valid argument for a link. Consistent with this idea, a brief review of the resource-based view and subsequent attempt to identify the general resource profiles of professional service firms suggests that human capital, reputation, and client relationships are key resources in professional service industries. Hence, any conceptualization of international

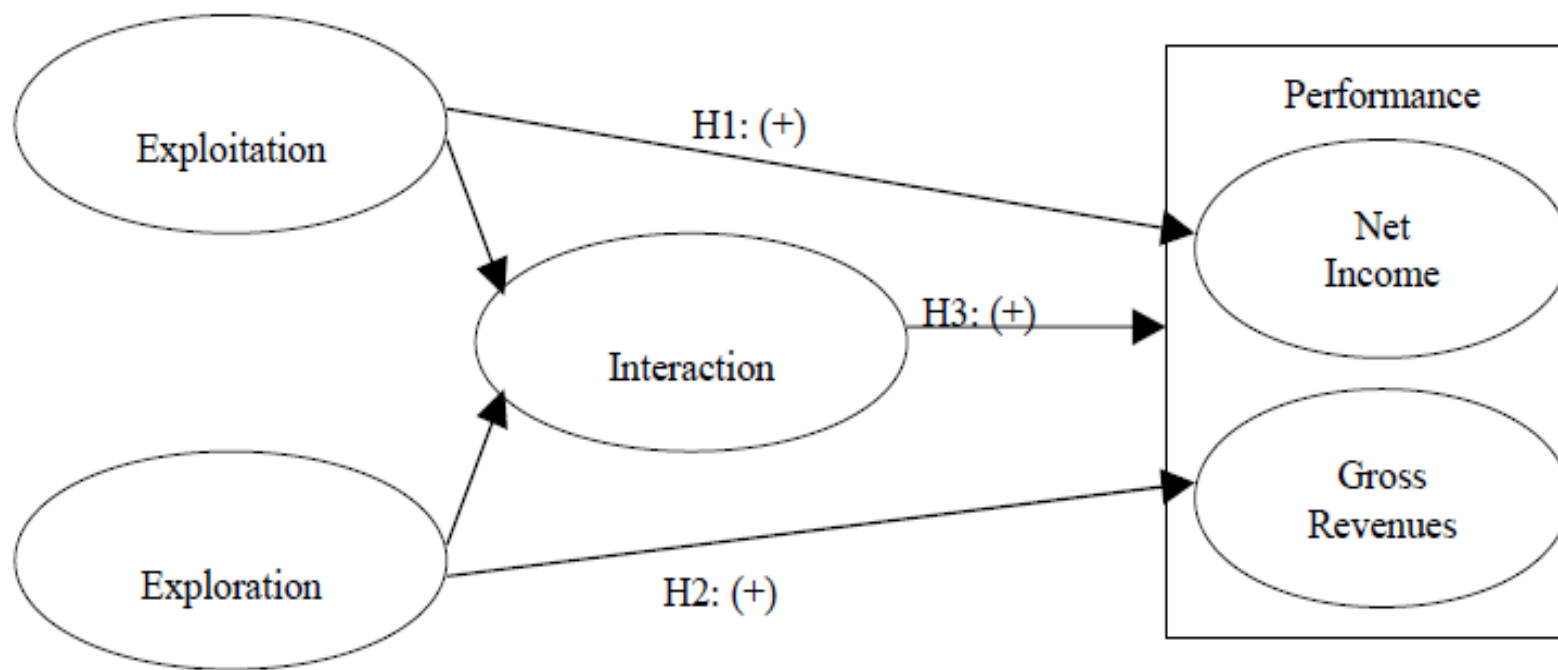
diversification in the context of professional service industries should take these resources into account as motives for international expansion.

The motives for international expansion could be to both utilize advantages afforded by these resource, and to further develop these resources to create resource positions that are difficult for competitors to match (Barney, 1991; Reed & DeFillippi, 1990; Wernerfelt, 1984). Following the above section on key resources in professional service firms, there was a brief review of literature on exploitive and explorative activities and learning and performance outcomes. These concepts offer a unique and well suited framework from which to view the international diversification-performance link in the context of professional service firms. Specifically, firms are motivated to go abroad by the potential to exploit their existing resources, or explore and develop new resources. As a result, it may be possible to view the international diversification-performance link in terms of spatial exploration-exploitation and performance. Consistent with this idea, in the context of innovation, Sidhu, Commandeur, and Volberda (2007) suggested that exploitation and exploration could be viewed as local or non-local searches that can occur across several dimensions, including geographic space. In this case, non-local geographic searches represent the pursuit of opportunities, knowledge embedded in localities, and experience in different geographic regions.

In the context of this research, existing client relationships, human capital, and existing reputation are likely to represent ownership advantages in markets where corporations from a firm's home region operate subsidiaries. This is because the employees within a firm are more likely to be familiar with the requirements and issues of companies from their home region, with whom they have long-term relationships, or

companies that operate in the same industries as long-term clients. As a result, offices located in foreign markets populated by companies from a professional service firm's dominant-home-region industry represent exploitive strategies that seek to repeat successes of the past and present. Additionally, because these foreign offices represent exploitive strategies, they utilize a learning mode consistent with efficient performance (Auh & Menguc, 2005), and are predicted to have a positive relationship with net income as illustrated in Figure 1.

Figure 1: Model and Hypotheses



As an example from the legal industry, in the 1980's, the New York law firm Skadden, Arps, Slate Meagher and Flom opened offices in Tokyo, London, and Hong Kong to utilize their knowledge, experience, and reputation in takeover work (Caplan, 1993; Veenswijk, 1994). In addition, the legal industry is full of examples of firms following their existing clients abroad. For example, the Houston firm, Vinson and Elkins, opened an office in Moscow in 1991 to better serve its domestic clients with subsidiaries in that location (Hyman, 1998 pg.484), and the Chicago firm Winston and Strawn opened an office in Paris in 1963 to better serve the interests of a key client, Beatrice Foods (Winston & Strawn, 2004 pg.128). Similarly, in the 1950's and 1960's, American management consulting firms began to aggressively enter Europe as their traditional domestic clients were opening large numbers of foreign subsidiaries in European markets (McKenna, 2006 pg.166 & 172) and accounting firms have targeted foreign markets for the same reason (Stevens, 1985 pg.ix & 20). This idea leads to the first hypothesis in this chapter.

Hypothesis 1: The number of offices that a firm opens in countries that are known for the industries of its domestic clients (exploitation) will be positively associated with higher levels of net income.

Alternatively, offices located in markets that are not traditionally populated by companies from a firm's home region, or companies that operate in the dominant industries in a firm's home region, represent exploratory strategies. In particular, these markets represent attempts to develop new client relationships, develop new human resource capabilities, and create a reputation in new markets. It follows that these

exploratory activities utilize a learning mode suited for effective performance (Auh & Menguc, 2005), and are predicted to have a positive relationship with performance.

For example, when Coudert Brothers opened an office in Hong Kong in 1985, their first permanent office in Asia, the firm was able to improve its resource position for all three of the key resources identified (Veenswijk, 1994). At the time, Coudert Brothers was one of the few large New York law firms that did not rely heavily upon banks as clients, but within the Hong Kong market the firm quickly attracted US multinational banks. In particular, the headquarters of these banks were uncomfortable with the idea of local Hong Kong firms, or British firms with a local presence, writing agreements involving millions of US dollars under Hong Kong or English law (Veenswijk, 1994 pg.360). As a result of the new relationships, Coudert Brothers did a lot of ship financing work, which involves negotiating and structuring loans, security, leases, contracts and other aspects of purchasing large ships and was a new practice area for the firm (Veenswijk, 1994 pg.361). In particular, the attorney charged with running this office had to quickly familiarize himself with the intricacies of ship financing work, eventually gaining a reputation for quality service and attracting local clients in addition to US clients in Hong Kong (Veenswijk, 1994 pg.360-361). Similarly, after their initial push into European markets, American management consulting firms began to target markets that would allow them to serve new European clients (McKenna, 2006). This idea leads to the second hypothesis in this chapter.

Hypothesis 2: The number of offices that a firm opens outside of countries that are known for the industries of its domestic clients (exploration) will be positively associated with higher levels of gross revenues.

Next, there is the potential for benefits when simultaneously maintaining offices located in markets that are, and are not, traditionally populated by companies from a firm's home region, or companies that operate in the dominant industries in a firm's home region. More specifically, exploitation activities offer short-term stability and income generation which can be used to finance new exploratory locations. At the same time, offices in new exploratory locations can lead to new capabilities, the development of positive reputations in new locations, and establishing new relationships with corporate clients. All of these new resource developments can be used to strengthen a firm's business in more traditional exploitive locations. This is illustrated by a quote from a senior partner at the Houston law firm, Vinson and Elkins, who notes that offices should "feed each other work" (Hyman, 1998 pg.460). This interaction between exploitive and explorative activities could potentially lead to positive performance outcomes beyond the additive effects of exploration and exploitation alone. This argument is also reflected in the previously reviewed literature that suggests a synergistic relationship between exploration and exploitation (Cao, Gedajlovic, & Zhang, 2009; He & Wong, 2004; Schilling, Vidal, Polyhart, & Marangoni, 2003). This idea leads to the following hypothesis.

Hypothesis 3: The interaction between the numbers of offices that a firm opens inside (exploitation) and outside (exploration) of countries known for the industries of its domestic clients will be positively associated with higher levels of performance.

3.3 METHODOLOGY

3.3.1 Data

Multiple sources were consulted to construct an unbalanced panel containing data on 155 different large US law firms from 1984 through 2008. In particular *American Lawyer's* yearly report on America's 100 highest grossing firms, *the AM Law 100*, provided data on firm size, performance, and the ratio of attorneys to partners. Additionally, the founding dates of firms were identified through firm websites and other published materials. In order to locate the foreign offices of each firm, published histories and timelines were consulted along with available yearly issues of the *American Bar Reference Handbook*, and *Chamber's USA*. The locations identified through these resources were further cross checked against published media articles, press releases, firm letterheads, and issues of the *National Law Journal*, *American Lawyer*, and *Of Counsel*. Finally, to identify which industries firms serve, the *National Law Journal's* annual listing, *Who Represents Corporate America*, was used. As a result, the sample used in this analysis contains 2,418 firm-year observations.

3.3.2 Dependent Variables

The key dependent variable of interest of this analysis is firm performance. More specifically, the reviewed literature in this study distinguishes between effective performance and efficient performance. *Gross Revenues* refers to overall revenues generated from operating a law firm, and can be linked to the earlier discussion on effective performance. This concept of performance is related to the entire amount

generated before subtracting any costs, and does not necessarily reflect a firm's ability to efficiently operate and reduce coordination costs and other expenses. To operationalize this dependent variable, gross revenues were used and these values were adjusted to 2008 price levels using consumer price index data (Bureau of Labor Statistics, 2010).

Following this adjustment, the natural log of the adjusted gross revenues was used. This was done for two reasons. First, the data on adjusted gross revenues was left skewed in this sample and taking the log transformation allowed for a more normal distribution.

And second, when all of the independent variables are also logarithms, the use of a log-transformed dependent variable makes it possible to interpret elasticity, or the percentage increase in the dependent variable given a one percent increase in an independent variable. Additionally, *Net Income* implies the ability to effectively employ and exploit resources to maximize the firm's income after expenses and can be linked to the earlier discussion on efficient performance. In an attempt to operationalize this idea of performance the net income of firms was used and again all values were adjusted to 2008 price levels (Bureau of Labor Statistics, 2010). The log transformation of this variable was also used to correct for a skewed distribution and to interpret elasticity.

3.3.3 Independent Variables

The first independent variable of interest is the number of *ln.exploitation offices*, or offices that a firm operates in markets that are known for the industries of its domestic clients. In order to operationalize this variable, the 1986 through 2007 versions of *Who Represents Corporate America*, were used. The listed corporate clients and their two-digit SIC codes were coded for each law firm. Next, the top two industries that each firm represented over the entire period of time were recorded. Following the identification of

each firm's top two industries, yearly data from the Bureau of Economic Analysis on foreign direct investment (FDI) flows from the US by industry was examined and the top destination countries were identified for each of the two-digit SIC codes identified over the time period of interest. This list of FDI destinations by SIC code was cross checked with the top two SIC codes and foreign office locations of each firm, and as a result, a yearly count of offices in markets known for the industries of each firms' domestic clients was derived. Next, the log transformation of this variable was used because the distribution of the data was skewed. To operationalize the second independent variable of interest, the number of exploitation offices was subtracted from the total number of foreign offices to get the number of *ln.exploration offices*, and again, the log transformation of this number was used.

3.3.4 Control Variables

In addition to the previously noted independent variables, a number of control variables are also included in this analysis. First, *ln.age* is the natural log of a firm's age in years. This control variable was included because older firms, with more experience, may have more refined operating capabilities (Petersen, Pedersen & Lyles, 2008). Alternatively, Petersen, Redersen, and Lyles (2008) also offer that older, more experienced, firms may have developed dated and ineffective practices that are difficult to change. Second, *ln.size* is operationalized as the natural log of the total number of lawyers that a firm employs. It is important to control for firm size given that this variable is likely to affect firm performance (Hitt, Hoskisson, & Kim, 1997; Tallman & Li, 1996). Third, *ln.leverage*, as it is used in this research, is the ratio of the total number of lawyers that a firm employs to the total number of equity partners. This control variable may be associated with firm

performance as higher ratios of lawyers to partners may be positively related to the efficient and effective use of human capital (Galanter & Palay, 1993; Sherer, 1995). In addition, the log transformation is used in this analysis, to interpret results in terms of elasticity. Fourth, *ln.experience* refers to experience with operating a foreign office or offices and this control variable is operationalized as the natural log of the total number of years since a firm opened its first foreign office. Specifically, as firms gain experiential knowledge of foreign operations, this knowledge may be translated into the ability to make accurate assessments on existing knowledge and knowledge gaps (Petersen, Pedersen & Lyles, 2008) and this may allow firms to operate more successfully abroad. Fifth, *New York* is a dummy variable used to represent a firm's status as being founded and headquartered in New York. This control variable was included because past researchers have noted that New York-based firms have often been at the cutting edge of innovations in the industry and have tended to outperform peers headquartered in other US cities (Galanter & Palay, 1993; Hitt, Bierman, Uhlenbruck, & Shimizu, 2006; Hoffman, 1973; Smigel, 1969). Finally, *ln.practice concentration* refers to the degree to which a firm's practice relies upon specific industries. The expectation is that firms with highly concentrated practices may be limited in their abilities to perform well, given a lack of opportunities to provide services across a potentially larger set of more diverse clients. This control variable was operationalized using the 1986 through 2007 versions of *Who Represents Corporate America*. Reported corporate clients and their two-digit SIC codes were coded for each law firm, and the total number of listings in the two most frequent two-digit SIC codes divided by the total number of listings. The resulting control variable is a ratio that reflects how heavily a firm's practice is concentrated in the top two

industries it serves, and this natural log of this variable was used so results could be interpreted in terms of elasticity.

3.3.5 Analysis

In order to identify the appropriate method to estimate the models in this analysis, a number of steps were taken. First, Lagrange Multiplier (Breusch & Pagan, 1980) tests were used to test the presence of individual effects and the results were consistently significant ($p < 0.05$). Additionally, for all of the models in this analysis, Hausman tests (Hausman, 1978) were used to compare fixed and random effects estimation approaches, and in all cases the tests were significant ($p < 0.05$), suggesting that random effects models are more appropriate. Following these diagnostic tests, a feasible generalized least squares (FGLS) method was used to estimate models. The advantage of using this approach is that FGLS models allow for heteroskedasticity and serial correlation within multiple yearly observations of individual law firms.

Table 4: Pearson Correlation Matrix (2)

Variable	Mean	Std. Dev.	1	2	3	4	5	6	7	8	9	10
<i>Dependent Variables:</i>												
1. ln.Net Income	18.37	0.70	-									
2. ln.Gross Revenue	19.39	0.66	0.95	-								
<i>Independent Variables:</i>												
3. ln.Age	4.37	0.53	0.15	0.19	-							
4. ln.Size	6.02	0.53	0.79	0.89	0.20	-						
5. ln.Leverage	1.19	0.28	0.39	0.54	0.09	0.47	-					
6. ln.Experience	1.68	1.47	0.49	0.51	0.23	0.46	0.29	-				
7. New York	0.31	0.46	0.12	0.09	0.03	-0.13	0.31	0.33	-			
8. ln.Practice Concentration	-0.49	0.27	-0.35	-0.34	-0.11	-0.38	-0.05	-0.23	0.10	-		
9. ln.Exploitation Offices (X1)	0.66	0.68	0.58	0.60	0.17	0.58	0.32	0.82	0.24	-0.25	-	
10. ln.Exploration Offices (X2)	0.49	0.72	0.46	0.53	0.12	0.57	0.32	0.62	0.22	-0.24	0.64	-
11. X1*X2	0.62	1.39	0.27	0.30	-0.05	0.39	0.19	0.19	0.06	-0.11	0.46	0.66
n= 2,418												

Correlations of 0.04 and above are significant (p<0.05)

To assess the threat of multicollinearity in this analysis, the correlation matrix in table 4 was examined and moderate to strong correlations were found between independent variables. As a follow up, variance inflation factors (VIFs) were calculated using ordinary least squares versions of the models. The largest VIF was 4.92 for experience, or the natural log of the number of years since a firm opened its first foreign office. While researchers have suggested a number of different maximum thresholds for VIFs (O'brien, 2007), there is not a clear consensus on an acceptable limit. However, O'brien (2007) notes that the most common thresholds used by researchers have been 10 and 4. The more conservative VIF threshold of 4 suggests that multicollinearity may be an issue in this analysis. As a result, some precautions were taken. First, each model in this analysis was estimated with the control variable for international experience and then the models were estimated without the control variable for international experience. This was done to see if the inclusion of the experience control variable changes results on the main effects and interaction term of interest. Second, the two key independent variables of interest were mean centered to reduce the risk of multicollinearity with the inclusion of an interaction term.

3.4 RESULTS

In total, eighteen separate models, presented in tables 5 and 6, were used in this analysis. To begin with, practice concentration resulted in consistently negative and significant estimates across all of the models in this analysis ($p < 0.001$). These results suggest that firms that rely upon fewer industries for a greater portion of their business may

experience relatively lower performance outcomes, which is consistent with expectation. In table 5 which includes models that use net income as the dependent variable, the estimates for firm age are positive, but in some cases are not significant. For example, in model 9, which is the full model, including the interaction term but not the control variable for experience, the coefficient for age is not significant. However, in table 6 which includes models that use gross revenues as the dependent variable, firm age results in consistently positive and significant estimates (at least at $p < 0.01$). Interestingly, these findings suggest that firm age is not related to the net income of large US law firms, but is positively related to gross revenues.

Additionally, in nearly all of the models in table 5, which use net income as the dependent variable, the dummy variable used to represent New York firms resulted in estimates that are not significant. However, in models 14 and 18 presented in table 6, which are the full models that include interaction effects and use gross revenues as the outcome variable, the estimates for New York are negative and significant (at least at $p < 0.05$). This finding suggests that being founded and headquartered in New York may be associated with having a relatively lower level of gross revenues, which is contrary to expectation. Another unexpected outcome was the complete lack of significance for estimates on firm size in all of the models estimated in this analysis. Additionally, contrary to expectation, estimates for leverage were consistently negative and significant in all of the full models. And finally, the control variable for experience, or the natural log of the number of years since a firm opened its first foreign office resulted in a variety of results that suggest instability. In models 1 and 10, which only include control variables, the estimates for experience are positive and significant ($p < 0.001$). However,

in models 5 and 14, which include control variables, hypothesized independent variables, and the interaction term, the estimates for experience are negative and significant ($p < 0.05$). While these results lend credence to the threat of multicollinearity, the main effects for the hypothesized independent variables and the interaction terms do not change direction and maintain the same levels of significance in models estimated with and without the experience control variable.

Hypothesis 1 predicts that exploitation offices, or offices in markets that are known for the industries of a firm's domestic clients, will be positively associated with net income. This prediction offers that foreign offices represent exploitive strategies, or decisions which utilize existing client relationships and workforce knowledge, and this mode is consistent with positive net income. In table 5, models 4 and 8, which include both of the key independent variables but no interaction term, the coefficients for exploitation offices are positive and significant ($p < 0.001$). The the coefficient in model 8, which does not include the control variable for firm experience, suggests a general relationship where a one percent increase in the number of exploitation offices will result in a 0.533 percent increase in net income. Additionally, the coefficients for exploitation offices remain positive and significant in models 5 ($p < 0.001$) and 9 ($p < 0.001$), which include the interaction term. Using model 9, which is the full model without the control variable for experience, the coefficient for exploitation offices suggests a conditional relationship where a one percent increase in the number of exploitation offices will result in a 0.531 percent increase in net income when the number of exploration offices equals the sample mean. Overall, these findings offer support for Hypothesis 1. Interestingly, in table 6 the coefficient for exploitation offices also remains positive and significant in

models 13 and 17 ($p < 0.001$), which use gross revenues as the dependent variable. This suggests that in general, the number of offices that a firm maintains in markets known for the industries of domestic clients is positively associated performance, in terms of both net income and gross revenues.

Table 5: Exploitation, Exploration, and Net Income

	Y=ln(Net Income)								
	1	2	3	4	5	6	7	8	9
Constant	17.575*** (0.107)	17.883*** (0.101)	17.575*** (0.107)	17.883*** (0.101)	18.082*** (0.109)	17.885*** (0.101)	17.250*** (0.107)	17.885*** (0.101)	18.833*** (0.123)
<i>Control variables:</i>									
ln(Age)	0.033 (0.025)	0.047* (0.023)	0.033 (0.025)	0.047* (0.023)	0.034 (0.023)	0.048* (0.023)	0.140*** (0.025)	0.048* (0.023)	0.024 (0.024)
ln(Size)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)
ln(Leverage)	-0.001** (0.000)	-0.001*** (0.000)	-0.001** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	0.000 (0.000)	-0.001*** (0.000)	-0.001*** (0.000)
ln(Experience)	0.201*** (0.009)	0.006 (0.015)	0.201*** (0.009)	0.005 (0.015)	-0.050* (0.019)				
New York	0.009 (0.030)	0.021 (0.028)	0.010 (0.030)	0.023 (0.028)	0.019 (0.028)	0.024 (0.027)	0.231*** (0.029)	0.025 (0.027)	0.003 (0.028)
ln(Practice Con.)	-0.644*** (0.050)	-0.562*** (0.046)	-0.643*** (0.050)	-0.561*** (0.046)	-0.541*** (0.046)	-0.563*** (0.046)	-0.903*** (0.051)	-0.562*** (0.046)	-0.838*** (0.069)
<i>Independent variables:</i>									
ln(Exploitation) (X1)		0.524*** (0.031)		0.525*** (0.031)	0.609*** (0.036)	0.533*** (0.018)		0.533*** (0.018)	0.531*** (0.018)
ln(Exploration) (X2)			0.001** (0.000)	0.001*** (0.000)	0.128*** (0.025)		0.001** (0.000)	0.001*** (0.000)	0.087*** (0.019)
X1*X2					-0.127*** (0.025)				-0.086*** (0.019)

Notes: 1) *, **, *** significant at 0.05, 0.01, and 0.001, respectively, 2) Un-standardized estimates, 3) Standard errors in parentheses, 4) Models use FGLS method

Table 6: Exploitation, Exploration, and Gross Revenues

	Y=ln(Gross Revenue)								
	10	11	12	13	14	15	16	17	18
Constant	18.486*** (0.093)	18.779*** (0.088)	18.486*** (0.093)	18.779*** (0.088)	19.018*** (0.097)	18.786*** (0.088)	18.151*** (0.097)	18.786*** (0.088)	18.955*** (0.091)
<i>Control variables:</i>									
ln(Age)	0.072*** (0.022)	0.085*** (0.020)	0.072*** (0.022)	0.085*** (0.020)	0.069*** (0.020)	0.090*** (0.020)	0.182*** (0.022)	0.090*** (0.020)	0.065** (0.020)
ln(Size)	-0.001 (0.000)	-0.001 (0.000)	-0.001 (0.000)	-0.001 (0.000)	-0.001 (0.000)	-0.001 (0.000)	-0.001 (0.000)	-0.001 (0.000)	-0.001 (0.000)
ln(Leverage)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.000 (0.000)	-0.001*** (0.000)	-0.001*** (0.000)
ln(Experience)	0.207*** (0.008)	0.021 (0.014)	0.207*** (0.008)	0.021 (0.014)	-0.044* (0.018)				
New York	-0.063* (0.026)	-0.051* (0.024)	-0.063* (0.026)	-0.050* (0.024)	-0.056* (0.024)	-0.041 (0.023)	0.165*** (0.026)	-0.041 (0.023)	-0.068** (0.024)
ln(Practice Con.)	-0.548*** (0.046)	-0.470*** (0.042)	-0.548*** (0.046)	-0.470*** (0.042)	-0.445*** (0.041)	-0.476*** (0.041)	-0.815*** (0.048)	-0.475*** (0.041)	-0.444*** (0.042)
<i>Independent variables:</i>									
ln(Exploitation) (X1)		0.498*** (0.029)		0.498*** (0.029)	0.599*** (0.033)	0.532*** (0.016)		0.532*** (0.016)	0.530*** (0.017)
ln(Exploration) (X2)			0.001 (0.000)	0.001* (0.000)	0.153*** (0.026)		0.001 (0.000)	0.001* (0.000)	0.119*** (0.020)
X1*X2					-0.152*** (0.026)				-0.118*** (0.020)

Notes: 1) *,**,*** significant at 0.05, 0.01, and 0.001, respectively, 2) Un-standardized estimates, 3) Standard errors in parentheses, 4) Models use FGLS method

Hypothesis 2 predicts that exploration offices, or offices in markets that are not known for the industries of a firm's domestic clients, will be positively associated with gross revenues. This predicted relationship offers that offices in markets not known for the industries of a firm's domestic clients represent attempts to develop new relationships, human resource capabilities, and reputations. This sort of exploration utilizes a mode tailored for effective performance and achieving greater levels of gross revenues. Interestingly, in models 12 and 16 in table 6, which only include the main effect of exploration offices without an estimate for exploitation offices, the estimates for exploration offices are not significant. However, in models 13 and 17, which include both of the key independent variables but no interaction term, the coefficients for exploration offices are identical, positive and significant ($p < 0.05$). These coefficients suggest a general relationship where a one percent increase in the number of exploration offices will result in a 0.001 percent increase in gross revenues. Additionally, the coefficients for exploration offices remain positive and significant in models 14 ($p < 0.001$) and 18 ($p < 0.001$), which include the interaction term. Using model 18, which does not include the control variable for experience, the coefficient for exploration offices suggests a conditional relationship where a one percent increase in the number of exploration offices will result in a 0.119 percent increase in gross revenues when the number of exploitation offices equals the sample mean.

Overall, the positive and significant coefficients in models 13, 14, 17, and 18 offers support for Hypothesis 2. However, caution should be taken in interpreting these results because in models 12 and 16, which include exploration effects but not

exploitation effects, the coefficients for exploration offices are not significant. One possibility is that the positive relationship between greater numbers of exploration offices and gross revenues is conditioned upon the existence of a certain number of exploitation offices. Additionally, in table 5, which uses net income as the dependent variable, the coefficients for exploration offices are consistently positive and significant ($p < 0.01$ & $p < 0.001$). As a result, these findings suggest that the number of offices that a firm maintains in markets not known for the industries of prominent domestic clients may be positively associated with both gross revenues and net income.

Finally, Hypothesis 3 predicts that the interaction term for exploitation offices and exploration offices will result in a positive coefficient. Specifically, exploitation offices offer stability and income that can be used to support exploration offices, and exploration offices are expected to provide newly developed resources that can benefit exploitation offices. In addition, these two different types of offices can “feed” each other. However, models 5 and 9 in table 5 both use net income as the dependent variable and in both of these models the interaction term for exploitation and exploration offices results in a negative and significant coefficient ($p < 0.001$). Additionally, models 14 and 18 in table 6 both use gross revenues as the dependent variable and in both cases the interaction term for exploitation offices and exploration offices results in negative and significant estimates ($p < 0.001$). Together, these results do not offer support for Hypothesis 3 and suggest a relationship that is counter to expectation, where greater numbers of exploitation offices combined with greater numbers of exploration offices are associated with lower levels of net income and gross revenues in this sample of large US law firms.

However, these results should be interpreted with caution in light of the possibility for multicollinearity.

3.5 DISCUSSION & CONCLUSIONS

Over the past twenty-five years, professional service firms have greatly expanded their foreign presence. This research argues that client relationships and capabilities embedded in human capital represent ownership advantages in markets where corporations from a firm's home region are likely to operate subsidiaries. When professional service firms open offices in these markets, they are exploiting existing capabilities and pursuing past certainties to achieve positive performance. This idea is supported in the above analysis, which shows a positive association between the numbers of offices that a firm operates in markets known for the industries of its domestic clients and net profits. Alternatively, when firms open offices that are not in markets where their domestic clients are likely to operate subsidiaries, they may be engaged in an exploratory search for new relationships and capabilities to achieve positive performance. This idea receives cautious support from the above analysis, where a positive association is found between the numbers of offices that a firm operates outside of markets known for the industries of its domestic clients and gross revenues, i.e., effective performance.

Additionally, this analysis indicates that simultaneously pursuing strategies that locate greater numbers of foreign offices inside and outside of markets known for the industries of a firm's domestic clients may result in lower net income and gross revenues relative to competitors. One potential explanation for the negative interaction terms, that indicate relationships that are opposite from those predicted in Hypothesis 3, is that

increasing levels of international geographic diversification may result in increases in coordination costs (Gomes & Ramaswamy, 1999; Geringer, Beamish, & daCosta, 1989; Hitt, Hoskisson, & Kim, 1997). This argument assumes that when international geographic diversification occurs across a heterogeneous collection of markets, it is difficult to capitalize on economies of scale because market differences make communication and coordination more expensive. In the case where firms simultaneously operate greater numbers of offices in markets that are destinations for the industries of their domestic clients and markets that are not destinations for their clients, there is heterogeneity in the markets operated in and the motives for operating in them. This suggests that there will be increased costs for coordination and communications efforts. An implication for practice may be that firms should be cautious and aware of the difficulties in capitalizing on greater levels of both exploitation and exploration as they select foreign markets to enter.

This research makes contributions to several different literature streams. On the topic of international diversification, this study has classified markets based upon their potential to either offer opportunities to exploit existing firm-specific resources or explore and develop new firm-specific capabilities. In addition, the performance implications of operating in these different types of markets are addressed, and the potential effects of their mutual pursuit are explored. This is different from past research in this area, which has largely looked at international diversification and its various dimensions as an issue that is consistent across industries and firms. By classifying markets based upon the resources of each individual firm, the approach to international diversification offered here is potentially a more accurate representation of the motives

for location decisions and as a result, more theoretically valid predictions on the relationship between international diversification and performance can be made.

However, it is also important to note that while this paper offers an attractive approach to making theoretically sound arguments for the international diversification and performance link in specific contexts, it does not necessarily offer a general theory on a link between international diversification and performance. Rather, this research can serve as an example of an approach to the diversification-performance link that can be applied to specific contexts, to reach theoretically sound predictions.

In addition to contributing to the literature stream on the link between international diversification and performance, this research also makes a contribution to the literature stream on exploitation and exploration. To my knowledge, this chapter represents the first attempt to integrate this literature stream and the literature stream on international geographic diversification and performance. Research on how organizational structures can enable ambidexterity has largely looked at the structural separation of activities that have divergent demands, such as efficient production and research and development. Alternatively, this research considers geographic separation, and suggests that location factors have different implications for how resources are either refined and exploited, or newly developed through an exploratory search. Furthermore, the findings in this research suggest that there may be difficulties in deriving positive performance consequences from the simultaneous pursuit of exploration and exploitation in the context of the geographic structures of organizations.

In addition to contributing to the academic literature, this chapter may also be of interest to managers. More specifically, this analysis offers empirical support for the

potential pitfalls of simultaneously pursuing international expansion motivated by “follow-the-client” exploitation, and knowledge and new market seeking exploration. In the context of manufacturing, the need to simultaneously exploit and explore makes intuitive sense given product life-cycles and the shelf life of new technology. On the other hand, in professional services, such as legal services, the logic behind organizational ambidexterity is not as immediately intuitive. Demand for legal services in the corporate world is a continuous phenomenon and the services that law firms offer are dependent upon specific client needs. Hence, law firms are not necessarily offering a sequence of ever newer services to customers; rather, they are developing and refining resources and capabilities to meet increasingly complex client needs. This analysis highlights the applicability of the exploitation-exploration concept to international geographic diversification in the legal industry and offers some potential strategic implications of location decisions.

Like all research, this chapter comes with some limitations. In order to identify the markets where a firm’s domestic clients are likely to operate, the FDI flows from the US to specific destinations by SIC code were used and these locations were matched to the top-two industries represented by each firm. This approach is reasonable given yearly data limitations on the availability of foreign subsidiary locations for each client of each large US law firm. However, if such data becomes more readily available, future research may benefit from an opportunity to identify exploitation markets using the actual locations of each firm’s domestic clients.

CHAPTER 4: Qualitative evidence: five firm histories

4.1 INTRODUCTION

In the previous chapters of this dissertation, two broad research questions are explored. First, “why do firms decide to go abroad?” And second, “what are the performance implications of patterns in international geographic diversification?” These questions were empirically examined to explore hypothesized relationships between constructs across a sample of the largest US law firms. However, it is also helpful to look at specific cases of firms that may be outliers for one reason or another. Looking at such cases may reinforce the conclusions of earlier chapters in this research, or cases may depart from these conclusions. Hence, the objective of this chapter is to look at different firms, with distinct histories and strategies, and to identify instances which are consistent with the overall relationships identified in the earlier empirical analyses, and also to identify cases that depart from the relationships identified in the previous chapters.

In total, this chapter presents brief case studies for five different large US law firms, each with at least one international office. After presenting these case studies, a discussion and conclusions section attempts to compare and contrast the internationalization motives, strategies, and outcomes for these five different firms. Among these firms, there are some examples that suggest prestigious firms are more likely to maintain a higher ratio of foreign to total offices. However, there are also some exceptional firms, such as the Chicago firm Baker and McKenzie, which have

consistently maintained greater ratios of foreign to total offices than many of their more prestigious competitors. In addition, these case studies do offer examples of foreign offices being opened to serve domestic clients who are operating in a foreign market. On the other hand, in some cases, these case studies offer examples of exploratory offices being opened in foreign markets.

In addition to the reasons why these firms went abroad, these examples also offer some insight into how patterns of internationalization may influence performance outcomes. In the case of the Houston firm Vinson and Elkins, which has used a strategy that focuses on exploitation markets, the firm has consistently achieved competitive levels of net income. On the other hand, in the case of the New York firm Coudert Brothers, which used a more exploratory approach to internationalization later in its history, the firm experienced a gradual decline in performance and eventually disbanded. And finally, in two of the case studies, for Baker and McKenzie and the New York firm Skadden, the firms used strategies that focus on both exploitation and exploration markets. In both of these cases, the firms have consistently achieved positive performance outcomes. These two examples are different from the findings on the interaction term between exploitation and exploration in the previous chapter, which resulted in negative correlations with performance outcomes. Overall these brief case studies do offer some interesting examples that are both consistent with and different from the expectations that were set in the previous chapters.

4.2 METHOD

In order to achieve the objective of this chapter, five brief case studies are presented below. Following the conclusions of Yin (2009), case studies are particularly well suited for answering “how” and “why” questions. In this research, the case studies seek to offer some insight into the following questions: 1) Why have these unique firms decided to go abroad, 2) how have these unique firms entered foreign markets, and 3) how have these unique firms performed? In addition, Yin suggests that case studies for research purposes can be explanatory, descriptive, or exploratory. In the cases presented here, the analysis deliberately focuses on five firms, which seem to be outliers for a number of reasons, including long histories of international operations, consistently positive performance, high status, and strategies that strongly focus on either exploration, exploitation, or a combination of both. These firms have different histories and approaches to internationalization, and because of the diversity among these firms and the characteristics that make them stand out, this analysis contains elements that are descriptive, exploratory, and explanatory.

These short case studies use a research protocol that focuses upon archival data available from a number of different sources. In some cases, published firm histories and timelines are consulted. In addition, articles in national and international newspapers are used, along with articles that appeared in trade publications. Data collection and the construction of these brief case studies is an iterative process, where broad firm histories are informed by articles and reports that describe specific episodes and decisions.

4.3 CASES

4.3.1 Case 1- Coudert Brothers

In 1857, three brothers, whose father had immigrated to the United States from France 33 years earlier, started a law practice in New York City (Walden, 2000). Frederic Rene Coudert, the eldest brother, had been practicing law since 1853 and the middle brother Charles and youngest brother Luis Leonce later joined Frederic Rene to form the practice that took their family name, Coudert Brothers. Because of the Coudert family's recent immigrant history and continued connections to the French community in New York, many of the firm's early clients were French nationals (Veenswijk, 1994). These ties to the local French community combined with strong French language abilities lead the French consulate in New York to employ Coudert Brothers for work on immigration cases (Walden, 2000).

The early experiences of the firm in representing the French consulate and immigrant community in New York, coupled with the family's strong French-American identity, appear to have played an important role in shaping the nature of its practice and the types of clients represented. In particular, Coudert Brothers gained a reputation for representing governments in international disputes and by the beginning of the twentieth century the firm represented or had represented the governments of the United States, Turkey, Italy, Russia, France, Belgium, and Venezuela, as well as the Roman Catholic church (Veenswijk, 1994; Walden, 2000). In addition, the firm represented well known families such as the French Rothschilds, the Guggenheims, and the Vanderbilts in France and the United States (Veenswijk, 1994; Walden, 2000). This client base of national governments and influential families was a departure from the client base of most large

New York law firms, which have traditionally relied heavily upon banks, railroads, and other large corporations (Smigel, 1969 pg.186; Walden, 2000).

This strong French connection and practice that relied heavily upon foreign governments and wealthy families led Coudert Brothers to establish an office in Paris in 1879 (Veenswijk, 1994). The Paris office was the first foreign office established by a US law firm. In the decades following the Paris office's opening, the firm benefited greatly from an influx of US citizens living in Paris and US multinationals opening offices in France (Veenswijk, 1994). In addition, this office also played important roles in the French government's efforts to borrow from US banks during World War I and the French government's efforts to purchase US defense equipment prior to the German invasion of World War II (Veenswijk, 1994; Walden, 2000).

Despite its early move into international law, by the late 1920's the firm's growth was not keeping up with other large New York City law firms who were expanding with their more traditional corporate clients (Smigel, 1969; Veenswijk, 1994 pg.302; Walden, 2000). Still, the firm did continue to grow, opening offices in London and Brussels in the 1960's and embarking on a more aggressive program of international expansion from the 1970's forward. In addition, Coudert Brothers differed from its peer firms in that it maintained a more familial trajectory in terms of leadership and succession, with three successive generations of Coudert decedents heading the firm, which ended in 1980 with the death of Alexis Coudert (Veenswijk, 1994). Following the death of Alexis Coudert, the firm grappled with finding strong leadership and eventually adopted a system of management by two committees, which was frequently criticized by those in the industry (Cherovsky, 1991).

Table 7: Offices Opened by Coudert Brothers

Domestic:	Moscow, Russia (1988)
New York (1857)	Bangkok, Thailand (1990)
Washington, DC (1899)	Jakarta, Indonesia (1990)
San Francisco (1977)	Ho Chi Minh City, Vietnam (1994)
Los Angeles (1986)	Hanoi, Vietnam (1994)
San Jose (1986)	Berlin, Germany (1995)
Denver (1995)	St. Petersburg, Russia (1996)
Palo Alto (1998)	Melbourne, Australia (1997)
	Montreal, Canada (1997)
International:	Almaty, Kazakhstan (1998)
Paris, France (1879)	Frankfurt, Germany (1999)
London, UK (1960)	Bonn, Germany (2000)
Brussels, Belgium (1965)	Munich, Germany (2000)
Hong Kong (1972)	Antwerp, Belgium (2000)
Singapore (1972)	Ghent, Belgium (2000)
Rio de Janeiro, Brazil (1976)	Stockholm, Sweden (2000)
Beijing, China (1979*)	Prague, Czech Republic (2000)
Manama, Bahrain (1979)	Rome, Italy (2000)
Riyadh, Saudi Arabia (1979)	Milan, Italy (2000)
Sydney, Australia (1984)	Shanghai, China (2001)
Tokyo, Japan (1987**)	

*Notes: *From 1979 to 1981 Coudert Brothers maintained a “presence” in China and their lawyers taught classes in corporate law and offered only limited legal counsel (Veenswijk, 1994 pg.398-399), and in 1992 the firm obtained an official office license in China (Orrick, 2010). ** From the 1970’s the firm maintained a close relationship with the office of Tokyo’s Judge Tanaka and both firms adopted each other’s names on their official letterhead.*

As previously noted and illustrated in table 7, which shows the locations and years that Coudert Brothers opened offices, the firm had a long history of international operations. However, table 7 also shows that the firm became more aggressive in its effort to expand from the 1970's onward. Interestingly, the selection of locations for new offices seems to have often times been based more upon individual interests in a particular country or region and less upon the operations of existing clients or formal analysis of market opportunities (Veenswijk, 1994 pg.395-396). Some of the early experiences in this new push towards internationalization, such as opening offices in Hong Kong, Beijing, and Tokyo offer interesting insights into how the firm followed an exploratory pioneer spirit to select locations for new offices and learned from these experiences.

In 1972 the firm opened an office in Hong Kong, making it the first US law firm to do so. In highlighting the firm's reasons for opening their Hong Kong office, Veenswijk (1994, pg.356) describes a situation where Coudert Brothers decided to enter the market without any real systematic planning or assessment, moving instead because it was a new frontier, fresh with unknown opportunity. Initially, this office was set up as a joint venture with a Montreal firm, Phillips and Vineberg, and included one lawyer from each firm. At the time, Hong Kong had prohibited the entry of non-commonwealth lawyers, but this joint venture with a Canadian firm allowed Coudert Brothers to gain access. Eventually the Hong Kong office began to attract US banks with a Hong Kong presence as their main clients. This was a new development as Coudert Brothers had not maintained the strong ties to investment banks that were prevalent for large US, and

especially New York, law firms. However, US banks were uncomfortable using local Hong Kong and British solicitors and writing agreements involving millions of US dollars under Hong Kong-British law. With this new client base, the lawyer in Coudert Brothers' Hong Kong office was quick to familiarize himself with servicing the needs of these banks and the office eventually gained a strong reputation among US businesses in Hong Kong, as well as local businesses and companies from third locations. In particular, the Hong Kong office attracted a lot of ship-financing work in its early years and handled deals between parties from many different countries.

Following the establishment of its Hong Kong office, the firm was eventually attracted to the Chinese mainland following US President Richard Nixon's trip to that country in 1972 and subsequent steps towards normalizing US-China relations (Veenswijk, 1994 pg.398-399). While it was not initially sure how, or if, the firm would make money in China, and the local government restricted foreigners from practicing law, Coudert Brothers was successful in securing year-round visas for its attorneys in 1979. This made the Coudert Brothers the first foreign law firm in the People's Republic of China. However, the firm was careful to highlight that they had a presence in China, but not necessarily an office. In fact, the firm was restricted to room 1009 of the Beijing Hotel, where the lawyers lived, entertained clients, and worked.

While the firm consulted on a handful of investments in China in these early years, much of the work of the attorneys in Beijing was in giving lectures on international business law (Veenswijk, 1994 pg.400-403). In particular, the Chinese government invited descriptions of international law and US laws on foreign direct investment (FDI). This early relationship with the Chinese government paid off in 1992, when foreign firms

were first allowed to open offices in mainland China. More specifically, Coudert Brothers was the first foreign firm to receive an official office license to operate in China (Orrick, 2010).

To enter the Japanese market, in the 1970's Coudert Brothers found a young American lawyer who had recently graduated from law school and spoke Japanese (Veenswijk, 1994 pg.351-355). This young lawyer, Charles Stevens, had a keen interest in starting a practice in Japan. However, foreign firms were largely restricted from opening offices in Japan; with the exception of a few foreign firms that had entered the country during the post World War II occupation years and whose permission to operate offices came from "grandfathered" agreements. Despite these restrictions, Mr. Stevens made personal connections with a Tokyo Judge, Judge Tanaka, through a Japanese law professor. These connections allowed Stevens to act as a foreign legal trainee at Judge Tanaka's Tokyo office, while Judge Tanaka's son acted as a foreign trainee in the New York office of Coudert Brothers. As a result of this experience, Judge Tanaka's office and Coudert Brothers were able to initiate the continuous practice of exchanging employees as foreign trainees. Additionally, the trust and knowledge that these two parties gained through their interactions eventually lead both firms to adopted each other's names on letterhead. By placing each other's names on their letterhead Tanaka was able to maintain a presence in the US without an actual office, and Coudert Brothers was able to maintain a presence in Tokyo, without an actual office. Veenswijk (1994) notes how unusual this was for both US and Japanese law firms. In addition, this author offers that in the Japanese context, corporate law was often viewed in a negative light because business agreements and exchanges were more commonly pursued through

relational channels, whereas corporate law often represented conflict and litigation.

Additionally, Veenswijk notes that “the cultural prejudice against litigation was so strong that relatively few important commercial issues had ever been subject to a written judicial opinion” (pg.367).

After Alex Coudert’s death in 1980, for the first time in its history, the firm was not managed by a member of the Coudert Family. In addition, this change seems to coincide with new trends in how the firm grew and entered foreign markets. In 1986, the firm hired away 17 key lawyers and partners who brought prestigious clients such as Coca-Cola from their competitor, Jones Day (Hoffman, 1994). In addition, in early 2000 the firm merged with the Belgian firm Coppens Van Ommeslaghe and Faures to expand its Brussels office and acquire additional offices in Ghent and Antwerp (Coudert Brothers, 1999). In the same year, Coudert Brothers completed a merger with the German firm Schurmann and Partners, allowing them to expand their Frankfurt office and access new offices in Berlin, Munich, and Bonn (Coudert Brothers, 1999). This merger with Schurmann and Partners also allowed Coudert Brothers to enter into negotiations with, and take over the operation of, associated offices in Prague, Italy, and Stockholm.

Table 8: Coudert Brothers Size and Performance

Year	Lawyers	Partners	Gross Revenues	Net Income	Profits Per Partner	AM Law 100 Rank
1985	206	67	\$83,160,000	\$21,780,000	\$326,700	65
1986	260	91	\$100,880,000	\$27,363,700	\$300,700	65
1987	300	85	\$157,080,000	\$46,750,000	\$551,650	39
1988	298	94	\$162,000,000	\$57,600,000	\$612,000	45
1989	333	99	\$206,400,000	\$68,800,000	\$696,600	37
1990	369	115	\$192,340,000	\$74,980,000	\$652,000	44
1991	370	116	\$188,760,000	\$72,540,000	\$624,000	46
1992	366	120	\$193,040,000	\$71,440,000	\$592,800	46
1993	322	114	\$140,385,000	\$43,365,000	\$382,200	73
1994	328	99	\$173,030,000	\$52,195,000	\$529,100	53
1995	324	91	\$168,000,000	\$39,200,000	\$434,000	62
1996	326	95	\$166,600,000	\$40,800,000	\$428,400	68
1997	343	104	\$188,940,000	\$52,930,000	\$509,200	64
1998	388	106	\$204,600,000	\$55,440,000	\$521,400	67
1999	452	123	\$234,240,000	\$67,200,000	\$544,000	69
2000	484	137	\$239,940,000	\$66,340,000	\$483,600	75
2001	521	142	\$264,130,000	\$78,824,200	\$555,100	75
2002	586	152	\$299,285,000	\$85,918,000	\$565,250	71
2003	630	170	\$306,540,000	\$83,538,000	\$491,400	75
2004	552	132	\$259,900,000	\$61,155,600	\$463,300	83

Source: American Lawyer's AM Law 100 1986-2005

Notes: All dollar values are adjusted to 2008 values

By 2005 the firm maintained offices around the world and had a global reach, but problems were starting to surface. Table 8, which highlights the size and performance of Coudert Brothers from 1985 through 2004, shows that after a continuous history of modest growth, performance began to decline after 2003. In addition, throughout this period the firm's growth lagged behind that of other peer firms, illustrated in table 8 by their decline in the annual *AM Law 100* rankings of the largest US law firms by gross revenues. Earlier merger talks with the New York firm Dewey Ballantine fell through and a later attempt to merge with the Chicago firm Baker and McKenzie also fell through in 2005 (Rosen, 2007; Koppel, 2005), leading to an exodus of partners and associates. And finally, in August of 2005 the partners of the firm voted to disband (Koppel, 2005). One observer offered that for middle tier firms, global ambitions can be treacherous, implying that firms such as Coudert Brothers are more vulnerable to the increased complexity and risk in operating across many markets (Rosen, 2007). Additionally, a second observer offered that Coudert Brothers was less effective in profiting from its foreign operations because it often expanded into new markets that were a gamble, whereas more successful competitors often entered markets with proven opportunities and existing client bases including domestic clients (Glater, 2005). Although, this strategy offered exciting and interesting opportunities for practicing international law, the highly profitable New York office ended up funding many of the less successful offices such as those in Jakarta and Stockholm, and this resulted in relatively lower overall rates of compensation for associates (Glater, 2005). In particular, many of Coudert Brothers' more successful competitors expanded to better serve existing corporate clients in industries such as investment banking. However, Coudert Brothers' client base included fewer of these

clients. The lower salaries that Coudert Brothers paid associates motivated many of the firm's lawyers to leave, and contact with competitors through failed merger talks offered opportunities to leave for better paying positions.

In summary, Coudert Brothers maintained a strong international identity from the firm's beginning to its end in 2005. In the early years of the firm, the strong French-American identity of its founders combined with experiences representing foreign nationals and governments created a distinctly international orientation. This international orientation led the firm to establish the first foreign office of a US law firm. Coudert Brothers was also unique because its client base included more governments and wealthy families than many of its competitors. While Coudert Brothers also maintained relationships with banks and corporations, it had relatively fewer of these clients than its competitors. Early international expansion into Europe was motivated by opportunities to exploit relationships with the firm's existing client base of Europeans and Americans in Europe. However, from the 1970's onwards, Coudert Brothers pursued international expansion that was more exploratory, often seeking to create new client relationships with American companies operating abroad, or foreign clients in new markets. In addition, from the 1980's, when the firm was no longer managed by members of the Coudert family, it often grew through mergers and hiring away the human resources of competing firms. Eventually, the firm's over reliance on offices in exploratory markets led to lower levels of compensation and this factor combined with repeated failures to merge resulted in its demise.

4.3.2 Case 2- Baker & McKenzie

In 1925, New Mexico native Russell Baker graduated from the University of Chicago Law School and quickly gained experience representing members of Chicago's Mexican-American community (Jacobson & Walden, 2002; Stevens, 1986). These experiences coupled with a short stint overseeing international legal matters for Abbot Laboratories solidified the desire to create an international firm. However, it was difficult for Baker to find partners who would be interested in collaborating on the creation of a law firm with a global reach. Then, in 1948 Baker met John McKenzie purely by chance as the two shared a taxi in Chicago (Baker & McKenzie, 2010a). Shortly thereafter, Russell Baker and John McKenzie entered into a partnership and created the firm Baker and McKenzie in 1949 in Chicago. At this time, Russell Baker's litigation practice in Chicago was already flourishing and he shifted the management of this practice to John McKenzie, so he could devote more of his energy towards building an international firm.

In 1955, the firm was approached by a lawyer from Venezuela, Ramon Diaz, who wanted to enter into a partnership (Jacobson & Walden, 2002). Soon after, Donald Baker, the son of Russell Baker, moved to Caracas to open an office and practice law with Ramon Diaz and Baker and McKenzie's first foreign office was established (Baker & McKenzie, 2010a). This model of partnering with local lawyers became the preferred approach of Baker and McKenzie. Within three years of opening the Caracas office the firm had opened six offices and by 1960 Baker and McKenzie was increasingly taking advantage of its knowledge of complex tax laws to generate more work from corporate clients such as Honeywell, Wrigley, and Eli Lilly. In 1963, the firm opened its first office in Japan, partnering with local lawyers in Tokyo. Later, the firm created the Tokyo

Aoyama Law Office in 1972 through a partnership with local attorneys, which was later renamed Baker and McKenzie in 1996 and is today known as Baker and McKenzie GJJ Tokyo Aoyama Aoki Koma Law Office (Baker & McKenzie, 2010b). Nine years later, in 1974, the firm opened its office in Hong Kong, which has consistently played an important role in their Asia presence (Lewin, 1998). More recently, following the Clinton Administration's 1994 decision to lift the US trade embargo on Vietnam, Baker and McKenzie was the first US-based firm to receive a license to establish representative offices in that country (Mehta, 1994). This allowed the firm to further expand its Asia presence by opening offices in Ho Chi Minh City and Hanoi in January of 1994.

Table 9, which lists the locations and dates of offices opened by Baker and McKenzie, shows that the firm increasingly focused on opening new offices in Eastern Europe in the late 1980's and early 1990's. In 1989 the firm opened an office in Moscow, and as western companies moved to establish a presence in the former soviet bloc, Baker and McKenzie followed its clients with offices in Warsaw (1992), Kyiv (1992), St. Petersburg (1992), and Prague (1993). Following this aggressive expansion into Eastern Europe, the firm began to open offices in oil producing regions to meet the demands of clients in the oil industry. In particular, the firm opened offices in Kazakhstan (1995), Azerbaijan (1998), Bahrain (1999), and the United Arab Emirates (2009).

Table 9: Offices Opened by Baker and McKenzie

Domestic:	Buenos Aires, Argentina (1981)
Chicago (1949)	Singapore (1981)
Washington, DC (1957)	Melbourne, Australia (1982)
New York (1957)	Cairo, Egypt (1985)
San Francisco (1970)	Juarez, Mexico (1986)
Palo Alto (1970)	Tijuana, Mexico (1986)
Miami (1984)	Budapest, Hungary (1987)
Dallas (1986)	Valencia, Venezuela (1987)
Los Angeles (1988-1993)	Barcelona, Spain (1988)
San Diego (1988)	Moscow, Russia (1989)
Houston (1997)	Jakarta, Indonesia (1989*)
	Berlin, Germany (1990)
International:	Stockholm, Sweden (1991)
Caracas, Venezuela (1955)	Warsaw, Poland (1992)
Amsterdam, Netherlands (1957)	Kyiv, Ukraine (1992)
Brussels, Belgium (1957)	St. Petersburg, Russia (1992)
Zurich, Switzerland (1958)	Brasilia, Brazil (1992*)
Sao Paulo, Brazil (1959*)	Prague, Czech Republic (1993)
Mexico City, Mexico (1961)	Beijing, China (1993)
London, UK (1961)	Ho Chi Minh City, Vietnam (1994)
Toronto, Canada (1962)	Hanoi, Vietnam (1994)
Milan, Italy (1962)	Monterrey, Mexico (1994)
Frankfurt, Germany (1962)	Santiago, Chile (1995)
Manila, Philippines (1963*)	Almaty, Kazakhstan (1995)
Paris, France (1963)	Munich, Germany (1997)
Tokyo, Japan (1963**)	Kuala Lumpur, Malaysia (1998*)
Sydney, Australia (1964)	Baku, Azerbaijan (1998)
Madrid, Spain (1965)	Dusseldorf, Germany (1999)
Rio de Janeiro, Brazil (1967*)	Manama, Bahrain (1999)
Geneva, Switzerland (1968)	Guadalajara, Mexico (2000)
Rome, Italy (1968)	Porto Alegre, Brazil (2001*)
Hong Kong (1974)	Antwerp, Belgium (2002)
Bangkok, Thailand (1977)	Shanghai, China (2003)
Taipei, Taiwan (1977)	Vienna, Austria (2003)
Bogota, Columbia (1979)	Chihuahua, Mexico (2004)
Riyadh, Saudi Arabia (1980)	Abu Dhabi, UAE (2009)

*Notes: * Associated offices, ** Later, in 1972, the firm established the Tokyo Aoyama Law Office, an associated office of Baker and McKenzie, changing names to Baker and McKenzie in 1996.*

Some competitors have suggested that the firm suffered from a lack of camaraderie between partners and an over-reliance on local attorneys that looks like a fast food franchise, or a “McLaw” (Economist, 1993; Stevens, 1986). Additionally, critics argued that the Baker and McKenzie model boiled down to alliances between independent offices instead of an integrated international organization and this created inconsistencies in the quality of work done between offices (Economist, 1993; Stevens, 1986). Despite the criticisms of the Baker and McKenzie model for international expansion and organization, the firm continued to steadily grow and improve its financial performance throughout its history. In addition, as Stevens (1986) notes, the structure and model of Baker and McKenzie may have attracted criticism from competitors, but it did have merits.

“When the system works well, it’s like a Swiss watch. Should a Chicago partner land a worldwide trademark case for a Midwest-based consumer products giant, pieces of the work may be handled through Baker and McKenzie offices in London, Paris, Sydney, Caracas and Tokyo.” (Stevens, 1986)

One of the key resources in the international expansion of Baker and McKenzie has been human capital in the form of lawyers familiar with international legal issues and the US legal system. While he was still alive, recognizing the importance of hiring quality international legal talent, Russell Baker often acted in the capacity of talent scout. After encountering and observing the work of gifted lawyers from around the world, Baker would recruit them, bring them back to Chicago for training, and then send them back to Baker and McKenzie offices in their homelands with a more in-depth knowledge of the US legal system (Stevens, 1986). These stints in Chicago served an additional

function, beyond familiarizing recruits with the US legal system. Baker hoped that recruits would be able to interact with their colleagues from around the world and develop a more honed set of cross-cultural skills. Once again, the Baker and McKenzie model drew criticism from its competitors as they compared the firm's training approach to a fast food "Hamburger University" (Stevens, 1986).

After Russell Baker's death in 1979, large US law firms began a period of rapid expansion in the 1980's, and Baker and McKenzie looked to large scale mergers as a means of growth both internationally and domestically. In 1988 the firm merged with the California firm Macdonald, Halsted and Laybourne, giving it a presence on the west coast from which to further develop its business in the Pacific Rim (Globe and Mail, 1988). And more recently Baker and McKenzie attracted 25 partners and 30 associates to add to its New York office when Coudert Brothers disbanded (Maley, 2005).

In addition the firm has grown through mergers, acquisitions, and raids in its international locations. In 1995, Baker and McKenzie merged with the Chilean firm Cruzat, Ortuzar and McKenna to establish a presence in Santiago (Maley, 1995). A year later, the firm lured a partner away from the Munich firm Dissman and Partners to strengthen its practice in Germany (Sage, 1996). In 2002, the firm acquired a four-partner practice in Warsaw from one of its US rivals, Hunton and Williams, and in the same year they expanded their offices in France and Poland by attracting partners and associates from other US firms with offices in those locations (Tromans, 2002). And in 2003, Baker and McKenzie acquired the Vienna firm of Kerres and Diwok to establish its first office in Austria (Collins, 2003a).

Table 10: Baker and McKenzie Size and Performance

Year	Lawyers	Partners	Gross Revenues	Net Income	Profits Per Partner	AM Law 100 Rank
1984	702	278	\$248,050,000	\$116,850,000	\$420,250	2
1985	751	287	\$253,440,000	\$114,840,000	\$396,000	2
1986	807	307	\$304,580,000	\$142,939,200	\$465,600	3
1987	920	340	\$366,520,000	\$160,820,000	\$476,850	3
1988	1,098	373	\$469,800,000	\$202,500,000	\$540,000	3
1989	1,339	432	\$587,380,000	\$232,200,000	\$541,800	2
1990	1,522	478	\$658,520,000	\$242,870,000	\$505,300	2
1991	1,582	484	\$744,900,000	\$283,140,000	\$585,000	2
1992	1,604	470	\$765,320,000	\$297,920,000	\$630,800	1
1993	1,667	537	\$752,640,000	\$279,300,000	\$521,850	1
1994	1,642	500	\$780,780,000	\$303,160,000	\$607,750	2
1995	1,776	505	\$831,600,000	\$303,800,000	\$602,000	2
1996	1,886	506	\$878,560,000	\$310,080,000	\$612,000	2
1997	2,094	515	\$933,310,000	\$328,970,000	\$636,500	2
1998	2,330	535	\$1,035,540,000	\$369,600,000	\$693,000	2
1999	2,477	558	\$1,047,040,000	\$346,880,000	\$620,800	2
2000	2,721	566	\$1,165,600,000	\$414,160,000	\$731,600	2
2001	3,031	571	\$1,220,000,000	\$390,107,200	\$683,200	2
2002	3,156	596	\$1,261,400,000	\$421,997,800	\$708,050	2
2003	3,053	611	\$1,326,780,000	\$425,347,650	\$696,150	2
2004	2,992	614	\$1,387,640,000	\$450,983,000	\$734,500	2
2005	2,984	501	\$1,473,680,000	\$415,028,400	\$828,400	3
2006	3,082	648	\$1,628,540,000	\$603,223,200	\$930,900	3
2007	3,335	683	\$1,902,160,000	\$756,490,800	\$1,107,600	3
2008	3,626	711	\$2,188,000,000	\$856,755,000	\$1,205,000	2

Source: American Lawyer's AM Law 100 1985-2009

Notes: All dollar values are adjusted to 2008 values

By the late 1990's it had become clear that despite the criticism of Baker and McKenzie's approach to organization and international expansion, the firm was a solid performer. In table 10, which offers data on the firm's size and performance over the years, the steady rise and growth of the firm is clear and the firm has consistently been ranked as one of the top three law firms in the US by gross revenues according to *American Lawyer's* annual *AM Law 100* publication. In a 1999 interview, the firm's newly appointed chairperson, Christine Lagarde, reflected upon Baker and McKenzie's success and position in the US and international legal industries.

“A few years ago we were looked at as strange, exotic mavericks. Look at where our competitors are heading – they are clearly trying to go international, following our path” (Moir, 1999 pg.10).

In addition, Baker and McKenzie's use of local lawyers was beginning to gain traction and earlier criticism about the system being like a “Hamburger University” was fading away. This is illustrated by comments from Russell Lewin, who was the managing partner of Baker and McKenzie's London office in the late 1990's.

“We aim to provide a service which both satisfies the exacting standards demanded by our clients and takes full account of local markets and cultures. Other multijurisdictional firms that once preferred exporting lawyers from their head offices rather than recruiting locally have increasingly followed our lead” (Lewin, 1998).

Still, in the early 2000's under the stewardship of Lagarde, the firm set out to transform itself into a more integrated and “corporate” model, through the consolidation of back-office administrative functions, reorganization based upon specific industries,

and pairing clients with specific partners who are always available to offer advice (Sachdev, 2004). As a result, the firm received positive feedback from key domestic clients such as Abbott Laboratories.

In summary, Baker and McKenzie was founded with a vision to become a law firm with an international reach. Throughout the firm's history, it has used local lawyers, who spend some time training at the home office in Chicago, to staff its foreign offices. This approach was different from the approach of competitors who often exported American lawyers to foreign offices. However, many of Baker and McKenzie's competitors have begun to increasingly use local lawyers in foreign markets. In addition, many of Baker and McKenzie's location decisions are based upon the growth of US clients. This "follow-the-client" approach to expansion can be seen in decisions to follow American corporations into Eastern Europe and oil producing regions. In addition, the firm has opened a number of offices in more exploratory markets in an attempt to fill holes in its global network. While the firm's network of offices stretches across a large number of markets, some competitors have suggested that it is more akin to a loose set of alliances, creating inconsistency in the quality of services being offered across the offices. In response to this issue, Baker and McKenzie underwent some restructuring in the 2000's to create a more integrated multijurisdictional firm. In addition, over the past two decades, the firm has sought to grow through large scale mergers and has consistently ranked among the top three US firms by gross revenues. However, despite Baker and McKenzie's large gross revenues, measures of efficient performance including net income and profits per partner have been lower than close competitors at the very top of the *AM Law 100* rankings.

4.3.3 Case 3- Vinson & Elkins

In 1917, two young lawyers, William A. Vinson and James A. Elkins, formed a partnership to practice law in Houston, Texas (Vinson & Elkins, 2010). Vinson, who was born in North Carolina and came to Texas at the age of thirteen, was a well dressed person who abstained from drinking, which made him unique among Houston's hard-drinking and gambling lawyers of the time (Hyman, 1998 pg.61). Elkins was born in Hunstville, Texas and grew up to briefly consider a career in professional sports before eventually deciding to go into law.

When the firm first opened for business, the Houston legal market was dominated by the firm Baker and Botts, which maintained close relationships with local companies and banks (Hyman, 1998 pg.71). From the beginning, Vinson and Elkins modeled its practice after that of Baker and Botts, but initially much of Vinson and Elkins business came in representing defendants in criminal cases, which Elkins disliked (Hyman, 1998 pg. 53). However, once the firm began to establish itself, it quickly built a client base of smaller Texas oil companies, leading to rapid growth throughout the 1920's and 1930's (Hyman, 1998 pg.147; Vinson & Elkins, 2010). This relationship with the oil industry would continue throughout the firm's history and would drive many of the changes that occurred as the firm grew and continuously re-invented itself (Hyman, 1998 pg.152; Vinson & Elkins, 2010).

Despite the firm's growth up to the 1970's, the partners remained focused on expanding their presences in the Houston market. If clients did need the firm to offer services outside of Texas, Vinson and Elkins would establish intentionally temporary

“outposts” wherever they were needed and these locations often drew heavily upon local pools of legal talent for staffing needs. Over the years, the firm established and closed such temporary outposts in various markets including Denver, Billings, Tulsa, and Chicago (Hyman, 1998 pg.458). However, these experiences did pay off when the firm decided to open its first foreign office in 1971 in London, to represent their existing clients in the energy markets. While this office has traditionally focused on representing US oil companies in the energy markets, for a brief time in the early 2000’s it also pursued a finance practice which it abandoned in 2003 when the chief partner in this area left the firm (Hoare, 2003).

After establishing an office in London, Vinson and Elkins again focused on growing its presence in Texas, opening offices in Austin (1979) and Dallas (1986) (Vinson & Elkins, 2010). In addition, the firm opened an office in Washington, DC in 1973, largely as a symbolic act in support of the work they did lobbying for their clients in the energy sector. This consciousness of the symbolic value of maintaining a local presence where existing clients do business became an important part of Vinson and Elkins’ strategy for location decisions in internationalization. Hyman (1998, pg.460) recounts a statement made by a managing partner who offers that local offices in foreign markets symbolize the home office’s commitment to those markets and conveys to clients that the firm is competent with the complexities of the local markets.

In 1991, as the Cold War came to an end, Vinson and Elkins and other firms followed American corporations as they set out to establish a presence in the former Soviet Bloc by opening an office in Moscow (Stewart, 1995; Torry, 1991). In addition, the firm chose Warsaw as a location for a second office to represent oil companies

throughout Eastern Europe in 1993, but the office closed shortly after opening when its managing partner left (Hyman, 1998 pg.485; Stewart, 1995). This expansion into Eastern Europe, and later office openings are illustrated in table 11, which lists offices opened by the firm.

Table 11: Offices Opened by Vinson and Elkins

Domestic:	International:
Houston (1917)	London, UK (1971)
Washington, DC (1973)	Moscow, Russia (1991)
Austin (1979)	Warsaw, Poland (1993*)
Dallas (1986)	Mexico City, Mexico (1994**)
New York (1999)	Singapore (1995***)
Palo Alto (2010)	Beijing, China (1997)
	Tokyo, Japan (2004)
	Shanghai, China (2005)
	Hong Kong (2006)
	Abu Dhabi, UAE (2007)

*Notes: *The Warsaw office closed in 1993, shortly after being opened. ** The Mexico City office closed soon after it opened as a result of the economic crisis in Mexico. *** The Singapore office closed shortly after opening.*

Following its expansion into Eastern Europe, the firm began to focus its efforts on creating a presence in Asia. Vinson and Elkins first began to represent US oil companies in Asia in the 1970's, and was subsequently involved in large projects throughout Asia, including energy projects in Vietnam, India, the Philippines, Bangladesh, Papa New Guinea, and China (Petroleum Economist, 1998). To establish a presence in Asia, the firm opened offices in Singapore (1995), Beijing (1997), Tokyo (2004), Shanghai (2005), and Hong Kong (2006) (Business Times, 1995; Vinson & Elkins, 2010). As this Asia expansion was underway, Vinson and Elkins was being singled out as a leader among firms providing legal services in the energy sector and in 1999, a survey by *Petroleum*

Economist magazine identified the firm as the top law firm for oil companies (Petroleum Economist, 1999).

In 2001, in the midst of their Asian expansion, the firm gained notoriety as the law firm of the energy company Enron, which collapsed and erased billions of dollars in wealth after misleading shareholders and the public (Ackman, 2002; Lazarus, 2002). Following the implosion of Enron, the firm was left without its largest client and was the target of law suits from Enron shareholders (Raymond, 2008). Table 12, which lists performance and size data for the firm, shows that from this point forward there was a steady reduction in the number of partners in the firm and growth in gross revenues was stagnant through 2005. This reduction in the firm's business coupled with law suits from Enron shareholders meant a lack in resources for growth, but in 2006 the firm paid a \$30 million settlement in the Enron case, and was dismissed from the Enron class action suit a year later. This meant that the firm could once again direct its attention towards growth, with a strong preference for expansion in the Middle East to support its energy practice (Raymond, 2008). As an initial step in this Middle East expansion, the firm established an office in the United Arab Emirates in 2007 (Vinson & Elkins, 2010).

Table 12: Vinson and Elkins Size and Performance

Year	Lawyers	Partners	Gross Revenues	Net Income	Profits Per Partner	AM Law 100 Rank
1984	340	146	\$218,325,000	\$101,475,000	\$697,000	4
1985	400	165	\$225,720,000	\$104,940,000	\$633,600	7
1986	409	181	\$218,250,000	\$98,319,200	\$543,200	14
1987	401	171	\$273,955,000	\$140,250,000	\$822,800	11
1988	437	182	\$311,400,000	\$164,700,000	\$900,000	11
1989	450	191	\$303,580,000	\$152,220,000	\$799,800	21
1990	493	200	\$449,065,000	\$287,695,000	\$1,434,400	6
1991	497	210	\$288,600,000	\$127,140,000	\$608,400	22
1992	514	218	\$278,920,000	\$123,120,000	\$562,400	23
1993	524	212	\$297,675,000	\$133,035,000	\$624,750	19
1994	495	219	\$301,730,000	\$135,135,000	\$614,900	19
1995	512	235	\$303,800,000	\$137,200,000	\$581,000	21
1996	501	234	\$314,840,000	\$148,240,000	\$632,400	20
1997	509	243	\$341,700,000	\$170,850,000	\$703,500	20
1998	561	261	\$371,580,000	\$181,500,000	\$693,000	22
1999	615	277	\$419,200,000	\$207,360,000	\$748,800	21
2000	690	281	\$479,260,000	\$228,160,000	\$812,200	24
2001	777	307	\$555,710,000	\$260,305,300	\$847,900	22
2002	795	312	\$543,235,000	\$237,619,200	\$761,600	26
2003	740	297	\$514,800,000	\$238,030,650	\$801,450	34
2004	661	226	\$514,150,000	\$228,565,100	\$1,011,350	37
2005	645	228	\$555,900,000	\$265,916,400	\$1,166,300	39
2006	659	213	\$569,240,000	\$256,398,750	\$1,203,750	43
2007	688	235	\$619,840,000	\$293,280,000	\$1,248,000	45
2008	683	189	\$590,500,000	\$247,590,000	\$1,310,000	45

Source: American Lawyer's AM Law 100 1985-2009

Notes: All dollar values are adjusted to 2008 values

In summary, since its founding, Vinson and Elkins has focused primarily on serving clients in the oil industry. From the 1920's to today, most of the firm's core clients have been oil companies and the firm has grown with these clients. In addition, most of the foreign expansion decisions of Vinson and Elkins have involved opening offices in markets where their domestic oil clients operate, such as Russia and the Middle East. This concentrated focus on the oil industry represents an exploitation strategy, and as a result, Vinson and Elkins has gained a reputation as a law firm that specializes in the legal issues of the oil industry.

4.3.4 Case 4- Skadden, Arps, Slate, Meagher & Flom

On April fool's day in 1948, three lawyers who had been passed over for promotion at large New York firms, Marshall Skadden, John Slate, and Les Arps, joined to open their own practice (Caplan, 1993 pg.15; Skadden, 2010). The firm's name was Skadden, Arps, Slate and Meagher, often referred to as "Skadden." In its first year of operation, the firm hired a Harvard educated lawyer named Joseph Flom as an associate, and eventually Flom would become the driving force behind Skadden's growth and success (Ingram, 1997). Flom initially started as a specialist in derivative actions, where shareholders file suit against the management and board of directors of a company if they are derelict in their duties (Ingram, 1997). In 1961, the firm added Flom's name, creating Skadden, Arps, Slate, Meagher and Flom (Skadden, 2010).

In the mid 1960's Skadden shifted its focus from proxy fights, or derivative actions, to tender offers, or takeover bids (Caplan, 1993 pg.15; Ingram, 1997; Skadden, 2010). At the time, most of the prestigious large New York law firms tried to avoid

working on corporate takeovers because they considered this area of practice to be a distraction from serving preferred corporate clients, and not fitting of a gentleman (Andrews, 1994; Caplan, 1993 pg.52-53; Marcus, 1986). However, Joseph Flom saw an opportunity in this underserved practice area and aggressively pursued it, building Skadden into the top takeover firm in the US (Andrews, 1994; Caplan, 1993 pg.15; Ingram, 1997; Skadden, 2010). By the time competing firms began to overcome their reservations against representing “raiders” (Caplan, 1993 pg.73), Skadden had already earned a reputation for their specialization in this area, allowing them to charge sizeable premiums over regular fees (Andrews, 1994). In addition, some firms paid large retainers to block the availability of Skadden’s services to potential raiders who might initiate a hostile tender offer (Marcus, 1986). By 1988, Skadden was so actively involved in takeovers that by October it had been involved in 39 of the 99 largest US takeovers that year, 18 more than its nearest competitor (Stelzer, 1988).

Skadden was also a pioneer in the use of a more business-like model for law firm management. In 1982, the firm hired Irving Shapiro as a partner in their Wilmington office. Irving Shapiro was an attorney who had served as the CEO of E.I. du Pont de Nemours and Company until he reached the mandatory retirement age of 65 in 1981 (Lewin, 1982). Irving Shapiro pushed for Skadden to create a Chief Executive position to handle long-term planning for the firm and also argued for the adoption of other more corporate like practices. For example, Irving Shapiro argued that the firm was wasting money and energy in training lawyers for seven years, just to ask them to leave if they did not make partner (Lewin, 1982). This appears to be one of the earlier pushes to create permanent non-partner positions. In addition, coming from a position as the head of Du

Pont, Irving Shapiro noted that law firms lagged behind in integrated management systems and suggested that Skadden should collect data from across the firm to monitor overall economic performance (Lewin, 1982). As a result, it appears that Irving Shapiro initiated a drive towards a more business-like model in Skadden, which continues to today.

By riding the wave of takeovers in the 1970's and 1980's, Skadden had achieved considerable growth and was looking for ways to achieve further growth. Caplan (1993) writes that the partners in the firm envisioned four potential strategies for growth. First, Skadden could continue with its specialty in mergers and acquisitions and improve its practice in related areas. Second, the firm could attempt to expand its service offering to existing clients, and build its reputation to attract new clients. Third, they could expand their practice by using existing skills in new areas. And finally, the partners thought that they could develop new specialties and move into new geographic areas. Collectively the partners agreed that this final option was the future of Skadden and set out to develop new capabilities and expand into new geographic areas.

Consistent with the decision to expand geographically, Skadden opened its first foreign office in Tokyo in 1987 (Caplan, 1993; Margolick, 1988). Margolick (1988) offers that one reason Skadden may have selected Japan for its first foreign office was that the firm stood "to gain from cash-rich Japan's infatuation for foreign acquisitions" at the time. Similarly, in the late 1980's, a weak US dollar led foreign companies, and especially UK corporations, to view US companies as attractive investments. As the number of foreign-initiated merger bids rose, Joseph Flom flew to London to open Skadden's first European office in 1988 (Stelzer, 1988). A year later, in 1989, Skadden

opened an office in Sydney to advise Australian companies on US acquisitions (Perrett, 1989) and also opened an office in Hong Kong (Wall Street Journal, 1989).

Table 13: Offices Opened by Skadden

Domestic:	International:
New York (1948)	Tokyo, Japan (1987)
Boston (1973)	London, UK (1988)
Washington, DC (1976)	Sydney, Australia (1989)
Wilmington (1979)	Hong Kong (1989)
Los Angeles (1983)	Toronto, Canada (1990)
Chicago (1984)	Paris, France (1990)
San Francisco (1987)	Frankfurt, Germany (1990)
Houston (1993)	Brussels, Belgium (1990)
Palo Alto (1998)	Moscow, Russia (1992)
Newark (2001*)	Beijing, China (1992)
Reston (2002**)	Vienna, Austria (1993)
	Singapore (1995)
	Munich, Germany (2004)
	Shanghai, China (2008)
	Sao Paulo, Brazil (2008)

*Notes: *Newark office closed in 2004. ** Reston office closed in 2003.*

As illustrated in table 13, which lists the offices opened by Skadden, in 1990 the firm's geographic expansion increased in pace as they opened an office in Toronto. The Toronto office was opened to serve the firm's growing Canadian client base and offer a US perspective on mergers and acquisitions, corporate restructuring, reorganization, and bankruptcy (Globe and Mail, 1990). In addition, the firm opened offices in Paris, Frankfurt and Brussels in 1990 (Caplan, 1993 pg.105). Two years later, Skadden entered the newly opened Russian market with an office in Moscow. This move paid off as newly privatized Russian industries began to consolidate and there was no existing Russian legislation on tender offers (Thornhill, 1995; Uchitelle, 1992). In the absence of such legislation, the Russian government sought to follow western practices, leaving Skadden

in a prime position as the top takeover firm from the US (Uchitelle, 1992). Skadden was able to represent the Moscow food products company, Koloss, in its acquisition of the iconic Russian chocolate company, Red October, whose operations were located across from the Kremlin (Thornhill, 1995). This high-profile deal was the first case of a Russian company making a formal public bid to buy a rival and firmly established Skadden in Moscow (Thornhill, 1995).

In the same year that the firm opened their Moscow office, they also opened a Beijing office to serve existing clients with operations in China and to offer counsel on US law. However, the start of the Beijing office was a long time coming as Skadden had postponed previous plans for the office in the wake of the Tiananmen Square incident in 1989 (Caplan, 1993 pg.286). Following the offices opened in 1990 and 1992, Skadden opened two more offices in the 1990's. The Austria office opened in Vienna in 1993 through an agreement with the local firm Reich-Rohrwig and Partners (Pollock, 1993). Two years later, in 1995, the firm also opened its Singapore office.

By the year 2000, it appeared as though Skadden's international geographic expansion had slowed down and it had been five years since the firm opened its most recent foreign office in Singapore. Instead, the firm set out to expand its foot print in the US market, opening an office in Palo Alto in 1998 and later opening offices in Newark in 2001 and Reston in 2002. However, the Newark office was later closed in 2004 and the Reston office was closed in 2003, a year after it had opened. The close proximity of these offices to existing Skadden offices in New York and Washington, DC led to their closing. Skadden also sought growth in the US by expanding its existing offices and in the late

1990's it began work on a 600,000 square foot-headquarters at 4 Times Square (Ravo, 1998).

Despite the slowdown in Skadden's international expansion, the firm was able to maintain steady growth in revenues and size, as illustrated in table 14, which lists data on the firm's size, performance, and ranking among US law firms by gross revenues.

Additionally, when measured by gross revenues, Skadden has been consistently ranked as the top US law firm from 1984, with the exceptions of 1992 and 1993, when Skadden took the number two spot and Baker and McKenzie was ranked number one.

For most of the 2000's, Skadden's strategy was to pursue growth in its existing offices, with a few exceptions. In 2004, the firm opened an office in Munich to complement its practice in Germany and was able to hire away a key partner at Baker and McKenzie to head the office (Hiralal, 2004). Four years later Skadden opened its second China office in Shanghai in 2008. The Shanghai office was opened in support of Skadden's practice in mergers and acquisitions, consistent with the firm's historical trajectory of international expansion as Chinese firms increasingly looked towards the US for acquisitions (Hiralal, 2008a). And finally, Skadden's most recent international office was opened in Sao Paulo in 2008 (Hiralal, 2008b).

Table 14: Skadden Size and Performance

Year	Lawyers	Partners	Gross Revenues	Net Income	Profits Per Partner	AM Law 100 Rank
1984	428	108	\$264,450,000	\$119,925,000	\$1,107,000	1
1985	526	122	\$334,620,000	\$157,410,000	\$1,287,000	1
1986	712	140	\$442,320,000	\$211,848,000	\$1,513,200	1
1987	830	157	\$542,300,000	\$259,930,000	\$1,654,950	1
1988	846	177	\$792,000,000	\$367,200,000	\$2,079,000	1
1989	948	197	\$890,100,000	\$405,060,000	\$2,055,400	1
1990	996	225	\$819,890,000	\$336,595,000	\$1,499,600	1
1991	996	216	\$764,400,000	\$312,000,000	\$1,443,000	1
1992	920	215	\$668,800,000	\$288,800,000	\$1,345,200	2
1993	948	222	\$702,660,000	\$224,910,000	\$1,014,300	2
1994	968	227	\$832,260,000	\$265,980,000	\$1,172,600	1
1995	1,001	236	\$889,000,000	\$292,600,000	\$1,239,000	1
1996	1,032	243	\$965,600,000	\$326,400,000	\$1,346,400	1
1997	1,074	257	\$1,106,840,000	\$444,210,000	\$1,728,600	1
1998	1,187	285	\$1,174,800,000	\$518,760,000	\$1,821,600	1
1999	1,322	292	\$1,312,000,000	\$597,760,000	\$2,048,000	1
2000	1,441	302	\$1,430,960,000	\$598,920,000	\$1,984,000	1
2001	1,602	316	\$1,494,500,000	\$603,338,800	\$1,909,300	1
2002	1,632	336	\$1,558,900,000	\$641,743,200	\$1,909,950	1
2003	1,650	350	\$1,556,100,000	\$655,200,000	\$1,872,000	1
2004	1,554	361	\$1,627,200,000	\$707,758,550	\$1,960,550	1
2005	1,616	377	\$1,754,900,000	\$784,876,300	\$2,081,900	1
2006	1,690	392	\$1,979,500,000	\$876,629,600	\$2,236,300	1
2007	1,858	421	\$2,256,800,000	\$998,275,200	\$2,371,200	1
2008	1,994	440	\$2,200,000,000	\$908,600,000	\$2,065,000	1

Source: American Lawyer's AM Law 100 1985-2009

Notes: All dollar values are adjusted to 2008 values

In summary, Skadden rose to prominence by specializing in tender offers, or corporate takeovers. Media accounts of the firm often portray Skadden as an aggressive force in the world of mergers and acquisitions, whose lawyers will do nearly anything to close a deal. This focus on helping firms to acquire other businesses has also influenced Skadden's international geographic expansion. First, the firm has opened offices in foreign markets as US companies entered these markets and began to buy local firms. This sort of expansion is an attempt to exploit the firm's existing client base of US corporations. Second, Skadden has opened offices in countries with local companies that view US companies as attractive investments, and this type of expansion is an attempt to explore and create new client relationships. And finally, the firm has entered markets with newly privatized industries in the midst of consolidation, without an existing legal approach to takeovers. In these newly opened economies, Skadden has been in a good position to capitalize on its position as the top takeover firm in the US and has been able to influence how tender offers look in these markets. Furthermore, expansion into these countries represents an attempt to explore and develop new markets and client relationships. It is also important to note that over the years Skadden has attempted to offer a broader set of legal services and these new areas have grown to account for a larger portion of the firm's business.

4.3.5 Case 5- Cravath, Swaine & Moore

Cravath, Swaine and Moore, often referred to simply as "Cravath," has a history that stretches back to 1819, when Richard Blatchford started his own practice in New York City (Walden, 2002). Later in his career, Blatchford would go on to serve on the US

Supreme Court (Swaine, 1948 pg.220). Shortly after Blatchford started his practice, another new lawyer, William Seward, started his own practice in Auburn, New York with a retired judge. Later in his career, Seward would go on to serve as Senator from New York, the state's Governor, and US Secretary of State under Presidents Lincoln and Jackson (Swaine, 1948; Taylor, 1991). While Blatchford and Seward maintained a close relationship from the beginning of their practices, they did not formally combine their offices until 1854 (Walden, 2002), but when they did merge, they created what would become one of New York's most prestigious and profitable "white shoe" law firms (Martinez, 2006).

Perhaps one of the best known stories in Cravath's past is the introduction of the "up-or-out" system. In the 1880's, one of the firm's named partners, Paul Cravath, instituted a policy where the firm only hired new graduates from prestigious law schools (Sherer & Lee, 2002). New associates were given the opportunity to prove themselves in the firm, with the possibility to being promoted to partner. However, if an associate was not promoted to partner, he would have to leave the firm and find work elsewhere (Galanter & Palay, 1993; Sherer & Lee, 2002). The benefit of this model is that firms can promote based upon merit and they can also avoid being forced to grow the ranks of their partnership if they wish to increase the number of associates that they hire. However, by the 1980's, the demand for legal services had outpaced the supply of new graduates from prestigious schools and corporations were increasingly competing with law firms for new graduates to work in their in-house legal departments (Caplan, 1993 pg.70-73; Galanter & Palay, 1993; Hyman, 1998 pg.149). As a result, some firms such as the New York Firms Davis, Polk and Wardell, and Skadden began to increasingly shift away from the

up-or-out model and started to offer permanent salaried associate positions, so those who did not make partner could stay in the same firm (Curriden, 2001; Sherer & Lee, 2002). However, Cravath has maintained its preference for the up-or-out system, which it still uses today. To compete with in-house legal departments, especially in investment banks, and other firms who use permanent salaried associate positions, Cravath has led the industry in compensation for associates (Lewin, 1986). However, the associates who do come to Cravath face unfavorable odds in their prospects for promotion to partner. As an example, when the firm's 2002 cohort of approximately 80 associates came up for review and promotion in 2009, none of them were promoted to partner (Smith, 2009). One senior partner in the firm offered the following comment.

“We want to make partners even in bad economic times. But this year, no one met our standards” (Smith, 2009).

Beyond its competitive approach to maintaining its workforce and offering promotions, one of the unique aspects of Cravath's history is that the firm has continuously maintained a prestigious position among law firms and an international presence, without operating a large number of offices outside of the US (Collins, 2003b; Walden, 2002). Even though Cravath's New York office makes up the majority of the firm, by 2003 Cravath's presiding partner estimated that one third of the firm's clients were from outside of the US and half of the deals that they handled involved at least one foreign client (Collins, 2003b). In addition, in 1999 the firm estimated that 25 to 30 percent of their corporate work was in Europe alone (Farrell, 1999). Even though the firm successfully competes in international deals, it appears that Cravath has deliberately

avoided competing with other law firms through size and geographic expansion by opening foreign offices. This philosophy is reflected in the following statement describing the firm.

"We are not, and never will be, the largest law firm measured by number of offices or lawyers. Our goal is to be the firm of choice for clients with respect to their most challenging legal issues, most significant business transactions and most critical disputes" (Cravath, 2010).

Cravath has, however, continuously maintained an office in London since 1973, and from 1927 to 1934, and from 1963 to 1981 the firm operated a small office in Paris. Cravath also opened an office in Hong Kong in 1994 (Woo, 1994). However, in 2003 the firm shut down its Hong Kong office, deciding instead to concentrate its resources in the New York and London offices (Collins, 2003b). In explaining the reasons for closing the Hong Kong office, Cravath's presiding partner offered that the market did not offer enough "premium work for legal services which clients will pay premium rates," making the Hong Kong office a misdirected use of firm resources (Collins, 2003b). This issue of premium rates is important to Cravath's strategy, which is to focus on "top-end international transactions that are governed by US law" (Collins, 2004). From 1973, with the exception of the nine years when Cravath operated its Hong Kong office, the firm has only operated the New York and London offices.

Table 15: Cravath Size and Performance

Year	Lawyers	Partners	Gross Revenues	Net Income	Profits Per Partner	AM Law 100 Rank
1984	225	56	\$168,100,000	\$72,775,000	\$1,301,750	8
1985	230	56	\$192,060,000	\$85,140,000	\$1,524,600	11
1986	233	58	\$230,860,000	\$109,144,400	\$1,881,800	11
1987	270	64	\$282,370,000	\$145,860,000	\$2,281,400	9
1988	277	67	\$360,000,000	\$192,600,000	\$2,871,000	8
1989	288	64	\$366,360,000	\$194,360,000	\$3,035,800	9
1990	284	66	\$334,150,000	\$166,260,000	\$2,518,350	16
1991	296	70	\$319,800,000	\$159,120,000	\$2,269,800	17
1992	308	73	\$317,680,000	\$156,560,000	\$2,105,200	18
1993	280	73	\$296,205,000	\$151,410,000	\$2,072,700	21
1994	262	69	\$265,980,000	\$120,835,000	\$1,751,750	23
1995	299	74	\$312,200,000	\$138,600,000	\$1,876,000	19
1996	323	72	\$326,400,000	\$148,240,000	\$2,060,400	19
1997	341	71	\$365,820,000	\$170,180,000	\$2,398,600	18
1998	334	77	\$440,880,000	\$208,560,000	\$2,706,000	17
1999	363	83	\$448,000,000	\$224,000,000	\$2,700,800	20
2000	344	80	\$471,200,000	\$222,580,000	\$2,783,800	25
2001	389	79	\$466,650,000	\$205,771,300	\$2,604,700	33
2002	431	74	\$392,105,000	\$172,597,600	\$2,332,400	49
2003	439	77	\$497,250,000	\$187,387,200	\$2,433,600	37
2004	389	79	\$514,150,000	\$196,840,350	\$2,491,650	37
2005	391	87	\$545,545,000	\$246,558,000	\$2,834,000	40
2006	406	87	\$588,500,000	\$280,666,350	\$3,226,050	40
2007	412	90	\$634,920,000	\$308,880,000	\$3,432,000	43
2008	440	90	\$532,500,000	\$226,800,000	\$2,520,000	52

Source: American Lawyer's AM Law 100 1985-2009

Notes: All dollar values are adjusted to 2008 values

While Cravath does not aim to compete with other US firms through size or geographic foot print, table 15, which offers data on the firm's size and performance, shows that they have remained competitive. In particular, the firm consistently ranked in the top 50 US law firms by gross revenues in the *AM Law 100* annual rankings through 2007. In addition, Cravath's profits per partner have consistently been higher than nearly all of its competitors (Collins, 2004). In order to achieve this consistent positive performance, the managing partner of Cravath's London office offers that the firm does not need to open anymore offices abroad (Farrell, 1999). Instead, Cravath has cultivated a network of "close and friendly" connections with individual local law firms in foreign markets and these relationships coupled with Cravath's reputation generate business through referrals (Farrell, 1999).

In particular, Cravath has strong relationships with US investment banks and a number of law firms in continental Europe, with whom they trade referrals (Farrell, 1999). Examples of Cravath's clients include close relationships with JP Morgan, Goldman Sachs, Salomon Smith Barney, Credit Suisse-First Boston, Cambell's Soup, Bayer, Bristol-Myers Squibb, Levi Strauss, IBM, Unilever, Johnson and Johnson, and more (Collins, 2004).

In summary, Cravath has used its prestige to successfully compete with other large US law firms domestically and internationally, without making some of the same changes that competitors have made in response to the demands of clients and the business environment. In particular, Cravath has differed in the ways that it grows and its rate of growth. The firm successfully attracts US and international clients, even though it

does not operate a large number of international offices. Instead, Cravath relies on its reputation and referrals from other firms who are aware of this reputation. In addition, the firm continues to use a very competitive approach to selecting partners, often forcing the vast majority of their associates to leave after being passed up for promotion. Despite the grim prospects for making partner, Cravath is still able to attract a continuous supply of first year associates that join the firm because of its prestigious name and high salaries. In addition, those associates, who are forced to leave the firm after failing to make partner, can benefit from having the Cravath name on their employment history. And finally, Cravath successfully leverages its status to limit its practice to high-end legal work that commands considerable premiums. Taken together, as Cravath avoids creating permanent salaried positions and opening foreign offices, the firm is perpetuating its legend and maintaining its status, which allows it to successfully compete. In a sense, Cravath's reputation is more than just the foundation of the firm's strategy.

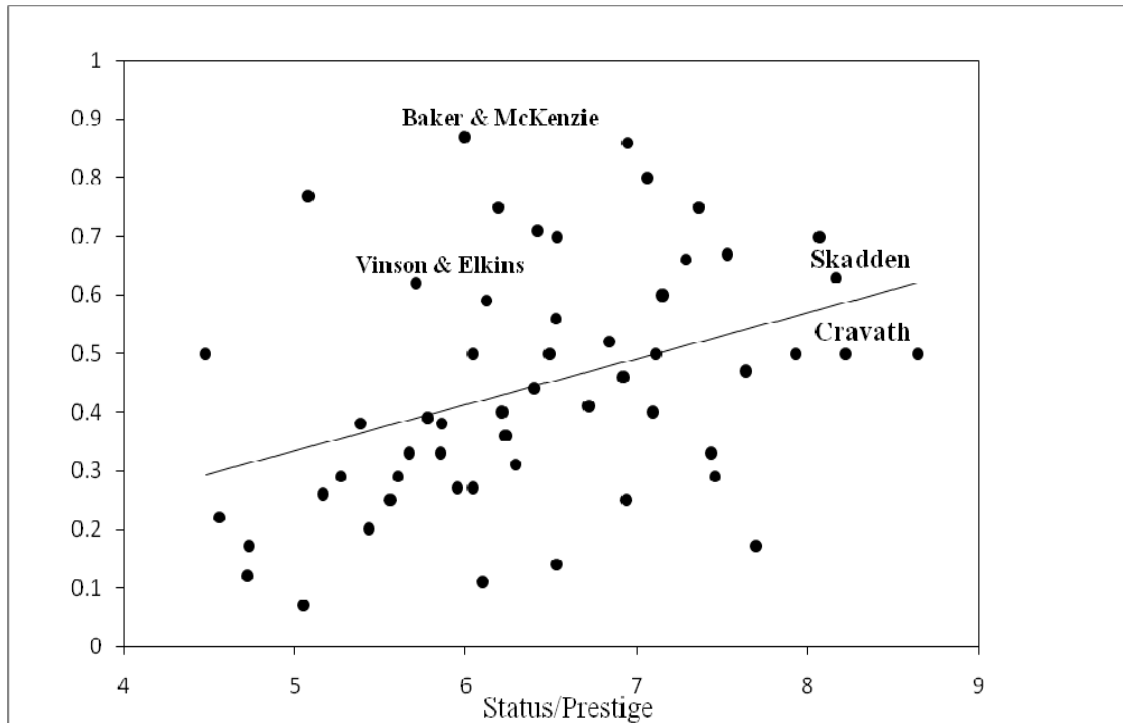
4.4 DISCUSSION & CONCLUSION

Chapter 2 of this dissertation offered a hypothesis on the relationship between law firm status and internationalization. Specifically, Hypotheses 1 in chapter 2 predicted that law firm status would be negatively related to internationalization. The results in the analysis in chapter 2 suggested that when internationalization is viewed as the ratio of foreign offices to total offices, status is positively related to internationalization. In the above examples, Cravath and Skadden are the two most prestigious firms and Vinson and Elkins, Baker and McKenzie, and Coudert Brothers are less prestigious (Vault, 2010). However, an inspection of tables 7, 9, 11, and 13 suggests that Baker & McKenzie has

the most foreign offices, even though it is not the most prestigious firm among the five. In addition, when the ratio of international offices to total offices is used as a measure of internationalization, in 2008 the ratio for Cravath was 0.50, while it was 0.63 for Skadden, 0.62 for Vinson and Elkins, and 0.87 for Baker and McKenzie. This means that even when the ratio of international offices to total offices is used as a measure of internationalization, Baker and McKenzie would be considered more internationally diversified. It is important to note that Coudert Brothers was no longer operating in 2008.

This finding suggests that Baker and McKenzie may be an exceptional case. In order to illustrate this, data from Vault Career Intelligence (Vault, 2010) was used. More specifically, every year, Vault surveys more than 15,000 associates and has them rate the prestige of other firms on a scale of 1 to 10, with 10 being the highest level of prestige possible. This published annual ranking is available from 2006 through 2010 and includes the top 100 firms by prestige. The average Vault ranking for available firms, which were also in the samples in chapters 2 and 3, were calculated and plotted along with the ratios of foreign to international offices for each of these firms in 2008, which was the middle year in the Vault rankings. The resulting scatter plot is presented in figure 2 and shows that Baker and McKenzie does seem to be more international than firms with similar prestige ratings. In addition, the trend line fitted to this scatter plot seems to be consistent with the findings in chapter 2.

Figure 2: Status/Prestige and Ratio of International to Total Offices



Chapter 2 also found support for the idea that New York firms tend to have higher ratios of foreign to total offices. Consistent with this finding, the brief case studies of Coudert Brothers, Skadden, and Cravath do offer good examples of New York firms with ratios of foreign to total offices that are above the sample mean of 0.24 in chapter 2. However, the case of Cravath may offer some insight into why chapter 2 did not find a significant relationship between being from New York and having a greater number of international offices. More specifically, Cravath has consistently sought to limit its geographic footprint and only operates two offices, one in New York and one in London. While this combination results in a ratio of foreign to total offices that is greater than the sample mean, it does not necessarily mean that Cravath is more geographically dispersed, in

terms of number of offices, than the average firm in the sample. If this is related to the level of Cravath's status or prestige, it is possible that other highly prestigious firms in the sample may also maintain fewer domestic and international offices, but larger ratios of international to total offices. In this case, one explanation for why chapter 2 did not find support for the idea that New York firms would be more likely to operate greater numbers of foreign offices is because New York contains more prestigious US law firms.

Chapter 2 also found support for the idea that firms would be more likely to enter foreign markets where their local domestic clients are likely to go. This idea is consistent with the brief firm descriptions presented above. For example, early in the firm's history, Coudert Brothers opened an office in Paris after maintaining a strong relationship with the French consulate in New York. In addition, Coudert Brothers was able to serve its American clients in Paris in the 1920's and 1930's. However, from the 1970's Coudert Brothers began to enter a greater number of exploration markets. In addition, Vinson and Elkins has continuously based its geographic expansion on the internationalization trends of its key clients in the oil industry. On the other hand, the above examples also offer that firms may enter markets to pursue new clients, or even to look for new opportunities without an exact idea on what they are. As an example, Skadden has entered markets where there are potential clients with an interest in acquiring American companies, and have also entered markets where there is a domestic market for takeovers, as illustrated by the firm's entrance into Russia in the 1990's. Similarly, Coudert Brothers started its first Asia expansion in the 1970's before it had a clear idea on what its operations there would look like.

Chapter 3 of this dissertation looked at relationships between patterns in international geographic diversification and performance. More specifically, the first hypothesis in chapter 3 suggested that the number of foreign offices in countries where a firm's domestic clients are likely to open offices is positively related to performance. In the brief case studies above, Vinson and Elkins is the firm that has most consistently made location decisions based upon its existing clients. Vinson and Elkins has been consistently profitable, achieving yearly net profits and profits per partner that are competitive; however, the firm's gross revenues have not grown at the same rate as its competitors. This slower relative growth in gross revenues is illustrated by Vinson and Elkins' gradual decline in the annual *AM Law 100* rankings listed in table 12. In the case of this particular firm, a strategy that focuses on exploitation markets appears to result in positive net income, but slower growth in gross revenues. Alternatively, this slow growth in gross revenues may have resulted from the collapse of Vinson and Elkins' largest client, Enron.

The second hypothesis in chapter 3 found cautious support for the prediction that the number of offices in markets where existing domestic clients are perhaps less likely to operate is positively related to firm performance. Among the brief case studies above, Coudert Brothers is the firm that most consistently entered exploration markets, especially from the 1970's until the firm's failure in 2005. However, contrary to the expectation that this type of growth would be positively related to performance, Coudert Brothers achieved net profits and profits per partner that were consistently lower than firms of similar size. In addition, Coudert Brothers' gross revenues relative to

competitors gradually declined over the period from 1985 through 2004, as illustrated by the decline in the *AM Law 100* rankings listed in table 8.

Finally, chapter 3 offered a hypothesis on the interaction effect between exploitation offices and exploration offices and firm performance. Specifically, this hypothesis offered that greater numbers of both exploitation and exploration offices would mean that firms could learn from their offices in exploration offices and establish new client relationships, while simultaneously benefiting from existing client relationships in exploitation offices. In addition, these two types of offices could exchange knowledge and client referrals to ensure positive performance in the present and new developments that will secure future capabilities. However, counter to expectation, results from the analysis in chapter 3 suggest that the interaction effect has a negative relationship with performance. A potential explanation for this finding is that the simultaneous use of greater numbers of both exploitation and exploration offices could create additional coordination costs and complexity, resulting in decreased performance.

In the brief case studies outlined above, both Baker and McKenzie and Skadden are the two firms that most clearly pursued strategies that targeted both exploitation and exploration markets simultaneously. In addition, both of these firms have led their American competitors in terms of gross revenues, as illustrated in tables 10 and 14 which show that these two firms have consistently been ranked among the top three by gross revenues in the annual *AM Law 100* rankings. In addition, Skadden and Baker and McKenzie have consistently achieved net profits which are greater than most of their nearest competitors. These examples suggest that the interaction between exploitation and exploration offices has a positive relationship with firm performance. However, as

already mentioned, the findings in chapter 3 suggest that within the overall sample, the interaction between exploitation and exploration offices is negatively correlated with firm performance. As a result, Baker and McKenzie and Skadden appear to be examples of firms which may be outliers in the sample.

Overall, these case studies offer examples that are consistent with many of the findings in chapters 2 and 3 of this dissertation. However, some of these examples also depart from the findings in the first two chapters. These differences show that there is some heterogeneity among firms within the sample. More specifically, the first two chapters dealt with the overall trends and relationships within the sample of *AM Law 100* firms between 2004 and 2008, but it is also important to note that individual firms have unique characteristics, histories, structures, and tendencies. As a result, there will be individual firms that depart from the overall relationships identified in the first two chapters.

CHAPTER 5: Conclusions and discussions

5.1 SUMMARY OF RESULTS & CONTRIBUTIONS

This dissertation makes a number of contributions to research and theory on FDI and multinational enterprises. In particular, this work focuses on a unique empirical context, large US law firms, to explore various factors that may be related to the propensity towards international diversification and patterns in diversification. In addition, this analysis has looked at how different patterns in international diversification, linked to strategic motives, may be related to the overall performance of large US law firms.

The objectives of the first analysis in this dissertation are to empirically analyze relationships between firm prestige, or status, and international diversification, and to assess how a firm's home location may influence the propensity towards international diversification and specific patterns in diversification. The results of an empirical analysis, utilizing hand-collected and coded panel data from 1984 through 2008, suggest that prestigious firms may be more likely to maintain a higher ratio of foreign to total offices. However, this analysis also suggests that more prestigious firms may operate fewer overall domestic and foreign offices. As a result, these firms may tend to be more diversified when we look at the ratio of foreign to total offices, but this does not necessarily mean that they maintain a greater number of foreign offices. In addition, this analysis also suggests that firms from New York tend to maintain a higher ratio of foreign to total offices, and the home location of firms may be related to specific patterns

in international diversification. More specifically, the results in the first analysis offer some support for the idea that firms are more likely to enter foreign markets known by the same industries as the dominant industries in their home-town locations. By focusing on firm prestige and home location, this study offers unique contributions to the existing literature on international diversification. Additionally, while the results of this analysis are of interest to international business scholars, they may also be of interest to organizational theorists and economic geographers.

The objectives of the second analysis in this dissertation are to empirically analyze the relationships between international diversification patterns seeking to exploit existing firm resources, search for new firm resources, or both, and firm performance. Using hand-collected and coded panel data on large US law firms from 1984 through 2008, the results in this analysis suggest that there are positive relationships between international diversification to exploit existing resources and performance, and international diversification to develop or acquire new resources and performance. However, the results of this analysis also suggest that simultaneously pursuing ever greater levels of international diversification to exploit existing resources and acquire or develop new resources may have a negative relationship with firm performance. This analysis offers unique contributions to the literature on international diversification by incorporating the exploration-exploitation literature stream to link diversification patterns to motives. By considering firm motives and incorporating them into operational definitions of diversification and performance, this analysis may serve as an approach to making more theoretically valid predictions on the relationship between diversification and performance. Additionally, while the theoretical arguments and methodological

approaches in this analysis may be of interest to international business scholars, strategic management scholars, and organizational theorists, practicing managers in professional service firms may also be interested in the results. More specifically, the simultaneous pursuit of greater numbers of offices in both exploration and exploitation markets appears to be negatively related to overall firm performance, and suggests that there are pitfalls to this dual approach. On the other hand, clearly pursuing either an exploration, or exploitation strategy appears to have a positive relationship with performance outcomes in the analysis.

Finally, the third analysis in this dissertation includes five brief company histories, or case studies. This qualitative analysis offers examples that are consistent with the empirical results in chapters 2 and 3, but it also offers examples that depart from the empirical findings in chapters 2 and 3. In particular, in the case studies of Skadden and Baker and McKenzie, these firms appear to simultaneously pursue expansion into both exploration and exploitation markets, yet they also experience consistently positive performance, which is counter to the empirical results in chapter 3. In addition, another case study, which focuses on Coudert Brothers, shows an example of a firm that pursues mostly exploration in the markets that it enters, yet the firm experienced poor performance and was eventually disbanded by its partners.

5.2 RESEARCH LIMITATIONS & FUTURE DIRECTIONS

This research, like all research, comes with limitations. In particular, the empirical context of this analysis is large US law firms, which begs to question how generalizable

the results are to other professional service industries, and for firms from other national home contexts. In addition, status, or prestige, was operationalized using a binary variable to represent either white shoe firms or non-white shoe firms. Future research might benefit from a measure of status that covers a range of values. Unfortunately, at this time I am unaware of a continuous measure of status or prestige that is available for all of the firms in the sample and that covers all of the years in the sample. In addition, in chapter 3, it was impossible to identify all of the clients of each firm in the sample. However, if this type of data does become readily available in the future, it could be used to more accurately identify and classify exploitation and exploration offices.

Hopefully this dissertation serves as a platform from which to pursue further research to better understand strategy, organizational structures, behavior, and performance in the context of international professional service firms. In particular, this analysis has looked at status as a potential factor in the propensity towards internationalization. However, there are still questions on how status or prestige, but not necessarily defined by market share, might relate to location decisions and entry timing. Pursuing this line of research may prove to be especially beneficial. Examples of questions related to this line of inquiry include questions on whether firms avoid or enter markets based upon the status or prestige levels of competitors who are already operating in the markets. Or, does status or prestige influence the tendency to enter newly opened foreign markets earlier or later? Pursuing research that attempts to answer some of these questions will further add to our understanding of international professional service firms.

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APPENDIX

OMB No. 0990-0263

Protection of Human Subjects Assurance Identification/IRB Certification/Declaration of Exemption (Common Rule)

Policy: Research activities involving human subjects may not be conducted or supported by the Departments and Agencies adopting the Common Rule (56FR28003, June 18, 1991) unless the activities are exempt from or approved in accordance with the Common Rule. See section 101(b) of the Common Rule for exemptions. Institutions submitting applications or proposals for support must submit certification of appropriate Institutional Review Board (IRB) review and approval to the Department or Agency in accordance with the Common Rule. Institutions must have an assurance of compliance that applies to the research to be conducted and should submit certification of IRB review and approval with each application or proposal unless otherwise advised by the Department or Agency.

1. Request Type <input checked="" type="checkbox"/> ORIGINAL <input type="checkbox"/> CONTINUATION <input type="checkbox"/> EXEMPTION	2. Type of Mechanism <input type="checkbox"/> GRANT <input type="checkbox"/> CONTRACT <input type="checkbox"/> FELLOWSHIP <input type="checkbox"/> COOPERATIVE AGREEMENT <input type="checkbox"/> OTHER: _____	3. Name of Federal Department or Agency and, if known, Application or Proposal Identification No.
4. Title of Application or Activity "The Internationalization of Large US Law Firms"		5. Name of Principal Investigator, Program Director, Fellow, or Other Kristan Skylar Powell

6. Assurance Status of this Project (Respond to one of the following)

- This Assurance, on file with Department of Health and Human Services, covers this activity:
 Assurance Identification No. F-3526, the expiration date September 15, 2011 IRB Registration No. IORG0000169
- This Assurance, on file with (agency/dept) _____, covers this activity.
 Assurance No. _____, the expiration date _____ IRB Registration/Identification No. _____ (if applicable)
- No assurance has been filed for this institution. This institution declares that it will provide an Assurance and Certification of IRB review and approval upon request.
- Exemption Status: Human subjects are involved, but this activity qualifies for exemption under Section 101(b), paragraph _____.

7. Certification of IRB Review (Respond to one of the following IF you have an Assurance on file)

- This activity has been reviewed and approved by the IRB in accordance with the Common Rule and any other governing regulations.
 by: Full IRB Review on (date of IRB meeting) _____ or Expedited Review on (date) April 19, 2010
 If less than one year approval, provide expiration date _____
- This activity contains multiple projects, some of which have not been reviewed. The IRB has granted approval on condition that all projects covered by the Common Rule will be reviewed and approved before they are initiated and that appropriate further certification will be submitted.

8. Comments

CHS #18104

9. The official signing below certifies that the information provided above is correct and that, as required, future reviews will be performed until study closure and certification will be provided.	10. Name and Address of Institution University of Hawaii at Manoa 2444 Dole Street, Bachman Hall Honolulu, HI 96822	
11. Phone No. (with area code) (808) 958-5007 12. Fax No. (with area code) (808) 958-8683 13. Email: nrking@hawaii.edu	15. Title Interim Executive Secretary	
14. Name of Official Nancy R. King	17. Date April 26, 2010	
16. Signature		

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