

**The Global Law Firm:
An Initial Study of Strategy and Performance**

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Abstract

We explore large law firms, their strategies and measures of their effectiveness. Our findings suggest that optimal partner profitability is a function of moderate expansion strategies. Contextual variables, like baseline profitability and national origin, also have important impacts on performance.

Key words: strategy; profitability; law firms

JEL classification: M10; F23

1. Introduction

The competitive environment for law firms has been in a state of flux in recent years. In the 1990s accounting firms entered the field in a significant way, putting the legal profession on the defensive (Brock and Powell, 2005). While accounting's encroachment on law's turf was more advanced in Europe and South America than in North America, the clear trend and pace caused significant anxiety globally in the legal profession (Denny, 2004; Flood, 1999; Fox, 2000). Then, in the wake of major financial scandals in which some of these large accounting firms were implicated, the Sarbanes-Oxley Act (2002) caused a pause—if not a reversal—in accounting's assault on turf previously reserved for law. Meanwhile, in line with general globalizing trends and also as a possible strategic counter to sundry invasions on

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their turf, there was an increasing tendency for law firms to diversify internationally (Lowry and Siegel, 2004).

Nonetheless, scholarly research on law firms in general and their strategies in particular, is still very rare. In this paper we study their strategies and effectiveness. We use the *global* moniker to refer to the very largest (e.g., top 100) law firms in the world (see Figure 1), all of which are internationalized to some extent; although a few of them have offices in only one country, even these have significant overseas clients.

Figure 1. Introductory Lines from the Websites of Three Global Law Firms

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| <ul style="list-style-type: none"> • <i>Shearman & Sterling LLP</i> is one of the few global law firms, with more than 1000 lawyers located in all of the world's financial capitals. • Welcome to <i>Clifford Chance</i>, a truly integrated global law firm where our people believe in one approach—to help you achieve your objectives. • <i>Baker & McKenzie</i> is the world's leading global law firm. We have provided sophisticated legal advice and services to many of the world's most dynamic and global organizations for more than 50 years. |
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In the next section we survey relevant literature and build theory and hypotheses.

2. Strategy, Context, and Performance of Global Law Firms

In this paper we attempt to clarify some of the strategic and performance issues in global law firms. The vast majority of law firms are tiny, comprising perhaps a single professional or a small partnership; and their work is also mainly local, be it transferring a home from one family to another or representing a client in a local court. Global law firms, on the other hand, tend to focus more on investment banking, major litigation usually involving a multinational and/or governmental organization, and transactional law (e.g., contracts, patents) for similar large organizations (Brock et al. 1999; Pinnington and Morris, 2003).

2.1 Finding a Strategy Concept for Law Firms

Scholarly research on the strategy concept is rare in professional services in general and especially in law. Löwendahl (1997) presents three generic strategies for professional service firms in general based on whether the firms derived competitive advantage primarily via client relationships, selling solutions, or expertise at problem solving. However these large diverse law firms generally have several sub-units competing on all three of these bases for competition, making it impractical to neatly classify an entire global firm into any one of them. Hitt et al. (2001) study diversification of large American law firms without addressing the strategy concept in general. Cooper et al. (1996) developed the managed professional business concept for professional services in general, but this is more a description of all large/global firms' strategies and does not provide a framework for alternative

competitive strategies in this context. The same limitation applies to the Brock et al. (1999) global professional network model. Moreover, many well-accepted concepts from the competitive strategy domain do not apply readily to the global law-firm context; for example, the Porter (1980) “cost-leader” strategy would not be appropriate for these elite professional service providers, and scope for “growth” strategies in general (e.g., Hofer and Schendel, 1978) is limited because global law firms are already positioned as the very largest law firms in the world.

The work of Miles and Snow (1978), however, provides some strategic concepts related to planned expansion (versus stability) of product/market domain that can be applied to this context. Thus, based on our reading of this literature in general, we believe that global law firms are generally identifiable by one of the following three approaches to strategy: prospector, analyzer, or defender. (Because global law firms are, by definition, all members of an elite category in their profession, we do not identify reactors in this sample.) The prospector strategy has the highest rates of change in product/market domain; it relies on a constant search for new products, services, and/or locations to gain competitive advantage. At the other extreme, the defender strategy tends to concentrate on a similar products, services, and markets, gaining competitive advantage through a long-range commitment to satisfying the needs of traditional customers. The analyzer strategy has some prospector as well as some defender characteristics, holding some stable product-market positions while simultaneously investing in limited search for new markets. In the following section we describe how these strategies may relate to the performance of global law firms.

2.2 The Relationship between Strategy and Performance

In theorizing about how these strategies might relate to a firm’s effectiveness, a key point from which to proceed is that in essence law is a local (not global) phenomenon, and law firms have thus historically been local in focus. This suggests that the traditional competencies and efficiencies of law firms reside in local work with nearby clients. Like other service firms in general, diversification away from traditional (or local) competencies (or clients) is very risky and tends to be associated with questionable financial returns (e.g., Contractor et al., 2003; Capar and Kotabe, 2003). Not only are economies of scale generally not applicable in these contexts (Løwendahl, 2000), but the diversifying firm must constantly cope with the inefficiencies involved with entering unfamiliar and often remote markets, different legal systems, and unfamiliar cultures. While some firms may experience positive learning effects as they expand, research on service firm diversification has thus far not found these benefits to be consistently significant (Palich et al., 2000). This agrees with the findings of Contractor et al. (2003) as well as the sentiment expressed by Capar and Kotabe (2003, p. 353) in a note speculating that highly diversified firms get to the point where “costs of excessive scale and scope would begin to outweigh the benefits in service firms” resulting in negative incremental returns.

The above arguments indicate a negative prognosis for the growth and diversification-oriented prospector strategy. Their significant presence in relatively unfamiliar and remote markets counts against them, a factor especially important given the diversity of legal systems and local regulations. Also, the process of prospecting has been found to be generally costly and inefficient (Hambrick, 1983). The defender has the advantage of familiar turf, but lacks the capability to capitalize on the benefits of related diversification—argued to be a correlate to American firms in the Ruigrok and Wagner (2003) study. The fact that the vast majority of global law firms are US-based adds relevance to this argument. Further, in the contemporary, highly competitive, global deregulated market for legal services where one's home turf is increasingly open to competition from new directions, the defender's lack of ability to diversify is likely to be a significant liability. A related issue is that a proven ability to retaliate against a competitor entering a firm's home turf, or at least pose credible threat of a counterattack, is a signal that warns off the threat of new entrants (Porter, 1980). All these points militate against the defender: while they may well continue to be profitable in niches, the strategy is not optimal in a global deregulated market. The analyzer is thus likely to be the most effective of the three strategies because it pursues a manageable level of related diversification to capitalize on market opportunities but runs less risk of overextension into unprofitable areas. We thus expect to find superior levels of law firm profitability and profitability growth in the analyzer relative to the defenders and prospectors. The only area in which one of the other strategies may eclipse the analyzer is in the area of growth rates in which the prospector will have natural advantage.

Proposition 1: For these global law firms, a moderate expansion (or analyzer) strategy is optimal relative to either strategies of domain defense (defender) or more aggressive expansion and diversification (prospector).

Hypothesis 1: The analyzer strategy is more profitable relative to the defender and prospector options.

Hypothesis 2: The prospector strategy has superior growth rates relative to the analyzer, which in turn is superior to the defender.

In exploring this proposition we also want to control for various contextual variables that may account for unique variance in firm outcomes: origin, size, and baseline profitability. There have historically been two distinct domains for global law firms, namely London and New York. London firms have been more global yet less profitable than their American counterparts (Flood, 1999). We thus want to control for country of origin. Firm size, via its association with market power, is generally considered to be a correlate of profitability (Buzzell and Gale, 1987). Larger firms may also have more difficulty sustaining growth rates. Law firm size—either in terms of number of lawyers or gross revenues—is thus a relevant contextual variable. Finally, we want to control for baseline profitability since the

previous years' profitability is expected to be a close predictor of future profits. In the next section we describe our data sources, analysis, and conclusions.

3. Method and Findings

3.1 The Data

We selected a sample of the world's largest law firms from the *Legal Business 100* tables published in September 2003 (www.legalbusiness.co.uk). These tables list the top 100 law firms by revenue, profits per equity partner, and several other measures. In addition to these tables for the 2003 year, we collected comparable data for the 2001 year from *The American Lawyer* (www.law.com) thus giving our study a two-year time horizon. However, due to missing data, entry/departure from the list over the 2001-2003 periods, and an outlier, we were able to work with data from only 89 firms that remained on the lists throughout. Of these 89, 76 are US firms (or global firms originating from the US) and 13 British. A small number of Australian, Canadian, and Continental European firms that appeared in the second half of these top-100 rankings were among those eliminated for missing data.

3.2 The Variables

Strategy

We used three dependent variables as indicators of the performance of the firm. The first two are profits per equity partner (PEP) for the 2003 year and growth in PEP between the 2002 and 2003 years. These profitability measures are justified assuming that the prime objective of these super-large law firms is the maximization of partner profits—an assumption gleaned both from literature sources (Flood, 1999; Løwendahl, 1997; Sherer and Lee, 2002) and our own experience and interviews with top managers of global law firms. PEP maximization has an additional benefit, as various agencies like the *Amlaw* and *Legal Business* rank law firms according to variables like PEP and revenues; and these measures thus become a signal of status and quality in the industry, which in turn can enhance business opportunities. The third variable that we used as a dependent variable was the growth rate, or percentage increase in gross revenue (from 2001 to 2003), an important indicator of a firm's ability to compete successfully in the increasingly deregulated and cutthroat industry of legal business services. Positive growth is also essential for these elite firms to maintain good stature in annual rankings such as *Amlaw* and *Legal Business*.

Context

Three variables were used to control relevant factors that are generally considered strong predictors of current effectiveness. Profits per partner (PPP) in year 2001 provides a baseline measure of profitability. A country of origin indicator variable (UK=1 and US=0) is included because London firms have been more global

yet less profitable than their American counterparts (Flood, 1999). Finally, number of lawyers for year 2001 is a baseline measure of firm size.

Product/Market Strategy

The three strategies representing varying degrees of change (or growth) in product and/or market scope (Miles and Snow, 1978) were operationalized as follows. First, firms were classified as prospectors ($n = 25$) if they had greater than 35% growth in the number of lawyers over the two-year period or they had offices in over 10 countries. Remaining firms were classed as analyzers ($n = 38$) if they had greater than 25% growth in the number of lawyers over the two-year period, offices in 4 or more countries, or at least 11% of their lawyers abroad. The rest of the sample, i.e., those with the lowest rates of lawyer growth and offices in 3 or fewer countries, were labeled defenders ($n = 26$). The cutoffs used here (e.g., growth rates and numbers of countries) were chosen with a view to obtain roughly balanced sample sizes for the three strategies. As with most contemporary classifications of the Miles and Snow (1978) types, the intention is to indicate relative levels of prospecting and defending rather than purity in these strategies.

3.3 Analyses and Findings

Sample Statistics

The 89 global law firms present some interesting descriptive statistics, including mean PEP of nearly \$900,000 in 2003, mean profitability growth of nearly 10% over the two-year period, and an average international presence in 6 or more countries. Further statistics and correlations are reported in Table 1.

Table 1. Some Descriptive Statistics and Correlations

| | Mean | SD | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|-----------------------------|--------|--------|---------|----------|---------|---------|---------|--------|---------|------|
| 1. Country of origin | 0.15 | 0.36 | | | | | | | | |
| 2. PPP 2001 (\$'000) | 814.69 | 451.30 | 0.14 | | | | | | | |
| 3. Lawyers in 2001 (#) | 750.08 | 465.51 | 0.40*** | -0.05 | | | | | | |
| 4. Growth in lawyers | 0.17 | 0.18 | -0.00 | 0.04 | -0.05 | | | | | |
| 5. Lawyers abroad (%) | 14.05 | 17.57 | 0.54*** | 0.16 | 0.64*** | 0.06 | | | | |
| 6. Offices in countries (#) | 6.43 | 6.45 | 0.48*** | 0.15 | 0.71*** | 0.05 | 0.92*** | | | |
| 7. Growth in revenue (%) | 17.43 | 16.76 | -0.13 | -0.34*** | -0.06 | 0.71*** | -0.04 | -0.02 | | |
| 8. PEP in 2003 | 877.55 | 375.99 | -0.02 | 0.93*** | -0.02 | 0.06 | 0.08 | 0.08 | -0.20 | |
| 9. Change in PEP | 9.94 | 16.87 | -0.43** | -0.29** | -0.21* | 0.08 | -0.24* | -0.21* | 0.42*** | 0.04 |

Notes: Due to inconsistencies in our data sources, PPP is used for 2001 and PEP for 2003. That they are highly correlated ($r^2 = .93$) implies that PPP is a good control measure of baseline profitability. *, **, and *** denotes significance at the 5%, 1%, and 0.1% levels.

Hypothesis Tests

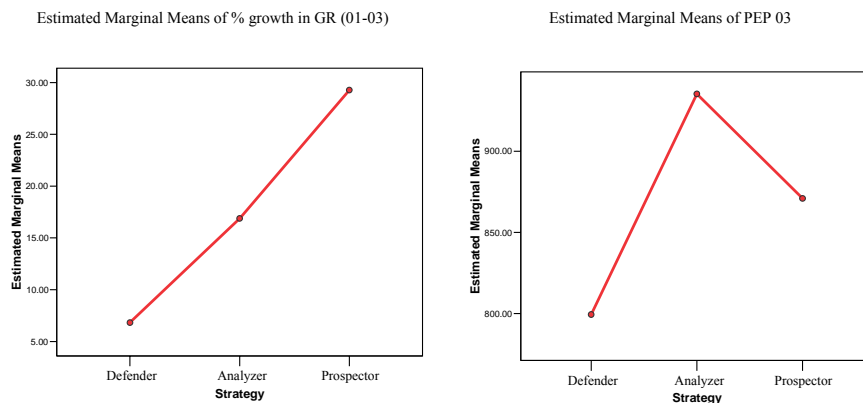
We began by categorizing each firm in the sample into the three strategy types. Group means and other descriptive statistics for the strategies by each of the three dependent variables—namely PEP in 2003, change in PEP, and revenue growth—are shown in Table 2 and illustrated in Figure 2. Generally the means indicate agreement with the hypothesized tendencies, with analyzers showing superior profitability and profitability growth, while the growth rate measure indicates that prospectors were ahead of the analyzers, followed by defenders.

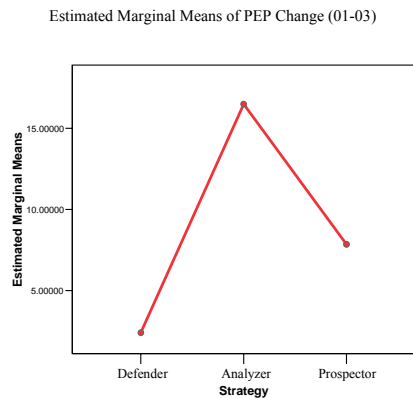
Table 2. Strategy and Effectiveness Variables: Descriptive Statistics and Univariate *F* Tests

| | Strategy | <i>n</i> | Mean | SD | <i>F</i> (2,83) | Partial Eta-Squared |
|---------------------------|------------|----------|----------------|--------|-----------------|---------------------|
| PEP (2003) | Defender | 26 | 701.02 | 321.11 | 9.96*** | 0.194 |
| | Analyzer | 38 | 1022.33 | 398.42 | | |
| | Prospector | 25 | 841.08 | 312.87 | | |
| | Total | 89 | 877.55 | 375.97 | | |
| Change in PEP (2001-2003) | Defender | 26 | 7.15 | 16.22 | 7.77*** | 0.158 |
| | Analyzer | 38 | 15.98 | 17.29 | | |
| | Prospector | 25 | 3.68 | 14.20 | | |
| | Total | 89 | 9.94 | 16.87 | | |
| Growth in Revenue (%) | Defender | 26 | 11.46 | 15.97 | 11.80*** | 0.222 |
| | Analyzer | 38 | 16.77 | 10.98 | | |
| | Prospector | 25 | 24.62 | 22.03 | | |
| | Total | 89 | 17.43 | 16.76 | | |

Notes: *** denotes significance at the 1% level.

Figure 2. Graphical Depiction of the Strategy Effectiveness Measures





We fit a generalized linear model in SPSS and performed a multivariate analysis of covariance to examine the strengths of the effects of strategy type on the three dependent variables, controlling for the country of origin, PEP in 2001, and number of lawyers in 2001. These controls accounted for profitability and firm size at the start of the period. Results indicate that strategy had a statistically significant effects on outcomes above and beyond the covariate effects (Wilk's Lambda = 0.62, $F = 7.295$, $p < 0.0001$). Univariate F tests reveal significant effects of strategy type on each of the three outcome variables in the hypothesized direction: growth rate ($F = 11.8$, $p < 0.0001$), profitability ($F = 9.96$, $p < 0.001$), and change in profitability ($F = 7.77$, $p < 0.005$).

The proportion of the variance explained by all the predictors in our model was approximately 31.6% in gross revenue growth, 91.1% in profit per equity partner in 2003, and 36.4% in profitability growth between 2001 and 2003. As evidenced by the partial eta-squared figures in Table 2, the net contribution of the strategy variable (after controlling for baseline profitability and firm size in 2001) was 22.2% in gross revenue growth, 19.4% in profit per equity partner, and 15.8% in profitability growth. These figures not only point to the relevance and legitimacy of our application of the Miles and Snow (1978) strategy typology, operationalization, and measures in this context, they also point to the significance of the implicit strategic lever—namely domain expansion.

The post hoc multiple comparisons support our hypothesis about the direction of group differences. Specifically, Fisher's least significant differences mean separation tests indicate the following conclusions. (1) In agreement with Hypothesis 1, analyzers were more profitable than defenders (mean $\Delta = 135.9$, $s.e. = 30.6$, $p < 0.0001$) and prospectors (mean $\Delta = 64.4$, $s.e. = 34.2$, $p < 0.06$); they also showed higher profitability growth than both defenders (mean $\Delta = 14.1$, $s.e. = 3.7$, $p < 0.0001$) and prospectors (mean $\Delta = 8.6$, $s.e. = 4.1$, $p < 0.04$). (2) In agreement with Hypothesis 2, the prospectors outperformed both analyzers (mean $\Delta = 12.4$, $s.e. = 4.2$, $p < 0.004$) and defenders (mean $\Delta = 22.5$, $s.e. = 4.6$,

$p < 0.009$) in growth rates. In addition, analyzers outperformed defenders in this measure (mean $\Delta = 10.1$, s.e. = 3.8, $p < 0.009$).

4. Discussion and Conclusions

Global law firms are a relatively recent phenomenon. This initial study is an attempt to contribute to the fledgling research area by beginning to understand these organizations' strategic behavior. Strategy is an under-explored area in professional service firms in general, partly due to their history and culture as collegial as opposed to competitive organizations (Brock et al., 1999). Globalization in accounting, engineering, law, and even medicine provides the impetus for exploring strategic management, especially in the more global, competitive sectors of these industries. Our analysis seems to indicate the relevance to this context of the strategy construct in general, and the adaptation of the Miles and Snow (1978) strategy types in particular. A contribution of this paper is its grounding and operationalization of the strategy concept in this context.

Our results suggest that the analyzer strategy, with its balanced approach to diversification, outperforms the other two strategies in the crucial areas of partner profitability and profitability growth. While it is relatively easy to explain why analyzers outperform prospectors—for example, due to lack of efficiency (Hambrick, 1983) and risks of internationalization (Hitt et al., 2001)—it is less clear why they outperform defenders. The results may thus be the result of an interaction between the strategy used and the market conditions at the time of the study given that the sample is from elite, successful firms that seem to have access—at least initially—to lucrative new product/market segments. Thus these findings may also be an indication of the relatively new field of global law firms. Future studies may find the original Miles and Snow (1978) concept of internal consistency—rather than external opportunities—to be the key to effectiveness.

Further, and consistent with other studies of context variables (Buzzell and Gale, 1987; Flood, 1999) past profitability and country of origin contributed significantly to all three effectiveness variables. However the size variable in our model (number of lawyers) was not found to be significant. Future research—preferably with a larger data set—should be able to explore non-linear effects better to understand the impact of firm size. Overall, though, while there are clearly variables out of managerial control (at least in the short-term), our findings support the relevance of strategy concepts in law firms for which profits and growth have traditionally been underemphasized.

Importantly, our findings lend support to those who caution against the highest rates of diversification. More generally, our findings support the inverted-U shape thesis of diversification, with initially positive but eventual negative returns to international diversification in these contexts (Contractor et al., 2003; Ruigrok and Wagner, 2003). It seems obvious that, once firms have entered several lucrative and/or relatively familiar product/market areas, continued diversification would inevitably take them into more distant and difficult areas. Such expansion leads to

what Capar and Kotabe (2003, p. 353) refer to as “costs of excessive scale and scope.”

We are clearly looking at relatively large and profitable law firms. It is natural to ask whether the results can be extended beyond the sample. We surely do not expect these corporate-style firms with hundreds of lawyers to represent the majority of small partnerships that deliver legal services to most people in the world. However—as mentioned before—this is a study of global law firms, and these organizations tend to be relatively large and few in number. Suffice it to say at this stage that the generalizability of our results is quite limited, though perhaps suggestive of other professional services, e.g., large engineering and accounting firms. However, like other diversification research discussed above, the general cautionary message is likely applicable to all multinational organizations as they internationalize.

In extending this line of research, one obvious direction is to explore the international aspects of strategy in greater depth. Apart from the specific internationalization tactics—like Greenfield versus joint venture versus acquisition—it would be interesting to follow the lead of Nachum (2003) and explore country of origin effects. It seems obvious, for example, that national cultural differences would be important influences on the choice and execution of strategy. While our paper finds negative returns to diversification, future research should delve into the international aspects of diversification (such as different legal, accounting, tax, language, and value systems) in an attempt to explain—and perhaps ameliorate—the problems associated with expansion across national borders.

Another domain for future thinking is firm-level implementation of strategy. For example, recent work has mentioned leverage (ratio of partners to non-partners) (Flood, 1999; Rose, 1998), multi-tier and non-equity partnerships (Denny, 2003, 2004), and corporate forms of ownership (Pinnington and Morris, 2002) as a key organizing mechanisms. These alternatives certainly present managerial challenges in the multi-cultural context; and differences in legal systems from country to country also present difficulties to managers trying to renegotiate partner contracts. However, it is likely that they lead to potential advantages, both in profitability as well as growth.

Our study has succeeded in its goals of applying the strategy concept to the management of law firms, operationalizing key constructs, investigating several influences on firm performance, and beginning to understand some contextual issues. Continuing efforts in these directions will inform not only the strategy field, but all those interested in the management of professional service firms.

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