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Rachel E. Stern

Berkeley Law

Su Li

Berkeley Law

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The Outpost Office: How International Law Firms Approach the China Market

Rachel E. Stern and Su Li

How are international law firms faring in China? Drawing on 2013 data, this article presents the first comprehensive overview of the field, including information about the global mix of players and variation in market niche. Three variables—years present in China, global strategy, and level of localization—help explain why some China practices grow bigger than others. Overall, however, there is a great deal of convergence on one business model: an outpost office with a median size of eleven lawyers responsible for under 5 percent of worldwide revenue. The common experience of stagnation following market entry illustrates the strength of hype, the constraints of partnership, and the persistent power of the Chinese state to shape the legal services market. At the same time, the rarity of market exit reflects perceptions that a China presence is a valuable symbol of global commitment and a worthwhile bet on future growth.

INTRODUCTION

International expansion is one of the biggest trends among law firms in recent decades. Just as partners once debated the wisdom of new offices outside their hometowns, law firms today are deciding when and how to go global. Journalists and scholars alike have written a great deal about the rise of the global law firm, especially the handful of giants who employ thousands worldwide.¹

But what do international offices look like? Are they bustling centers key to the firm's financial future or peripheral enterprises staffed by a dedicated few? How do they think about their comparative advantage over local firms? As a window onto what some have called "typologies of globalization" (Faulconbridge et al. 2008, 464), this article examines key aspects of international law firms' organizational form and

Rachel E. Stern is an Assistant Professor of Law and Political Science in the Jurisprudence and Social Policy Program at the University of California, Berkeley. She is the author of *Environmental Litigation in China: A Study in Political Ambivalence* (Cambridge 2013).

Su Li is the research methodologist and statistician of Berkeley Law School. She received a PhD in sociology from Northwestern University. She has published in various peer-reviewed journals and law reviews, including the *Sociology of Education* and *Stanford Law Review*.

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1. For a cross-section of the literature, see Abel (1993), Silver (2000, 2007, 2009), Morgan and Quack (2006), Flood (2007, 2013), Segal-Horn and Dean (2007), Sokol (2007), Faulconbridge et al. (2008), Liu (2008, 2013), and Quack (2012).

business strategy in a single, important emerging market: Mainland China.² Unlike previous work focused on US and British global law firms (Silver 2000, 2007, 2009; Segal-Horn and Dean 2007; Faulconbridge et al. 2008), this piece investigates all 174 international law firms registered with the Chinese Ministry of Justice (MoJ) in 2012. The goal is the first comprehensive snapshot of the full spectrum of the market, from low-grossing law firms to high-grossing ones, and including those headquartered in continental Europe, Asia, and Latin America as well as in the United States and the United Kingdom.³ It is a snapshot that captures the China market in a moment of crisis for many lawyers worldwide. Titles such as “The End of Lawyers” (Susskind 2010) and “The Last Days of Big Law” (Scheiber 2013) reflect a common concern that lawyers’ best days are in the past and a new model for a new age is needed.

As lawyers stand at this crossroads, there is reason to think China might feature prominently in their thinking. Growing globally can be easier than fighting for market share at home and China’s meteoric economic growth has been headline news for decades. In 2013, luminary investor Warren Buffet concluded: “the 19th century belonged to England, the 20th century belonged to the US, and the 21st century belongs to China. Invest accordingly” (quoted in Chu 2013).⁴ Subscribing to this logic, an average of twelve new international law firms per year opened China offices between 1992 and 2012. By and large, international law firms have also been reluctant to leave. Though an average of seven international law firms per year close their China practices, 55 percent of exit can be traced to mergers or bankruptcy. Just twenty-five law firms in twenty years changed their China strategy and left outright.⁵

However, China remains a tough market. Our data highlight international law firms’ convergence on a single organizational form: an outpost office with a median size of eleven lawyers responsible for less than 5 percent of global revenue. What accounts for constraints on growth, on the one hand, and reluctance to exit China, on the other? As the second half of the article turns to this puzzle, what emerges is an account of what the African historian Frederick Cooper once called “the limits of interconnection” (Cooper 2001, 189). The presence of 174 international law firms in China—and their difficulties growing beyond a certain size—illustrates the strength of hype, the constraints of partnership, and the ongoing power of the Chinese state to shape the legal services market. Though China is a specific market, and a specific story, we hope these new data will help those interested in the evolution of the legal profession to grasp the “goals, outputs, structure, and limitations of law firm expansion across countries” (Sokol 2007, 28).

2. All references to “China” or the “China market” refer to Mainland China.

3. Relatively little has been written about international law firms in China, though notable exceptions include Heller (2003), Liu (2008), Godwin (2009), Cohen (2011–2012), and ongoing coverage in *The Asian Lawyer*.

4. Of course, Western excitement about China has not always panned out. Popular accounts of disappointed dreams include Tim Clissold’s 2006 memoir, *Mr. China*, and the 2012 David Henry Hwang play *Chinglish*.

5. We used MoJ announcements published in 2001–2009 and 2011–2013 to infer the time of firms’ exit from the Chinese market. One caveat is that this list only captures formal entry and exit. Even after closing down a brick-and-mortar China office, a law firm might continue to handle China-related business through an office located outside the country.

Globalization and the Legal Profession

One offshoot of scholarship on the legal profession explores the reasons why law firms expand internationally and how they choose to do so. There is general agreement that most law firms are reactive and go abroad in response to client demand for services (Silver 2009; Flood 2013). In addition, international offices have good optics. They can help law firms project a cosmopolitan image and few want to be seen as lagging the competition. As Richard Abel wrote back in 1993, “law firms sometimes appear to be seized by the adolescent angst that all your friends are at a party to which you haven’t been invited—it is unbearable not to be there, even if you know you would have a terrible time” (741).

At the time Abel was writing, there was a push to open offices in global financial centers such as London, Tokyo, and Hong Kong, and the primary business was advising clients on mergers, acquisitions, and financial market transactions (Flood 2007; Silver 2007; Quack 2012). Over time, many of these first forays grew deeper local roots. Carole Silver’s work chronicles how the international offices of many US law firms slowly grew beyond a skeletal expatriate staff to include local talent. Local lawyers were often able to help foreign law firms navigate the local economic, political, and cultural context, a much-valued skill set. In places where regulations permitted it, hiring local lawyers also opened opportunities to compete with local law firms for domestic clients (Silver 2009). Localization has tended to go hand-in-hand with intensified competition between local and domestic law firms, as both sides try to duplicate the others’ advantages. One result can be a boundary blurring between local and global, as domestic players start to look outside the country’s borders and international law firms hire local expertise (Liu 2008).

Existing research tells us much about the patterns and causes of law firm expansion, especially among the biggest and best-known Anglo-American law firms. However, less has been said about stagnation without exit. Though we explore this dynamic in the Chinese context, we expect that similar challenges face international law firms in other emerging markets, and that they stay in the game for similar reasons. Though some outpost offices may become wildly successful, and future research should explore the conditions under which this is true, a close look at China helps explain the lack of correlation between law firms’ global presence and increased profits (Economist 2011).

Data and Methods

In 2012, there were 174 foreign law firms present in Mainland China.⁶ Though this is a vanishingly small number compared to the 19,361 Chinese law firms

6. Although joint ventures between foreign and Chinese law firms are illegal, there have been experiments with strategic alliances and Swiss vereins between Chinese law firms and foreign law firms. It is controversial whether these tie-ups are strictly legal. In practice, the Chinese authorities have proven willing to condone some coordination of business development and marketing, as long as taxes, profit pooling, and accounting remain separate. Though some foreign firms in these associations retain MoJ registration as a foreign law firm, there are also examples of foreign law firms giving up registration and asking the Chinese half of the alliance to hire all China-based lawyers. Though foreigners cannot obtain a license to practice Chinese law, Chinese law firms can hire them as legal consultants or counselors, and it is no longer rare to find a foreign lawyer working inside a Chinese law firm.

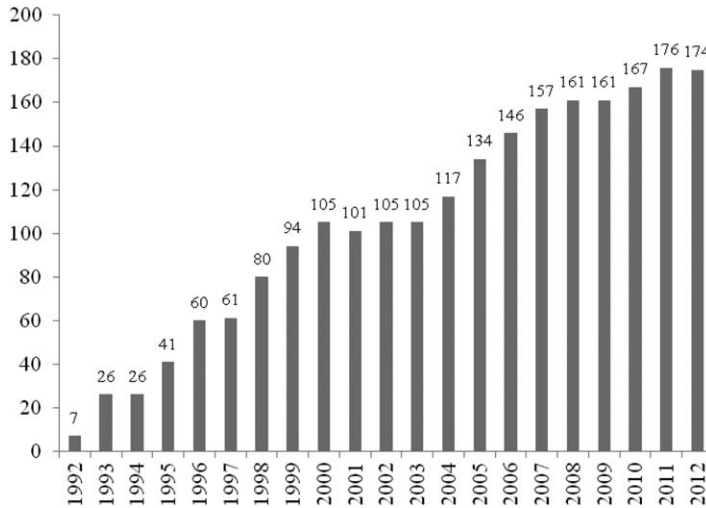


FIGURE 1.
Number of International Law Firms in China by Year (1992–2012)
 Data compiled from MoJ lists published between 1992 and 2013.⁷

registered that same year (Ministry of Justice 2013), Figure 1 shows an increasingly crowded market. In 2012, 57 percent of the international law firms present in China were American (eighty-one law firms) or British (nineteen law firms), with the balance split among a range of countries, including Australia (seven), Germany (nine), France (seven), and Japan (fifteen).

Our analysis is primarily based on quantitative and qualitative data collected during ninety interviews conducted in 2013–2014. In interviews, we combined a set list of ten questions about billing, competition, collaboration, profit sharing, future plans, and revenue with a more open-ended discussion about challenges and opportunities of the market. Ninety-two percent of foreign law offices are located in Beijing or Shanghai, and we focused our fieldwork on those two cities, tallying thirty-one interviews in Beijing and thirty-seven in Shanghai.⁸ Interviews either took place at law firm offices or cafes, and conversations ranged in length from thirty minutes to roughly three hours. English was our primary working language, with the

7. The MoJ publishes a list of approved foreign law offices in China roughly every year. The list includes the name of firm, country of origin, the city of the new office, and the certification date, and it can be published at any point during the year. If an announcement comes at the beginning or middle of the year, firms approved later that year appear in the following year's list. From 1992 to 2012, MoJ approved a total of 321 offices from 240 foreign law firms. We used the registration date on MoJ announcements to derive the number of firms registered each calendar year between 1992 and 2012. Data for 1993–1994, 1996–1999 and 2002 are estimates because the MoJ did not publish complete lists in these years. When two international law firms merged, we counted the two firms as separate before the merger and as one firm following it. In total, twenty-seven mergers took place between 1992 and 2012. Please note that the official MoJ list does not include a few foreign law firms operating illegally without registration.

8. Both authors were present for thirty-four interviews and forty-nine interviews were conducted separately. Though our focus was primarily on Mainland China, we also conducted seven interviews in Hong Kong to gain insight onto the legal market there. Sixty percent of the international law firms present on the Mainland lack Hong Kong offices, a reflection of how the Mainland is now an important market in its own right.

exception of twelve interviews in Mandarin Chinese. By design, we mostly spoke to partners at international law firms so that we could ask big-picture questions about the organizations. We supplemented seventy-seven interviews with lawyers at international law firms with conversations with in-house counsel at Chinese state-owned enterprises, legal recruiters, reporters from trade magazines, and Chinese lawyers. (A full list of interviews appears in Appendix 1.)

Rather than relying on snowball sampling—a strategy that would almost certainly lead US-based researchers to oversample US law firms—we drew a stratified random sample of eighty law firms to target for interviews. More detail about our sampling strategy is included in Appendix 2, a brief methodological note that we hope will help others interested in a similar approach. In brief, we selected law firms based on five factors: (1) whether the law firm appeared on three well-known lists of high-revenue law firms,⁹ (2) first registration date with MoJ (before or after 2002), (3) whether the law firm had multiple offices in China, (4) the presence or absence of a Hong Kong office as of 2013, and (5) country of origin. We created sampling strata based on the five variables and conducted random sampling within each stratum. In so doing, we ensured our sample included a wide range of international law firms, including law firms from all eighteen countries present in the market.¹⁰

Through a combination of e-mails, follow-up phone calls, and drop-in office visits, we were able to speak to lawyers at fifty of the eighty law firms in our sample.¹¹ These fifty law firms represent 62 percent of our sample and 28 percent of all international law firms registered with the MoJ in 2012.¹² Many lawyers expressed curiosity about our findings, especially what our research might reveal about their competitors, and told us the topic was not sensitive as long as their names and the names of their law firms were kept confidential.¹³

Timing is an important part of placing our findings in perspective. Our fieldwork in Beijing and Shanghai took place during the summer of 2013, and the 2007–2009 global financial crisis was still fresh in memory. The downturn left many China offices “in the fetal position . . . trying to cut costs and stay alive,” one

9. These three lists, all drawn up by *American Lawyer* magazine, were the 2011 American Law 100, the American Law 200, and the Global 100.

10. In rank order, the eighteen countries are the United States, the United Kingdom, Japan, Australia, Germany, Spain, France, Singapore, Brazil, Korea, Italy, Sweden, Switzerland, Belgium, Canada, the Netherlands, Norway, and the United Arab Emirates.

11. Once the sample was drawn, we checked each law firm’s website for the e-mail address of the top-ranked partner in the China office, usually the Chief Representative, to introduce the project and request a meeting. In cases where websites did not exist, or did not include lawyer contact information, we visited the office address on file with the Ministry of Justice. In total, we conducted sixteen drop-in visits that yielded five on-the-spot interviews. Equally important, these visits revealed five deserted offices, all locked and dark with piles of mail visible inside the door. In all five cases, workers in neighboring offices told us that lawyers at the deserted office live abroad and only occasionally stop by to pay bills and meet clients. We were unable to contact four firms in the sample because the law firm website lacked information about a China office and there was no office address on file with the MoJ.

12. Only two lawyers declined interviews directly. Most nonparticipants opted not to respond to e-mails and phone calls.

13. Statistical analysis shows no significant difference on the five stratifying variables between the law firms we interviewed and those we were unable to contact, which suggests our missing data were missing randomly and the collected data should serve as a good estimate of all eighty firms in the sample.

lawyer remembered (SH28).¹⁴ At the same time, however, a mood of cautious optimism reflected the broader worldwide economic recovery. Forty-seven percent of law firms in our sample reported (usually modest) plans to expand, 41 percent called their practice stable, and only 10 percent said they were going to shrink.¹⁵

A Constrained Market

Even in an era of declining trade barriers and widespread commitment to the idea of free trade, many markets are still shaped by state involvement. This is particularly true in China, where one hallmark of the transition to capitalism has been continued state control in some areas with a much more hands-off approach in others. State control is particularly pronounced in sectors with weak domestic firms and high strategic importance (Hsueh 2011). When the first foreign lawyers arrived in China at the start of market reforms, the legal market exhibited both of these qualities: nearly nonexistent competition from Chinese lawyers and high political sensitivity. Although Chinese law firms have grown into fierce competitors in recent years, today's legal market continues to highlight the tension between China's move toward free markets and ongoing state control of key sectors.

Above all, foreign law firms are constrained by regulations that prohibit them from practicing Chinese law or hiring Chinese lawyers. Though many international law firms employ Chinese citizens who have passed the bar exam, these lawyers must suspend their licenses to practice law for the duration of their employment. This means that much legal work, such as representing litigants in court, can be done only by Chinese lawyers working at Chinese law firms. In addition, foreign law firms can only open a representative office, rather than a partnership. This has tax implications, and many foreign lawyers express frustration at the lower taxes partnerships pay (Cohen 2011–2012, 2571; American Chamber of Commerce 2013, 286). Anywhere, tax treatment and scope of work would affect law firms' prospects. In China, these regulations give rise to the perception of a playing field sloped to benefit domestic players.

The history of lawyers in post-Mao China helps explain the Chinese leadership's decision to chart a middle course between a free market for legal services and total exclusion of foreign lawyers. At the start of China's economic reforms, foreign investment was a priority and the domestic bar was poorly trained. "Much like 'the drummers, messengers and concubines that accompanied ancient armies on the march,' the first foreign lawyers trailed their clients' worldwide expansion in the 1980s and 1990s" (quoted in Faulconbridge et al. 2008, 455). Joint ventures became legal in China in 1979, and what started as a trickle of foreign investment

14. Firms focused on capital markets especially struggled. The volume of IPOs by Chinese companies fell following the financial crisis for reasons including the growing popularity of venture capital (BJ1), accounting scandals in the IPO disclosure process (SH37), and the dwindling supply of SOEs not yet publicly traded (SH16). However, a few firms uncovered ways to make money during the economic downturn. Lawyers were needed to help foreign companies unload Chinese subsidiaries (SH20, SH30) and to represent Chinese companies snapping up firms overseas (SH34).

15. Forty-eight firms answered this question.

swelled over the next two decades from just over 1 billion USD in 1980 to 193 billion USD in 2000.¹⁶ Although opening a law office would not be legal until 1992, lawyers would ask clients to open a representative office, sponsor their visas, and then, under a sign bearing the client's name, set up shop inside (BA3; Lim 1984, 8; Heller 2003, 758). Chinese lawyers would remain part of the bureaucracy, working as civil servants in legal advisory offices modeled after the Soviet system, until the late 1990s and largely lacked the expertise to compete with foreign law firms for international work (Heller 2003, 756; Godwin 2009, 143).

If foreign law firms had been allowed to grow unimpeded, it is likely that they would have quickly dominated the market. In 1992, however, the Chinese government released the first regulations governing foreign law firms, a change that simultaneously legalized the firms' presence and limited their activities.¹⁷ Foreign law firms could now apply for a license to open an office, although hiring licensed Chinese lawyers and providing representation for Chinese legal matters remained off limits. Working around these restrictions, many firms built a practice guiding inbound investment (BJ12, BJ18; Jin 2012).¹⁸ Following China's WTO accession in 2001, foreign law firms' client base expanded to include multinationals hoping to sell to the China market, such as Carrefour and Wal-Mart, as well as companies interested in shifting manufacturing overseas.

The timing of China's entry to the World Trade Organization in 2001 roughly coincided with the privatization of the Chinese bar. Following a State Council decision to convert state-owned law firms to private partnerships, the proportion of state-owned law firms fell from 98 percent in 1990 to 14 percent in 2004 (Stern 2013, 160). This shift created a pool of Chinese lawyers free to collaborate with foreign law firms, as well as to compete with them.¹⁹ Even after revisions to the regulations on foreign lawyers in 2001, foreign law firms were still only permitted to provide information about China's legal environment—not to practice Chinese law (State Council 2001). Although supplemental rules issued by MoJ later in the year clarified a few “no go” zones, including participation in litigation and issuing legal opinions (Godwin 2009, 139), the blurry boundary of allowable practice continues to create “endless debates and conflicts” between Chinese and foreign lawyers (Liu 2008, 780).

Though no Chinese official has yet gone on the record to explain the rationale for restricting foreign law firms' scope of work, protectionism is likely. China's lawyers entered the twenty-first century newly liberated from the state payroll and self-conscious about their skills. Sheltering the nascent bar from international competition, at least temporarily, was a way to give Chinese lawyers breathing space to

16. These numbers are drawn from the UNCTAD statistical database, which measures foreign exchange stock in current US dollars and exchange rates. At first, foreign lawyers flew in from Hong Kong to meet clients, or rented hotel rooms to serve as offices. Those present in the early days recall the frustrations of conducting business in a hotel, especially if management balked at removing beds (BJ22).

17. One theory is that the regulations were part of a government effort to convince foreign investors to return to China following Tiananmen (Li and Liu 2011–2012, 2849).

18. Lawyers active in the 1990s report there were only about twenty Chinese foreign investment laws and regulations to master. It was no terrible task, especially once a lawyer had a few templates of previous contracts to work from (SH27).

19. On the balance between collaboration and competition, see Liu (2008).

learn about cross-border commercial law and how to run a law firm. In fact, a good number of developing countries have similar regulations in place. In Brazil, much like China, foreign lawyers are limited to practicing international law or the law of their home country. In India, too, foreign lawyers can only advise clients on foreign law on a “fly-in, fly out” basis (Wilkins and Papa 2013, 1172).²⁰ The explosive growth of Chinese law firms over the past decade suggests this strategy worked. Though no Chinese law firm was larger than 200 lawyers in 2002, China’s largest law firm, Dacheng, reached 3,200 lawyers by the end of 2013 (Liu and Wu 2014, 1). Chinese lawyers have also become much more savvy about international business, especially the growing group with foreign degrees or work experience (Liu 2008, 790).

In addition to protectionism, could there also be an authoritarian logic behind China’s regulation of foreign lawyers? It is hard to know for sure, though some foreign lawyers detect a fragile welcome. As one long-time practitioner describes it, the fear is that foreign lawyers “will infect China in some way that will lead to a coup, a revolution, whatever. . . . [The leadership] keeps us in a space and let[s] us do our business. If we do something bad, they can cut our throats. That’s Chinese social control” (HK5). Lawyers have often been at the forefront of calls for political liberalism (Halliday and Karpik 1997; Halliday, Karpik, and Feeley 2007) and keeping foreign lawyers away from Chinese law could be a way for the Chinese authorities to curb the diffusion of Western legal values, especially given potential difficulty controlling their activities. The surveillance, harassment, and detention meted out to outspoken Chinese attorneys would raise a clamor if applied to foreigners. Likewise, shutting down law offices and refusing to renew visas—two obvious strategies for disciplining expatriates—are far more high profile than eliminating a Chinese lawyer’s livelihood by revoking her lawyer’s license.²¹ One further sign the Chinese leadership views law as a sensitive sector is that constraints on foreign law firms exceed those on foreign accounting firms, even though accounting also plays a critical role in securing FDI and access to capital markets. Unlike foreign law firms, major international accounting firms have enjoyed the right to audit Chinese companies and to form joint ventures since the early 1990s (Gillis 2014).

Overall, then, law is a strategic sector from a number of angles: for nationalists ticklish about Chinese sovereignty, for economic planners concerned about the Chinese bar, and for Party strategists monitoring political stability. Though it is hard to say which of these three logics—nationalist, protectionist, and authoritarian—dominate internal discussions about foreign lawyers, it is clear how strongly state intervention has shaped the Chinese market for legal services. Foreign law firms operate in a regulatory framework that has likely been shaped by multiple goals, with free trade and legal development vying among other concerns.

20. For more on the political logic behind India’s ban, see Krishnan (2010).

21. Chinese lawyers must renew their lawyer license annually. Lawyers who have angered the authorities often encounter delays, and occasionally have their licenses revoked. Though we describe visa denials as a high-profile control strategy, it would not be unprecedented. In 2013, the Chinese government delayed requests for journalist visas from *The New York Times* and Bloomberg News following the publication of investigative reports exposing the wealth of top leaders (Jacobs 2013).

Types of Practice

If international law firms are not allowed to practice Chinese law, what business opportunities are left? In a constrained market, the main option is high-end, nonlitigation services related to foreign capital. This might include mergers and acquisitions, overseas IPOs, foreign litigation and arbitration, technology transfer, real estate transactions, intellectual property protection, and FCPA compliance. Many large international law firms have a great deal of experience in these areas and cooperation with domestic law firms is also common. A large acquisition such as Shuanghui's 2013 purchase of pork producer Smithfield Foods, for example, would require both a foreign law firm to review compliance with US law and a Chinese law firm to ensure the deal conforms with Chinese law.

Focusing on foreign capital leaves international law firms with two principal types of clients: branches or subsidiaries of multinational enterprises, and Chinese enterprises expanding overseas. Thanks to a surge in overseas investment, the latter group has grown in recent years. Between 2005 and 2012, overseas direct investment by Mainland firms grew an average of 35 percent annually, opening up new opportunities for foreign law firms to oversee cross-national deals and overseas IPOs (Ren 2013). An international law firm, to take one example, represents the Chinese company planning a \$40 billion dollar rival to the Panama Canal in Nicaragua. State-owned enterprises (SOEs) are particularly valuable clients. SOEs "want to be seen as engaging top firms," one lawyer explained, in order to "cast off the image of a developing country SOE and be seen as a global corporation" (SH11).

Our interviews also uncovered two ways of thinking about market niche. Lawyers at most of the Anglo-American firms in our sample talked about a practice area specialty, such as intellectual property or M&A. In contrast, lawyers from the vast majority of firms from continental Europe, Asia, and Latin America defined their market niche as handling work from their home country or region. For example, bread-and-butter work for an Italian law firm might include outbound work (e.g., helping an Italian luxury brand franchise in China) as well as inbound work (e.g., guiding a Chinese company's efforts to acquire an Italian business). We call this group "trade route lawyers," as their labor underpins a circuit of capital flowing between two fixed destinations.²² Here is a typical example of how a trade route lawyer discussed his firm's comparative advantage: "there's no way [clients] will come to us for a Houston deal or a Peruvian deal. Fortunately for us, there are a lot of mining companies and oil companies in [our country] . . . That's really our sweet spot" (BJ6).²³

22. There is a very strong correlation ($R = .85$) between firms dominated by trade route lawyers and firms from outside the United States and the United Kingdom. We coded a firm as a "trade route law firm" if either of the following two conditions were met: (1) the interviewee mentioned a specific geographic area in response to our open-ended question "How would you describe your firm's market niche?" (2) The interviewee described the main competition as firms from the same geographic area. In a few cases, we had to explain the term "market niche" to lawyers who spoke English as a second language.

23. Building a business around a specific geographic area requires close ties to the business community there. Strategies to win foreign clients without leaving China include cultivating relationships with expatriates, taking a leadership role in foreign chambers of commerce, and entertaining important officials and businesspeople in Beijing and Shanghai (BJ9, SH1, SH5, SH24, SH27, SH37). All this networking can be tiring work. One particularly social lawyer reports four to five dinners a week, which run as late as 4.00 A.M.

In an industry where global reach sometimes seems like a universal aspiration, the prominence of trade route lawyers reminds us that global ambitions can be modest as well as major. Trade routes, some well worn and others newly forged, create demand for lawyers who can handle transactions governed by local law, rather than US, UK, or Chinese law. Cultural affinity helps, too. Lawyers' skill navigating decision-making dynamics inside client headquarters is an advantage, along with the opportunity to speak a shared native language over a beer at the end of the day (SH15).²⁴

As Chinese law firms have grown in prominence and competence, it is reasonable to ask what comparative advantage foreign law firms still enjoy. The industry's global players point to a worldwide network of offices beyond what any Chinese law firm can currently match. Reputation matters too, and big deals sometimes require the imprimatur of an international law firm to verify the bona fides of a transaction. Acting as "sanctifiers" of business transactions remains an important role (Flood 2007, 35), particularly at SOEs where risk-averse legal departments prefer firms with international stature (BJ15). In contrast, offices of less well-known law firms emphasize value, individualized problem solving, and a more intimate relationship (SH5, SH14). Any price premium over Chinese law firms is worthwhile, some lawyers further argue, to avoid the risk that Chinese lawyers might sacrifice attorney-client privilege if asked to disclose information to a government authority (BJ26; Cohen 2011–2012, 2573).

The Outpost Office

When lawyers reflect on the China market, size is often the first way they differentiate between business models. More boots on the ground generally means a wider range of practice areas and closer proximity to a full-service model. Figure 2 shows the size distribution of international law firms' China practices.²⁵ Our findings echo what Carole Silver found when she mapped the international offices of sixty-four US firms in 2007: international offices are generally small. Excluding London, the average size of a US law office abroad was sixteen lawyers (Silver 2009, 1444). Six years later, we saw little sign of growth beyond that baseline. The median law firm in our sample employs eleven lawyers in China, and 60 percent of

when visitors want to stay out and have fun (SH1). Sometimes, wooing clients takes place back in the home country, too (SH1, SH5, SH15, SH21, SH30). One Japanese firm, for example, says competition for clients happens almost exclusively in Tokyo (SH21).

24. It is worth noting that few trade route lawyers in China are bullish about growth. Only 26 percent reported plans to expand their China practice, compared to 60 percent of lawyers at international law firms focused on a practice area specialty. For most, it is hard to envision expansion when competition is intensifying. As law firms from a widening array of countries enter the market, there is already shrinking demand for culturally close substitutes—say a Canadian firm for an Australian deal—over law firms based in the same country as the client or investment site (BJ6).

25. Figure 2 is a weighted distribution based on sample data from forty-nine firms. We show the weighted distribution because firms were selected from the population by stratified random sampling, which meant oversampling firms from countries with a small number of international law firms in China. Our head count does not include administrative staff, though it does include Chinese legal consultants who suspended their Chinese lawyer license in order to be eligible to work for a foreign law firm.

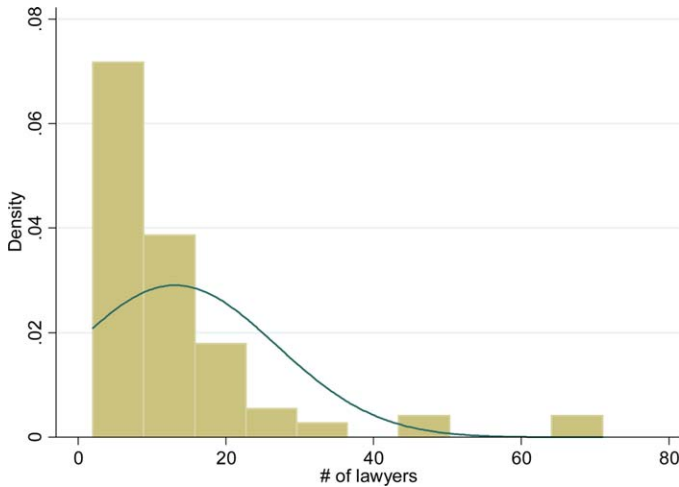


FIGURE 2.
Distribution of the Size of China Practices (N = 49). [Color figure can be viewed in the online issue, which is available at wileyonlinelibrary.com.]

firms are represented by six to nineteen lawyers. What counts as a large China practice is relatively small, as well. Employing twenty lawyers was large enough to join the eight biggest law firms in our sample, a miniscule size compared to several hundred lawyers at a sizable law office in a major US city.

To some extent, size and market niche are related. Much as economic sociologists would expect, many foreign law firms in China search for a narrow enough niche to reduce price competition (Fligstein 1996, 659). Micro-practices sometimes occupy a niche so specific to the skills of the partner-in-charge that they report no direct competition (BJ20, SH36).²⁶ On the other end of the size spectrum, law firms need a certain bulk to handle capital markets work, a lucrative, high-profile practice area that requires significant manpower and runs the risk of overemployment if deal flow slows (BJ12).

The small size of most international law offices goes hand-in-hand with grumbling about pricing pressures, client loyalty, deal flow, and competition. Taken together, this litany helps explain China practices' most basic problem: profitability. Although no reliable statistics exist, virtually no one thinks most China practices are making money. One long-time practitioner, a Beijing-based lawyer named Robert Lewis, estimated in a 2013 blog post that 70 percent of foreign firms in China are not covering operating costs (Lewis 2013). Certainly, lucrative markets such as New York and London drive up profits per partner (PPP) and revenue per lawyer, two prized measures of how law firms stack up against their competitors. One partner at an international law firm that typically generates over a million US dollars in revenue per lawyer told us that most China practices would be lucky to hit \$600,000 (BJ8). As one Shanghai-based partner explained: "If you come in here

26. Examples include transportation and logistics and defending Chinese companies from product liability lawsuits in the United States.

expecting to make a lot of money, especially right away, you ought to understand almost no one is making money” (SH37; see also Kriegl 2013).

Though lawyers often pin their financial problems on unsophisticated clients who undervalue their work, industry observers connect low fees to low legal risk. Hiring a top-notch lawyer is less urgent when few deals fall through and regulatory fines remain relatively low (Lin 2013). In addition, keen competition generates pressure to lower prices. “Frankfurt is far less competitive than Shanghai!” as one German lawyer exclaimed, and foreign lawyers have a long list of rivals (SH41). In addition to competition from other international firms, both long-established and freshly arrived, a majority of law firms in our sample cited Chinese law firms as key competitors. Global and local law firms have been chasing similar clients inside China for some time and, by the end of the first decade of the 2000s, a number of top Chinese law firms began opening offices abroad to move aggressively into the global market.²⁷ Compounding these pressures, international law firms also face competition from fly-in lawyers spending short stints in China and from consulting firms focused on helping foreign companies.²⁸

Choices about office space highlight the struggle many international law firms face to control costs while generating revenue. Offices in China are typically rented unfinished and the expense of renovation pushes smaller, more cost-conscious law firms toward shared executive offices (SH35, SH42) or lower-rent locations in an older building, on a less desirable floor, or in a less fashionable part of town. In contrast, law firms with deep pockets can pay for offices with a view, or located directly across from the elevator bank, and buy posh furnishings. As one Shanghai-based lawyer explained, some major firms “probably spent three to five million just fitting out their office. They have office space facing the Bund [and the Huangpu River]. When you see a set up like that, you know that breaking even is a pipe dream” (SH22).

Profitability remains a struggle even inside top-tier international law firms with global name recognition. At law firms accustomed to healthy profits, internal expectations can be high. As one partner at one of the five leading UK law firms, a group known as the Magic Circle, explained:

we have to target the more profitable work or we can't justify our existence within the firm. . . . When we find ourselves competing with a firm whose profitability is only half or three-quarters of ours, they can give a much cheaper quote and they'll still be a hero internally because they don't have the same profitability expectations. (BJ5)²⁹

27. Examples of this kind of mega firm include King & Wood Mallesons SJ Berwin (1,993 lawyers worldwide as of 2013) and Yingke (2,374 lawyers). In 2013, six Chinese law firms made the *American Lawyer* list of the top 100 most global law firms, a ranking based on the percentage of lawyers located outside the firm's home country (*American Lawyer* 2013). For more on Chinese law firms' overseas strategy, see Liu and Wu (2014).

28. A common way to launch a business venture in China is by setting up a wholly-foreign-owned enterprise (WFOE). According to one estimate, a law firm might charge about 70,000–80,000 RMB to set up a WFOE, while a consulting firm would only charge 35,000–40,000 RMB (SH39).

29. Meeting headquarters' sky-high profitability expectations is a recurrent complaint of China-based lawyers. As early as 1997, *The Wall Street Journal* reported slim profits for foreign law practices in China and

Nor has the promise of outbound investment materialized. Instead of building a roster of long-term Chinese clients, law firms often find their prices undercut by competitors anxious to put together a blue-chip deal list. The big SOEs “could get all their legal work done for free,” one partner said, “every firm in the world wants to say they worked for Sinopec” (SH36). At SOEs that report to the central government, price wars are institutionalized through the requirement that several law firms bid for every sizable job (BJ5, BJ8, BJ10, BJ29, BJ31). Though mandating multiple bids is designed to combat corruption, lawyers say the procurement department’s “horse and pony show” depresses prices (BJ8). As another lawyer put it, “the people in the procurement department are used to buying stationery, not professional services . . . The only thing they can actually comprehend is the price. They have no idea how to assess the quality of a firm” (BJ5).³⁰

The bottom line is that China is a marginal part of nearly every international law firm’s business. For more than 80 percent of the law firms in our sample, lawyers reported that Mainland China generates less than 5 percent of global revenue.³¹ Unprompted, many China-based lawyers offered justifications for losing money. Though most accept that a China practice should be judged by its accomplishments, an ideal that maps onto what sociologist Mark Suchman calls pragmatic legitimacy, many lawyers went on to argue that their achievements are either hard to measure or just around the corner.³² Stacking up revenue versus expenses, for example, fails to capture referrals for work ultimately billed overseas (BJ10, BJ25). Branch offices located far from headquarters often tend to feel peripheral unless they are highly profitable and, indeed, many China-based lawyers consider themselves far from the center of the action. As one partner put it, “our closest office is probably Abu Dhabi and they’re a small outpost as well, so I’m not at the center of things” (BJ24).

Toward a Theory of Law Firm Growth in Emerging Markets

Any paper that focuses on similarities between organizations runs the risk of overlooking differences between them. Though we argue that the outpost office is a popular and persistent organizational response to the pressures international law

cited Skadden as a firm “known for demanding . . . New York-levels of profitability, a feat that few China-based lawyers can achieve” (Johnson 1997, B7A).

30. An increasing number of large SOEs have a legal department that helps hire external counsel. However, the final decision about who to hire can also be made by either the SOE leadership or the head of the procurement department (BJ29, BJ31, SH9). Inside large central-level SOEs, Liu and Wu report that in-house counsel often prefers Anglo-American law firms for outbound investment projects because of their experience and global reach (2014, 13).

31. In interviews, we asked partners to estimate the percentage of law firm revenue generated by Mainland China. Forty firms were willing to answer the question, though some lawyers had to think hard to differentiate between revenue generated in Hong Kong and in Mainland China. There was no way to verify this information independently, and we view these estimates as an upper bound. If anything, China-based lawyers would be inclined to inflate their practice’s contribution to the bottom line.

32. A few firms also told us their accounting procedures were not precise enough to know if a particular office was making or losing money (BJ6, BJ21).

TABLE 1.
Regression Models Predicting the Variation in the Size of Foreign Law Firms'
China Practice

	Model (1) Firm Size	Model (2) Firm Size	Model (3) Firm Size
Years in China	0.886 (2.76)**	0.922 (2.99)**	0.906 (3.10)**
If have HK office	11.750 (2.97)**	6.217 (1.65)	5.842 (1.68)
If US or UK firm	6.370 (0.92)	5.395 (0.82)	5.948 (0.92)
If Global 100 firm	-4.557 (0.56)	0.012 (0.00)	-2.775 (0.34)
Proportion of offices outside home country		16.493 (2.19)***	16.358 (2.26)***
Percent partners with Chinese surname			8.151 (2.03)***
Constant	-2.539 (0.69)	-11.834 (1.86)	-12.716 (2.13)***
VIF	1.87	2.07	2.22
Observations	49	49	49
R ²	0.47	0.52	0.55

Linearized t-statistics in parentheses.

***Significant at 5 percent level;

**significant at 1 percent level.

firms face in China, there is also variation in size and market strategy. Even a hasty look at Figure 2 raises questions about outliers. Rather than ignoring heterogeneity, this section offers a first cut at the variables that explain variation in size.³³ This is also rich ground for future research. We see these findings as hypotheses worth testing, as scholars extend existing theories of law firm growth to include expansion globally.³⁴

We used linear regression to estimate the correlation between law firm size and six characteristics: (1) time in China, (2) the presence of a Hong Kong office, (3) whether the law firm was listed among the Global 100 highest revenue law firms in 2012, (4) whether the law firm is Anglo-American, (5) the percentage of offices located outside the home country, and (6) the percentage of partners with a Chinese surname.³⁵ Descriptive statistics for each variable, as well as more information about measurement, are available in Appendix 3.

To start, the regression models presented in Table 1 show a *first mover advantage*. In all three models, the correlation between size and time present in the

33. We call this section a “first take” because the following regressions only include forty-nine observations from the law firms we selected through random sampling. Rather than using information from law firm websites to estimate size, we relied on size estimates from interviewees. Too often, law firm websites were nonexistent, out of date, or did not include information about all lawyers based in China.

34. For an overview of theories of law firm growth, see Wilkins (2001).

35. Pair-wise correlation of all variables in the models and the VIF scores indicate that the models do not have a multicollinearity problem.

market is positive and statistically significant, holding other variables constant. In other words, the longer a law firm is in China, the bigger its offices in China tend to be.

Second, a firm's *global reach*—measured by the proportion of offices located outside the home country—is statistically significant.³⁶ In other words, international law firms with more of a global presence tend to have bigger offices in China. All eight of the practices with more than twenty lawyers in our sample are attached to law firms pursuing a global strategy.³⁷ These global players span multiple continents and aspire to “marshal, on a dime, a vast targeted array of impeccable talent, backed up by deep resources across virtually 24 time zones” (MacEwen 2013). British law firms are strongly associated with this global approach, which some attribute to the small size of the UK's domestic legal market (BJ33) and others chalk up to the colonial legacy (SH20, SH31). Either way, going global represents a bet on the future. If London and New York become less important markets over the next twenty years, a global strategy will appear prescient.

Finally, *localization* is a statistically significant variable, albeit one that is challenging to measure and interpret. We use the percentage of partners with a Chinese surname as a crude measure of localization and find that it is positively correlated with size. As job seekers know well, bilingual and bicultural lawyers are in high demand at international law firms, especially if they hold a foreign law degree. As one legal recruiter put it, “the market always wants somebody who is bilingual, ideally dual qualified . . . those people; you could place them in a second” (SH26). Partners with a Chinese background appear to embody the cultural knowledge and language skills necessary to navigate China, especially when it comes to wooing and winning Chinese clients. From our data, though, it is unclear which way the causal arrow runs. Are partners with a Chinese background better at business development? Or are bigger firms better at attracting this sought-after group?³⁸

Though there is room for a much more nuanced understanding of what drives growth, these three basic trends will confirm the suspicions of many market veterans. Our analysis lends support to the conventional wisdom circulated

36. The distribution of the dependent variable is skewed to the right with a tail of two outliers. We tested the regression models in two different ways to address the outlier issue. In the first approach, we ran the same analysis against the logarithm of the dependent variable, firm size. In the second approach, we ran the regression after dropping the two outliers. Using both approaches, the global outreach variable is no longer statistically significant. We believe the volatility is due to the small size of the dataset. We decided to report the original regression analysis for two reasons: (1) it was difficult to interpret the regression coefficients after transforming the dependent variable into a logarithm and (2) we felt it was important to include the outliers, as they represent major law firms with a long history and important presence in the market.

37. Typical public relations quotes from their websites depict a “global firm of exceptional credentials” and a “global reach and local depth that is simply unrivaled.”

38. Of course, surname is an imperfect measure of localization. Chinese heritage lawyers have a wide range of Chinese language skills and cultural familiarity. The dynamics of business development are also complicated by the fact that the decision makers are sometimes a different nationality than the company. In-house counsel positions at Chinese companies may be held by foreigners and vice versa, and in-house counsel at multinational corporations may well be Chinese.

among lawyers and legal recruiters: the largest China practices tend to be attached to firms that entered the market early, are committed to a significant international presence, and run by a leadership team with at least a degree of bicultural familiarity.³⁹

A Ceiling on Growth?

Outliers aside, the skew of the size histogram highlights how hard it has been for most law firms to grow into what one lawyer called “a full sized adult Rambo” (SH19). Beyond the obvious point that a competitive market is hardly an ideal environment for expansion, why have so many international law firms run up against a ceiling on growth?⁴⁰ Rather than detailing issues that are practice-area specific, or tied to business cycles, this section focuses on two factors that affect nearly every firm operating in the market: state regulation and internal firm structure.

Government regulations tend to produce coercive isomorphism, or convergence on a single way of doing business in response to similar rules, and the ban on practicing Chinese law has clearly shaped China’s market for foreign legal services (Powell and DiMaggio 1991). Advocates of protectionism would not be surprised to hear a foreign lawyer boast “if they [the Chinese government] allow me to practice Chinese law, I’m going to pick the best Chinese lawyers from Fangda, Jun He [top Chinese law firms]. I’m going to wipe them out” (SH16). At the same time, however, the prohibition on practicing Chinese law is not absolute. Instead, foreign law firms are allowed to dispense advice on the Chinese legal environment, a vague formulation that provides cover for a wide range of activities.

One way to gain insight on the effect of different regulatory regimes is by looking at Hong Kong. Hong Kong has long been a link between China and global capital markets, as well as a location where many international law firms opened early due to British colonialism. Since 1994, the regulations governing foreign law firms have also been more permissive than those on the Mainland. Individual foreign lawyers are eligible to become Hong Kong qualified,⁴¹ while foreign law firms can

39. In results not shown, we added the interaction term between percentage Chinese partners and proportion foreign offices. The interaction term was borderline statistically significant, which may have been the result of small sample size. If the interaction term was truly statistically significant, our results suggest that percentage Chinese partners and global focus mutually strengthen each other’s correlation with footprint. In other words, a firm with a global strategy and a high level of localization is especially likely to have a large office in China.

40. We refer to a “ceiling” because our data show a nonlinear relationship between law firm size and tenure in China, if the two outliers are removed from the analysis. Firm size levels off after 14.6 years in China. Likewise, the increase in law firm size flattens out when 60 percent of partners have a Chinese background. However, both relationships are statistically significant only at the .1 level, and only after removing the two outliers from the dataset. In addition, the nonlinear relationship was also only visible in Table 1 models after adding the squared term of two variables: years in China and percentage partners with a Chinese background.

41. For more on the qualification exam for foreign lawyers, see the Overseas Lawyers (Qualification for Admission) Rules (1994).

either join profit-sharing associations with local law firms⁴² or register as Hong Kong solicitors' firms.⁴³ For the 32 percent of the firms in our sample with a Hong Kong office, those offices are significantly larger than the firm's presence on the Mainland: an average of forty-one lawyers, compared to just twenty-two inside Mainland China.⁴⁴ As one Hong Kong-based lawyer explained, "you don't need an office of twenty or thirty people in [Mainland] China, but it is easy to grow to forty or fifty people in Hong Kong" (HK3).

The size of Hong Kong offices reflects the city's history and institutions, as well as the regulatory regime.⁴⁵ Before international law firms formally entered China in 1992, it was common to use Hong-Kong-based lawyers to set up a legal framework for investment in China. Habit has kept some of this work in Hong Kong and, as in earlier days, Hong Kong remains a regional economic center. Some lawyers still treat Hong Kong as a base for a pan-Asian practice and travel to other Asian cities to meet clients. This is credible both because people are accustomed to seeing Hong Kong as a hub, and thanks to the Hong Kong Stock Exchange and the Hong Kong International Arbitration Centre. These institutions sustain Hong Kong's reputation as a commercial center, and generate demand for legal work related to capital markets and arbitration. Yet regulation is also critical. Most international law firms with a footprint of at least forty lawyers have developed Hong Kong law capability in order to take on litigation and regulatory work (HK4, HK5). Local law capability offers entrée to next level of localization by allowing international law firms to compete for a broader range of commercial legal work. Though local law capacity is not a surefire route to greater profits, it is telling that a good number of international law firms in Hong Kong see value in developing it (Zhang 2014). When foreign law firms are allowed to participate legally in the full spectrum of the legal market, as in Hong Kong, investment in higher headcounts makes more strategic sense.

In Mainland China, where the regulations are much more restrictive, regulatory ambiguity about the boundaries of allowable practice stifles growth both directly and indirectly. Most directly, certain types of legal work are off limits, such as litigation and issuing legal opinions.⁴⁶ These can be major practice areas and eliminating them shrinks the number of lawyers needed on the ground. As others have detailed (Liu 2008; Godwin 2009, 142), one common workaround is hiring a

42. The two firms in an association can share profits, staff, and management, but only the Hong Kong firm can practice Hong Kong law (International Bar Association 2007). The regulations also impose a ratio requirement such that the number of foreign lawyers cannot exceed the number of local solicitors (Chiang 1995, 332).

43. Allen & Overy, DLA Piper, and Davis Polk, to take a few examples, are registered as Hong Kong Solicitors' Firms. A list of Hong Kong Solicitors' Firms is available at the Hong Kong Law Society website (<http://www.hklawsoc.org.hk/>). Under Hong Kong Law Society rules, all partners in Hong Kong Solicitors' Firms and at least half the lawyers must be locally qualified (Zhang 2014).

44. A two-sample *t*-test comparing the two means is statistically significant ($p < 0.01$).

45. In interviews, some lawyers suggested the larger size of Hong Kong offices also reflects expatriates' preferences for living in Hong Kong over the Mainland, thanks to low taxes, the ease of daily life without Chinese language skills, and air quality.

46. In addition, only domestic law firms can provide the legal documents necessary to list on the Shanghai and Shenzhen stock exchanges or file merger-related documents with the Ministry of Commerce (Godwin 2009, 153).

Chinese law firm to handle a lawsuit or provide a legal opinion.⁴⁷ Collaborating with capable Chinese lawyers can also allow foreign firms to avoid hiring.⁴⁸ Even outside forbidden areas where partnerships are strictly necessary, Chinese law firms are sometimes a welcome source of flexible labor. As one European involved in a two-lawyer micro-practice explained, “the simple reason we don’t need to expand is because we have access to capacity at XXX [name of Chinese law firm redacted]” (SH14).

More indirectly, legal ambiguity limits growth by fostering uncertainty. It is an open secret that foreign law firms offer advice on Chinese law in order to keep clients happy and stay in business. One experienced lawyer complained that following the letter of the law means that “you aren’t supposed to do anything! . . . The requirement to hire a Chinese law firm to provide your client with advice, it just doesn’t work that way. Clients are not going to accept double bills” (BA2). Although lawyers agree that the ban on practicing Chinese law is poorly enforced and the worst consequences are typically a warning or fine, it can be hard for firm leaders to invest in a practice that local authorities could credibly shut down at any time.⁴⁹ As one partner explained to us:

I’ve sort of come to the realization over the last year or so that things have really loosened up here in China, we can actually be a lot more aggressive and take more chances. But, once again, it’s having to convince the folks back home who have the English version of the 2002 regulations and to tell them that, hey, don’t worry about it . . . I’m not going to fight that battle and charge up the hill and tell them because, who knows, the Ministry of Justice can turn around [and start tighter enforcement]. (BJ6)

Second, the internal structure of international law firms creates dynamics that can hinder growth. Ninety-five percent of firms in our sample are global partnerships where equity partners divvy up worldwide profits.⁵⁰ Often, this profit-sharing structure creates isolationist wings of partners who see local business thriving and dislike the idea of international adventures. In their view, every dime spent outside the home country is a far-fetched business proposition that reduces the profit pool (BJ19, BJ20, SH31, SH35, SH38, HK3). In this environment, a small office is easy to justify and expansion can be hard to sell. An argument for increased headcount is often a nonstarter, especially in firms eager to improve profitability and move up

47. Legal opinions are much cheaper in China than in the United States, largely because malpractice lawsuits are not yet common (SH15, SH30).

48. In the past, foreign firms often dictated strategy and even language from behind the scenes. Though this still happens, outsourcing and teamwork are increasingly common.

49. On the other hand, it is not easy for the Chinese authorities to figure out whether foreign firms are in compliance. For example, two mainstays of foreign law firms’ legal work, participating in negotiations in which Chinese legal issues are discussed and drafting contracts governed by Chinese law, arguably fall in a legal gray zone (Godwin 2009, 145).

50. Twenty-two percent of the firms in our sample are strict lockstep partnerships, meaning that each equity partner receives a portion of the profits based on seniority. Seventy-two percent of firms reported some version of modified lockstep, by which partner pay is based on performance as well as seniority. The remaining 6 percent of interviewees either did not know how equity partners are compensated or chose not to answer the question.

the professional rankings. When times turn tough, even modest China practices find themselves forced to justify their continued legitimacy within the organization.⁵¹ “Headquarters is thinking: China is on fire,” one lawyer said, “there is tremendous growth there. [So] why aren’t you more profitable?” (SH11).

Even if the head of a China practice wants to take on risk to expand, in short, the structure of a global partnership makes it hard for him or her to do so. This has implications for innovation. It is no accident that there is more dynamism and diversity among Chinese law firms than among international China practices. Among Chinese law firms, prominent examples of fresh ways of doing business include Yingke, a fast-growing law firm often compared to the McDonalds franchise model, and Zhong Lun, a firm striving to foster a reputation as a prestigious and global legal brand (Liu and Wu 2014; *The Lawyer* 2014). Hotspots of innovation among international law firms are more unusual, and require either firm-wide buy-in or a willingness to grant atypical independence to an entrepreneurial individual.⁵² Another way of understanding outpost offices, in other words, is by looking at politics inside law firms, to see why arguments for expansion often struggle to attract champions.

The Logic of Entry and Exit

Our observation that most China practices struggle to grow beyond a mid-sized outpost is based on data from one point in time: summer 2013. Without longitudinal data, it is impossible to talk about trends over time, let alone pinpoint when international law firms reached their zenith in terms of size. There are reports that many foreign law firms doubled or tripled in size in the years directly following China’s WTO entry (Li and Liu 2011–2012, 2851) and, regulatory restrictions notwithstanding, their trajectory might have appeared ascendant had this article been written during that brief golden age.⁵³ Some international law firms have clearly stayed the course in China because of significant profits, either in the past or perhaps even now.

51. Following Suchman, organizational legitimacy is defined as “the process whereby and organization justifies to a peer or a superordinate system its right to exist” (1995, 573).

52. One example of firm-wide buy-in is King and Wood Mallesons SJ Berwin (KWMSJB), the mega firm forged by Swiss Verein agreements between the Chinese firm King & Wood, the Australian firm Mallesons Stephenson Jacques, and the British firm SJ Berwin. All but a handful of Australian partners voted for the tie-up, following an elaborate consultation process that included a “phonebook of materials,” a trip to China for more than forty Australian partners, and an emotional appeal from the chairman that cast the choice as part of a firm tradition of bold decision making (HK1). In a partnership, such unity is not inevitable, but forged by advocates gifted at persuasion. Our research also uncovered a few examples of China offices where exceptional independence has been granted to an entrepreneurial individual. These offices operate much more like independent small businesses than extensions of a firm’s reach and reputation. In these offices, there is an understanding with headquarters that the practice must stay in the black and subsidies to weather shortfalls will be short-lived.

53. When Latham & Watkins opened its first office in Mainland China in 2005, for example, Chairman Robert Dell called Shanghai “the strategic center of the Chinese market and the key to success in the global market” (quoted in Jin 2012).

Still, the small size and slim profits of most China practices begs two related questions: Why do new firms continue to enter a crowded, competitive market? And, once present, why are they so reluctant to leave? On the entry side of the ledger, quite a bit can be chalked up to mimetic isomorphism, the tendency to imitate organizations perceived to be successful (Powell and DiMaggio 1991). Today, lawyers practicing in China admit “it is a bit of a herd mentality” (BJ10) and identify a widespread “dot on the map strategy” characterized by “big offices and very few people inside” (SH6). “Firms [still] feel like they have to be in China if they are going to be global,” as an observer of the legal industry put it. “China is the third leg of the global axis—the US, Europe and China—even if no one is making any money” (BA5). Many inside the legal profession agree that a China presence is *de rigueur* for a firm to be a global contender (BA1, SH22, SH24, BJ11, BJ18, BJ24).

Though some firms approach expansion decisions with a great deal of forethought, others move forward with far less consideration. In initial discussions about China, some law firms work with outside consultants to develop a strategy (SH18, SH22), while others rely exclusively on insiders who can speak to marketing and business development in China. Regardless of who does the analysis, China’s rocketing economic growth offers a ready-made argument for expansion. Here is how Zhong Lun law firm partner Robert Lewis described a 2013 event targeting managing partners of more than 100 top law firms worldwide:

Economists presented compelling statistics to demonstrate that economic growth was centered almost exclusively in the emerging markets in the east and the south. China always looks so good in these charts. . . . Half of the managing partners in the room made two calls: first, to their brokers to shift their investment portfolios to emerging economies, and, second, to their PAs [personal assistants] to book flights east and south. (Lewis 2013)

For lawyers, it is unclear whether economic growth is a good proxy for business opportunities. Very little information is publicly available about the size of China’s legal services market, let alone estimates of revenue or market share for individual law firms. Limited data make it hard to put together a sophisticated cost-benefit analysis and, in the absence of good information, mimicking others is a time-tested response to uncertainty (DiMaggio and Powell 1983; Suchman 1995; Henisz and Delios 2001). One legal consultant is amazed by “how little thought” can go into the decision to open a new office. “A lot of it comes down to vanity and ego. To the extent that there is a rationale, it’s that such-and-such a firm, who is perceived to be a competitor, is doing it . . . Frankly, lawyers are not the best businesspeople” (BA5).⁵⁴ Other decisions about entry are idiosyncratic, such as lobbying from a partner eager to live in China. As in one case, a Chinese-speaking partner might

54. Interviewees report variation about who needs to sign off on the decision to enter a new market. Depending on the firm, the decision to open a new office can be made by the managing partner alone, require a majority vote at a partner meeting, or remain stalled until *de facto* consensus among partners is reached.

say “why don’t we open up an office in China? I can staff it and I’m sure we’ll do really well” (BJ18).

Once a China practice is launched, firms tend to see the value of staying put. Winning regulatory approval to open a representative office requires significant time and effort, and the license itself comes to be seen as an asset worth preserving. “Firms don’t close,” one lawyer offered, “because they figure if they close, they’ll never be able to get back in [because of] licensing and the cost to their reputation. And they are right” (HK3). The belief that the future is bright for law firms that stay the course corresponds to what economists call option value. As one lawyer put it, “think five years, ten years out . . . there’s cause for optimism because the market will only get bigger. And not all the firms here are going to survive. Some will pack up and go home” (SH37; see also SH38, BJ18; Sokol 2007, 14). An outpost office represents a bet that future benefits will exceed current costs, a calculation made with the knowledge that reentry is a hassle. A China presence can be a defensive play for firms unsure about the future, in other words, as well as an active effort to make money in the present. Nor does maintaining a financially marginal outpost office seem strange when so many other firms are doing it too.

Some law firms can better afford to bet on future benefits. For firms with at least \$1 billion in revenue, a group that included twenty-three law firms in 2013, allocating 1 percent of revenue to a China option value would give the China practice a sizable \$10 million dollar buffer to operate in the red. At lower-revenue law firms, or law firms that are financially troubled, subsidizing a China practice would be more of a stretch. At times, however, even smaller players decide future possibilities in China are alluring enough to justify investment. At one regional law firm hovering around \$200 million in revenue, an analogy to Japan proved persuasive. As the head of the China exploration committee put it, “firms were able to jump on opportunities in Japan, like MoFo [Morrison and Foerster], and that became very profitable for them. . . . China could be even bigger” (SH18).

The option value argument is particularly attractive because of the perennial possibility that the regulations governing foreign law firms could change. Rumors about loosening restrictions have been circulating for some time now, accompanied by speculation that competition with Singapore and Tokyo to serve as the financial hub of Asia might trigger reform, particularly coupled with the growing competitiveness of domestic law firms.⁵⁵ Certainly, the regional trend is toward liberalization, with Japan allowing international law firms to hire local lawyers in 2005 and Korea permitting joint ventures with local firms in 2016. The Japanese experience, however, is a reminder that removing regulatory roadblocks is not a panacea. In Japan, international law firms have struggled to attract top-notch Japanese lawyers and compete with Tokyo’s Big Four law firms (Brennan 2013). For all that new regulations would change the game, challenges such as stiff competition and the pressures of partnership are unlikely to disappear.

55. During our interviews in summer 2013, we heard rumors that liberalization would soon arrive (BJ28, SH1, SH40).

CONCLUSION

For the growing group interested in globalization and the legal profession, what can we learn from the experience of international law firms in the China market? One answer is that China is an important emerging market and a good place to begin constructing a theory of international law firm expansion. Above, we draw on different levels of analysis to explain organizational convergence and divergence. Convergence on the outpost office business model stems from a combination of international and domestic pressures that all foreign law firms present in China experience: worldwide economic trends, competition from local law firms, and government restrictions on allowable practice. In the section focused on understanding outliers, however, it became even more necessary to look inside the firm. Organizational-level variables, such as strategy and lawyer biographies, reveal much about how growth happens under challenging conditions. As comparative research starts to track international law firms across emerging markets, researchers will need to pay attention to what is happening inside the firm as well as outside of it.

Another takeaway is that outpost offices can be a persistent organization form, rather than a way station encountered en route to a vigorous international presence. Though more comparative and longitudinal data are needed to make the point ironclad, both our data and Silver's (2009) study suggest that modest international offices are as much the norm as the exception. Worldwide, too, we expect similar arguments serve to stabilize the status quo. Although outpost offices may not contribute much to the bottom line, they serve as valuable symbols of global commitment and a bet on future gains. The symbolic value and option value of outpost offices are arguments that we expect echo across markets, and surface when profitability is difficult and exit is unpalatable.

An in-depth empirical look at the China market also reminds us that law firms go global in more than one way. Discussions about globalization and the legal profession often focus on the giants striving to build a global legal empire. Yet narrowing our attention to the upper echelon of legal practice overlooks much of the market. Many smaller players are also present in emerging markets, particularly trade route lawyers specializing in there-and-back circuits of capital. Though the most complicated deals might need a large team conversant in the law of multiple jurisdictions, much of the legal work done by international lawyers in China requires far less firepower. Bringing the full spectrum of the market into view tempers expectations of a dawning age of legal interconnectedness and, in so doing, inches us away from the heyday of hype about globalization. The experiences of international law firms in China do not herald a new age of boundless connectivity so much as reflect a familiar landscape where shifting commercial ties link regions together and states remain critical gatekeepers for legal work.

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APPENDIX 1: LIST OF INTERVIEWS

Beijing

- BJ1 Partner at international law firm, June 9, 2013
- BJ2 Partner at international law firm, June 9, 2013
- BJ3 Partner at international law firm (by phone), June 10, 2013
- BJ4 US government expert, June 11, 2013
- BJ5 Partner at international law firm, June 13, 2013
- BJ6 Partner at international law firm, June 13, 2013
- BJ7 Partner, lawyer, and associate at an international law firm, June 14, 2013
- BJ8 Partner at international law firm, June 14, 2013
- BJ9 Partner at international law firm, June 17, 2013
- BJ10 Partner at international law firm, June 17, 2013
- BJ11 Partner at international law firm, June 17 and July 13, 2013
- BJ12 Two partners at an international law firm, June 18, 2013
- BJ13 Partner at international law firm, June 18, 2013
- BJ14 Partner at international law firm, June 19, 2013
- BJ15 Chinese lawyer, June 19, 2013
- BJ16 Associate at international law firm, June 19, 2013
- BJ17 Partner at international law firm (by phone), June 19, 2013
- BJ18 Journalist at trade magazine (by phone), June 20, 2013
- BJ19 Partner at international law firm, June 20, 2013
- BJ20 Partner at international law firm, June 20, 2013
- BJ21 Partner at international law firm, June 20, 2013
- BJ22 Partner at international law firm, July 1, 2013
- BJ23 Partner and three lawyers at an international law firm, July 2, 2013
- BJ24 Partner at international law firm, July 2, 2013
- BJ25 Partner at international law firm, July 2, 2013
- BJ26 Partner at international law firm, July 3, 2013
- BJ27 Partner at international law firm, July 5, 2013
- BJ28 Chinese lawyer, July 9, 2013 (in Chinese)
- BJ29 Lawyer at a Chinese state-owned enterprise, July 9, 2013 (in Chinese)
- BJ30 Partner at international law firm, July 11, 2013 (in Chinese)
- BJ31 Lawyer at a Chinese state-owned enterprise, July 11, 2013 (in Chinese)
- BJ32 Partner at international law firm (by phone), July 11, 2013
- BJ33 Partner at international law firm, July 16, 2013 (in Chinese)
- BJ34 Partner at international law firm, July 17, 2013 (in Chinese)
- BJ35 Partner at international law firm (by phone), July 30, 2013 (in Chinese)

Shanghai

- SH1 Partner at an international law firm, June 25, 2013
- SH2 Partner at an international law firm, June 25, 2013
- SH3 Office manager and lawyer at an international law firm, June 25, 2013 (in Chinese)
- SH4 Lawyer at an international law firm, June 26, 2013 (in Chinese)
- SH5 Partner at an international law firm, June 26, 2013
- SH6 Partner at an international law firm, June 27, 2013
- SH7 Lawyer at an international law firm, June 27, 2013
- SH8 Partner and two lawyers at an international law firm, June 28, 2013 (in Chinese)
- SH9 Lawyer at a Chinese state-owned enterprise, June 28, 2013 (in Chinese)
- SH10 Partner at an international law firm (by phone), June 29, 2013
- SH11 Lawyer at an international law firm, July 2, 2013
- SH12 Partner at an international law firm, July 3, 2013
- SH13 Partner at an international law firm, July 3, 2013
- SH14 Partner at an international law firm, July 4, 2013
- SH15 Partner at an international law firm, July 4, 2013
- SH16 Partner at an international law firm, July 5, 2013
- SH17 Lawyer and legal assistant at an international law firm, July 8, 2013
- SH18 Partner at an international law firm (by phone), July 9, 2013
- SH19 Partner at an international law firm, July 9, 2013
- SH20 Partner at an international law firm, July 9, 2013
- SH21 Partner at an international law firm, July 10, 2013
- SH22 Partner at an international law firm, July 10, 2013
- SH23 Partner at an international law firm, July 11, 2013
- SH24 Partner at an international law firm, July 12, 2013
- SH25 Partner at an international law firm, July 15, 2013
- SH26 Former partner at an international law firm (by phone), July 17, 2013
- SH27 Partner at an international law firm, July 18, 2013
- SH28 Partner at an international law firm (by phone), July 19, 2013
- SH29 Partner at an international law firm, July 19, 2013
- SH30 Partner at Chinese law firm, July 19, 2013
- SH31 Partner at an international law firm, July 22, 2013
- SH32 Partner at an international law firm (by phone), July 24, 2013
- SH33 Partner at an international law firm (by phone), July 24, 2013
- SH34 Partner at an international law firm, July 25, 2013
- SH35 Partner at an international law firm, July 25, 2013
- SH36 Partner at an international law firm, July 26, 2013
- SH37 Partner at an international law firm, July 27, 2013
- SH38 Partner at an international law firm, July 29, 2013
- SH39 Employee at a European consulting firm, July 30, 2013
- SH40 Partner at an international law firm, July 30, 2013
- SH41 Partner at an international law firm, July 31, 2013
- SH42 Partner at an international law firm, July 31, 2013

Bay Area

- BA1 Legal recruiter (by phone), May 13, 2013 (in Chinese)
- BA2 Partner at an international law firm (by phone), May 22, 2013
- BA3 Former partner at an international law firm, May 23, 2013
- BA4 Partner at an international law firm (by phone), September 30, 2013

- BA5 Legal consultant (by phone), October 9, 2013
 BA6 Former partner at an international law firm, October 9, 2013

Hong Kong

- HK1 Partner at an international law firm, May 20, 2014
 HK2 Partner at an international law firm, May 21, 2014
 HK3 Partner at an international law firm, May 21, 2014
 HK4 Legal recruiter (by phone), May 22, 2014
 HK5 Former partner at an international law firm, May 22, 2014
 HK6 Two partners at an international law firm, May 26, 2014
 HK7 Partner at an international law firm, May 26, 2014

APPENDIX 2: METHODOLOGICAL NOTE ON SAMPLING DESIGN

In October 2012, the MoJ published a complete list of all foreign law firms registered in China.⁵⁶ This list included 174 law firms from eighteen countries and we used it as the population base from which we drew a stratified random sample of law firms to interview.

We decided to select interviewees using a probability sampling method for the following two reasons. First, the complete list of international firms officially registered with the Chinese government made random sampling possible. Having the population list also made it possible to calculate the oversampling weight and sampling probability. Second, many basic facts about international law firms in China were unknown. As a result, we wanted to make sure our sample included all types of law firms, so that our research could offer a representative portrait of the market.

First, we stratified the population of 174 firms on five variables: (1) whether the firm was a big firm, based on whether the firm appeared on the AmLaw 100, AmLaw 200, or Global 100 in 2011 (binary); (2) country of origin (eighteen categories); (3) whether the firm had multiple offices in China in 2011 (binary);⁵⁷ (4) whether the firm's earliest registration date with the MOJ fell before 2002 (binary); and (5) whether the firm had an office in Hong Kong in May 2013, according to its website (binary).

The combination of these five variables created forty-eight nonempty strata.⁵⁸ We wanted to ensure that the sample covered every valid stratum. The largest strata included nineteen firms and the smallest included one firm.

Second, we sorted the firms within each stratum in random order using Stata's pseudorandom number generator. Based on that ordering, we assigned each firm a number calculated on the basis of the size of the stratum and the random position of each firm. For example, in a stratum of three firms, after the three firms were ordered randomly, the first firm was assigned with the number 0, the second firm was assigned with the number .333 and the third firm was assigned with the number .667.⁵⁹

56. This was the most up-to-date list published by MoJ when we designed the project.

57. We used both the historical data and the 2011 data to define this variable. Data showed that the distribution of firms with multiple offices in 2011 was comparable with that in the historical data (from 1992 to 2001).

58. A stratum means a type of law firms fit in one combination of the five variables. For instance, a stratum might include big firms from the United Kingdom that had multiple offices in China, registered with MoJ before 2002, and had an office in Hong Kong.

59. The assigned numbers were calculated using the formula: $A = (\text{position} - 1) / \text{stratum size}$. Position referred to the ordered position of each firm within the stratum. Stratum size referred to the number of the firms belonging to the stratum. The assigned numbers were bigger than or equal to 0 and less than 1. The firms in strata that included one firm were assigned a 0.

Finally, we used the assigned number as a threshold value to select sampled firms. Depending on the sample size we wanted, we changed the threshold value from 0 to 1, increasing gradually by steps of .00001. Firms with assigned numbers smaller than the threshold value fell in the sample. We decided that our final sample needed to cover all valid strata and also needed to be at least fifty in order to allow for statistical inference. We took possible attrition (i.e., missing values due to nonresponses) into consideration and decided to draw a random sample of eighty firms to interview. The tremendous advantage of this approach is that we enjoyed flexibility to adjust sample size in the field without comprising the rigorosity of probability sampling.

APPENDIX 3: DESCRIPTIVE STATISTICS OF VARIABLES IN THE REGRESSION ANALYSIS

	Mean	Standard Deviation	Min	Max	Median	N
(1) Lawyers in China	12.51	12.21	2	71	10	49
(2) Years in China	10.71	5.8	2	21	9	49
(3) If have HK office	33%	0.47	0	1	0	49
(4) If US or UK firm	55%	0.5	0	1	1	49
(5) Proportion of offices outside home country	57%	0.24	11%	98%	60%	49
(6) Global 100 firm	44.9%	0.51	0	1	0	49
(7) Percentage Chinese partners	24%	0.33	0	1	0	49

Explanation of Variables

1. Lawyers in China: The total number of lawyers working for an international law firm in Mainland China, drawn from interview data. This count includes associates with a Chinese law degree who suspended their Chinese lawyers' license in order to be eligible to work for a foreign law firm.
2. Years in China: The number of years since the law firm first registered with the MoJ.
3. HK office: Binary variable capturing the presence or absence of a Hong Kong office, as of May 2013.
4. US or UK firm: Binary variable capturing whether the firm is from the United States or the United Kingdom.
5. Proportion of offices outside home country: The number of offices located outside the law firm's home country, divided by the total number of offices globally.
6. Global 100: Binary variable capturing whether the law firm appears on *The American Lawyer's* 2012 list of the top 100 highest revenue global law firms.
7. Percentage Chinese partners: The number of partners with an identifiably Chinese surname, divided by the total number of partners based in Mainland China. Data drawn from firm websites.