INTERNATIONALIZATION OF PROFESSIONAL SERVICE FIRMS

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Recent research on internationalization has pointed to fluctuating degrees of success in maintaining profitability as firms expand from country to country. In this paper we attempt to understand the internationalization-performance relationship in general, with special attention to the dynamic context of professional service firms in particular through illustrations from the legal profession. We integrate aspects of transaction cost economics, the resource-based view of the firm, and organizational learning to understand what it takes for a firm to transfer its competencies from its home to a series of different international markets. Then we propose a framework for viewing how these firms can build their competencies in these contexts, with a view to improving their performance while internationalizing.

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INTRODUCTION

Services, especially those requiring strong local know-how, are among the least global industries. Historically, professional services were delivered locally, and thus most professional service firms were small, local organizations. Technological advances and deregulation in recent generations have enabled the emergence of ever-larger national, and even global, professional service firms (PSF). Not only are these firms geographically diverse, but they are increasingly diversified with respect to the variety of professional specializations offered. Big accounting firms, for example, have diversified their geographical presence and operational scope, moving from auditing to consulting to information technology management. The organizational challenges for firms growing, diversifying, and changing from their traditional forms are obviously substantial. International professional service firms sometimes have to battle the liability of newness along with the liability of foreignness.

We begin this paper with a theoretical framework for understanding various aspects of an effective globalizing professional service firm. We integrate aspects of transaction cost economics (the resource-based view of the firm) and organizational learning to understand what it takes for a firm to transfer its competencies from a national market to an international market.

Services are generally described as being invisible, intangible, non-fungible, ephemeral, non-storable, with a high fixed-to-variable cost ratio, and characterized by simultaneous production-consumption that requires close interactions between producer and user (Hauknes, 2001; Segal-Horn and Dean, 2007). Managerial responses to characteristics like invisibility and intangibility include investing in branding and promoting a reputation, whereas characteristics like non-storability and higher fixed-to-variable cost ratios imply relatively high pressures to sell (Porter, 1980). Consequently, services tend to be highly dynamic industries, competitive, and with intangible resources being the most likely to contribute to successful competition and value creation (Hitt, Bierman, Uhlenbruck and Shimizu, 2006a). International professional services, such as accounting, consulting, and law, are particularly difficult to manage because they embody additional knowledge capital requirements, problems in transferring know-how across organizational and national boundaries, and operations across distinctive institutional and legal systems for which local knowledge is needed.

A number of theories are useful to explain the internationalization of professional business firms. Transaction cost theory argues that because organizations exist to provide a more efficient way (than markets) to conduct business, firms continuously need to strive for efficiencies in order to survive. Efficiencies for internationally expanding firms may come from economies of scale, economies of scope, and experiential knowledge. Larger professional service firms, for example, are more likely to go global because they can achieve
economies of scale and accumulate resources, and experience diminished opportunities in their domestic markets (Alon and McKee, 1999). However, a firm’s ability to succeed in foreign markets requires an overall capability to achieve both revenue and cost benefits. We suggest that this is a set of dynamic capabilities that includes ongoing filtering and learning from new sources of information about clients, competition, costs, and technologies. Experiential knowledge is one of these capabilities that reflect the firm’s capacity to exploit such knowledge in an ongoing and effective way. The firm’s ability to accumulate and exploit these capabilities necessarily varies with its degree of globalization.

While providing examples from various professional service firms to build our model, we draw especially on examples from the internationalization of law firms because they have some unique characteristics identified in the literature that are specific to PSFs (Faulconbridge, 2008; Segal-Horn and Dean, 2007; Morgan and Quack, 2005): (1) law firms are limited in their scale and modes of internationalization, (2) law firms are locally embedded with strongly-rooted institutional legal traditions, (3) to be effective, law firms require specialized knowledge of and connections in the local environment, (4) legal services require a high degree of interaction between producer and consumer, and trust and guarantee of standards of service delivery. However, law firms not only are impacted by local institutions, but also are able to affect local institutions by bringing traditions from other countries, establishing the choice of law, and affecting the development of the legal system. Their growth globally is derived from growth in other business activities, such as finance, M&A, stock markets, international trade and investment across a wide spectrum of internationalizing industries, and the liberalization of the professional business service sectors of national economies. Most law firms internationalize via M&As, licensing, or Greenfield investments. Networks and organic growth typify legal firms’ transnational growth (Morgan and Quack, 2005). Legal firms are moving from international to global and forming integrated-global-network organizations to cope with the new environments: less autonomy at the local level, the rise of professional managers, a shared corporate culture, common technology platforms, knowledge management capabilities, and global human resource management systems (Segal-Horn and Dean, 2007). By focusing on examples from the legal profession, we can derive insights into other PSFs that share the same characteristics (e.g., accounting firms, consulting firms, etc.). Our focus on investigating the link between internationalization and performance in the legal profession is novel, providing a framework for understanding the paths of law firms, as well as other professional business services, toward globalization.

INTERNATIONALIZATION AND PERFORMANCE

Terminology is frequently confusing and overlapping in today’s increasingly boundary-less world. At the firm level of analysis, a global strategy (or, perhaps, globalization) indicates an intent to cover the globe with relatively standardized
offerings (Porter, 1994), typified by global brands like Coke, Microsoft, Toyota, and KPMG. Contractor, Kundu and Hsu (2003) and Sarkar, Cavusgil and Aulakh (1999) use the term "international expansion", Capar and Kotabe (2003) discuss “international diversification”, and Ruigrok and Wagner (2003) talk about "internationalization" to describe similar concepts in which strategic choices are made to commit to foreign markets. For service firms, this strategic choice is often a function of both organizational capabilities on the one hand, and environmental fit on the other (Alon, 2005).

Although firms generally expand internationally with an intention to improve their long-run financial performance, research on diversification in general, (e.g., Graham, Lemmon and Wolf, 2002; Palich, Cardinal and Miller, 2000), and international diversification in particular, (e.g., Brock, Yaffe and Dembovsky, 2006; Kotabe, Srinivasan and Aulakh, 2002; Lu and Beamish, 2004; Ruigrok and Wagner, 2003) has consistently questioned the overall efficacies of these strategies. There is a similar, ongoing debate concerning the effect of internationalization on the performance of services (Capar and Kotabe, 2003). However, very little has been published on knowledge-intensive services. Contractor et al. (2003) include a small sub-sample of knowledge-based firms and Hitt et al.’s (2006a) study of the importance of human and relational capital for internationalization also reports positive linear and negative quadratic internationalization-performance effects among internationalizing US law firms. Brock, Powell and Hinings (2007) also study large law firms and find various quadratic relationships between the degree of internationalization and performance.

These contradictory findings underscore the opportunity costs facing service firms in internationalization: Capar and Kotabe (2003) argue that initial internationalization necessitates investment that causes initial diseconomies of scale, but economies are achievable in the longer run. Their findings support a u-shaped relationship, which suggests an initially negative effect of international expansion on performance before a positive return may be achieved. Hitt et al. (2006a) rely on prior evidence to support their inverted u-shaped internationalization-performance hypothesis, which suggests initial positive returns to international expansion until some optimal level, followed by negative returns. Another recent study on the service sector (Contractor et al., 2003) builds and supports an s-shaped performance-multinationality curve, implying an initial u-shaped effect (economics then diseconomies) followed by decreasing returns. These decreasing returns are associated with highly internationalized firms expanding into peripheral, dispersed markets, areas with large cultural distances and high coordination costs.

This s-shaped curve may be one approach to resolve the contradictory u-shaped versus n-shaped positions. Another explanation to resolve the confusion
may be that the internationalization-performance effect is context-specific; that is, specific to the country or sector studied. For example, Capar and Kotabe’s (2003) sample is drawn from four German service industries (retail/wholesale, utility, IT, and tourism); Contractor et al. (2003) distinguish between capital-intensive and knowledge-intensive services; Ruigrok and Wagner (2003) compare German and US firms; and Matraves and Rodriguez (2005) contrast German and UK firms. Brock et al (2007) find a u-shaped internationalization-profitability relationship among American law firms, as opposed to an inverted u-shape among a small sample of British firms.

Given the confusion in the literature and the importance of the context, a central dilemma emerges: How can we understand and improve the relationship between internationalization and performance for professional business firms? To shed more light on these issues, in the next section we turn to the context of the professional service firm.

THE CONTEXT OF PROFESSIONAL SERVICE FIRMS

The context of the PSFs further highlights these dynamic and competitive issues. Not only are professional services more likely to be customized from country to country to take the local legal and other environmental conditions into account, but also there are minimal economies of scale achievable by centralized production (Løwendahl, 1997). One powerful pull to globalize is from client demand for the service provider to follow them in overseas expansion activities (Rose, 1998). Løwendahl (1997) presents three categories of clients that may benefit from an internationalized PSF, namely (1) global clients that prefer the same service provider in the various country markets in which they do business, (2) local clients that require some globally standardized services, and (3) local clients who simply prefer a global professional service provider for a variety of reasons like perceived quality, global knowledge-sharing opportunities, or personal preferences. So there seems to be some combination of contingent financial rewards and pulls from existing clients that induces PSFs to cross national borders.

On the one hand, the vast majority of professional firms are tiny, comprising perhaps a single professional or a small partnership, and their work is mainly local, be it helping transfer a home from one family to another, preparing tax returns, or designing residential buildings. On the other hand, global PSFs tend to focus more on large corporate or governmental clients, providing services like audits for global firms, designing commercial buildings, and providing investment banking, major litigation, corporate consulting, and transactional law (Brock, 2006; Pinnington and Morris, 2003). These large professional firms are highly competitive and profit-oriented, and they place substantial emphasis on the annual ratings of the firms based on various profitability and growth measures (Cannon, 1997; Carlson, 2004; Denny, 2003, 2004; Flood, 1999).
Between those two extremes, global service firms serving multinational companies and government entities and small “mom-and-pop” professional firms serving local needs, exist medium-sized companies which provide customized and specialized services and are on the cusp of an international expansion that is only available to select industry participants. Medium-sized engineering firms specializing in building theme parks or international business consulting firms specializing in franchising globally are two such examples.

Why do PSFs become global? Apart from the obvious perception that foreign markets present good business opportunities, an important pull to internationalize is from clients who demand that the service provider follow them in overseas expansion activities (Contractor et al., 2003; Rose, 1998). Further, a firm's proven ability to shift its product-market focus (i.e., diversify) is also a defensive foil against possible invasion of its turf by competitors—a proven capability for retaliation against a competitor entering a firm's home turf, or at least a credible threat of a counterattack, is a signal that warns off the threat of new entrants (Porter, 1980). So there seems to be some combination of contingent financial rewards, pulls from existing clients, needs for specialized services in global markets, and deterrence that induces PSFs to cross national borders. With a better understanding of the context of PSFs, we now turn our attention to the theoretical literature upon which we can rely for explanations of internationalization.

**Transaction Costs, Resources, and Organizational Learning**

Hitt, Hoskisson and Kim (1997) show how returns to internationalization are a function of the ability of the firm to structure its overseas operations to reduce transaction costs and expedite information processing, and, over time, to learn to attract and retain the relatively rare resources (like knowledge and experience) that are needed for foreign competitiveness. These premises form the basis for the theoretical framework that follows.

Roberts and Greenwood (1997) argue that organizations exist to provide a more efficient way (than markets) to do business, thus firms continuously need to strive for efficiencies in order to survive. On the one hand, internationalization generally results in increasing transaction costs (Hitt et al., 1997); whereas, on the other hand, an internationally expanding firm may decrease transactions costs in one or more of the following ways:

- Economies of scale: spreading fixed costs over larger output (resulting in lower average production costs);
- Economies of scope: benefits from shared common resources and increased market power (resulting in lower operating expenses); and
• Experiential knowledge: defined by Blomstermo, Eriksson, Lindstrand and Sharma, (2004) as “knowledge about how to internationalize.”

Operational efficiencies are generally more likely to be present in manufacturing and other capital-intensive industries than in services where usually the entire value chain needs to be replicated in each location (Contractor et al., 2003). Katrishen and Scordis find that economies of scale are available to multinational insurers—at least up to a point before diseconomies become a problem for very large organizations—largely by successful integrative and centralizing activities. They recommend that globalizing firms "develop new organizational systems to manage the factors that affect economies of scale" (1998: 320). Experiential knowledge reflects a firm’s ability to tap into its know-how with respect to making smart choices in the process of internationalizing. For example, an experienced firm is more likely to select suitable locations, suppliers, partners, and information systems in foreign locations (Fang, Wade, Delios and Beamish, 2007).

The resource-based view of the firm would see this experiential knowledge as a rare, inimitable, and valuable resource that leads to competitive advantages for the internationalizing firm. Internationalization can be justified if the firm can leverage this capability to achieve some combination of revenue and transaction cost benefits relative to the investment in internationalization. In service firms, the revenue benefits are derived from leveraging the firm’s brand, exclusive offerings, knowledge, experience, the ability to cross-sell, and other capabilities in a foreign market (Grönroos, 2000). Maister (2005) summarizes this set of capabilities as "a track record of being superb." Achieving this on a global scale requires not only services with qualities that are attractive in different markets, but—at a higher level—organizational capabilities that expedite ongoing learning and other transfers of knowledge among the scattered parts of the organization. Barney describes these complex social relations between the firm and its customers as "positive firm reputations"; and the complex, deeply embedded "information processing systems" that expedite the quick flow of large amounts of information, both of which may be sources of sustained competitive advantage (1991: 114-115).

However, a firm’s ability to succeed in internationalization requires an overall capability to achieve both the revenue and cost benefits outlined above. We suggest that this is a set of dynamic capabilities (Eisenhardt and Martin, 2000) that includes ongoing filtering and learning from new sources of information about clients, competition, costs, and technologies. Blomstermo et al. (2004) use the term “experiential knowledge” to include a wide range of accumulated knowledge concerning the firm’s international operations in various markets and the capability to exploit this knowledge in an ongoing and effective way. Hadley
and Wilson (2003) similarly discuss “experiential knowledge” as a key capability for the internationalizing firm. In sum, transaction costs, resources, and learning considerations help us conceive of the dynamic capabilities that a PSF needs for successful globalization. We will show below how a firm's ability to accumulate and exploit these capabilities necessarily varies over the internationalization time spectrum.

A successful global PSF requires two sets of capabilities: First, organizational growth capabilities to build a network of offices and to acquire and integrate the staff. These capabilities are the same for any growing domestic firm. The second set of capabilities includes those global capabilities specific to expanding into foreign markets, such as market selection, managing cross-cultural operations, and political/legal integration. We now turn to a discussion of these two categories: PSF growth capabilities and PSF global capabilities. For each, the capabilities of each category type, we distinguish among issues germane to the early, intermediate, and late (or mature) stages of internationalization.

**GROWTH CAPABILITIES OF PROFESSIONAL SERVICE FIRMS**

**Early growth**

The first step a PSF makes beyond its traditional domain (locality or product line) is to test its legitimacy as it may suffer from a liability of newness (Freeman, Carroll and Hannan, 1983; Singh, Tucker and House, 1986). The liability of newness suggests that newer organizations are at a greater risk of failure than older organizations because they depend on others, have low levels of legitimacy, have loose structures, suffer from the liability of smallness, and are unable to effectively compete (Freeman et al., 1983). Thus, there are significant challenges to the PSF’s marketing and PR functions to convey an appreciation of the firm’s competencies. The firm must learn to deal with growth, both by implementing appropriate business systems and by learning to operate across multiple locations. These points are well illustrated by Segal-Horn and Dean:

> “Whilst you are all … around the [same] table you can organise things, you know what is happening, you can see what letters are coming in and going out. Once it gets to something bigger you have to have proper systems….” (2009: 48).

This quote illustrates how small PSF companies have loose structures, but efficient ways to make decisions that give them added agility in the marketplace.

At this stage we can consider two separate groups of growing firms: those that grow by following clients and those that move unaccompanied to seek out new markets. The former category (PSFs that follow clients) has major advantages during this early phase, not only in the financial sense, but also in the legitimacy gained by association with an established client in the new market. The
early experiential learning may be less intense for those firms with the initial advantage of followed clients, but those PSFs that survive on their own will build better capabilities on which to base future growth success. In a sense, they are tougher and able to take the competition head-on without the cushion of established clients. For example, such a firm is more likely to invest in experiential knowledge relevant to selecting suitable locations, suppliers, partners, and information systems in cities that are remote from its home base.

**Intermediate growth**

To succeed, growing PSFs need the capability to constantly learn about their clients’ needs, develop their client services, and integrate these capabilities across their growing network of clients and professionals. For this growth to be profitable, a contemporary knowledge-intensive service firm needs to "cross-sell" new services to existing clients (Cranston, 2002; Harding, 2002; Jones, 2006; Maister, 1993). In order to achieve these capabilities, expanding PSFs employ a series of integrating mechanisms to enable their professionals—some from newly merged offices—to get to know one another in order to promote the cross-selling of services. An example from practice is cited by Brock et al. (2006: 487):

> “After the recent merger between Reed Smith and Richards Butler, the top managers were quick to stress cross-selling and client referrals. As part of this strategy a senior partner was ‘made responsible for ensuring cross-selling between the firms (Grimshaw, 2006)”.

Apart from setting the overall structure to facilitate integration, successful firms use a combination of communication strategies (Tursi, 2005) and integrative mechanisms to encourage and enable cross-selling. Brock ‘et al. provide the following examples:

> “[A] leading global law firm, in partnership with a prominent Business School, has a series of week-long training programs for its top lawyers. One of the exercises consists of a cycle whereby each participant posts a sheet of paper listing the three or four things for which ‘I need help’ followed by a rotation whereby they go around sticking yellow ‘I can help’ stickers on the original sheets. Another exercise used in-house by the same firm is called ‘speed-dating for lawyers’ that consists of brief, one-on-one sessions for people to describe their practice, their clients, the possible opportunities, and to encourage other participants to respond and to proffer their suggestions and opportunities” (2006: 487).
Other integrative mechanisms suggested by Segal-Horn and Dean (2007) include the creation of common IT platforms, HRM practices, training programs, partner retreats, social events, and secondments as important managerial tools for growing and globalizing law firms.

**Mature growth**

By this stage, the PSF is dominant in its domestic market and it is likely to suffer the diseconomies of scale mentioned by Katrishen and Scordis (1998), especially if it either struggles to wrest clients from established competitors or diversifies into service areas beyond its traditional capabilities. There are managerial and organizational approaches to maintain profitability by exploiting the partnership-professional nexus, including delegating routine work to lower-level employees and manipulating the non-equity partnership ratios (Brock and Yaffe, 2008). Growth-oriented PSFs must deal with both market saturation and intense competition in their respective field. Additional growth typically comes either from expanding markets or from taking market share from incumbents. We now turn our attention to the process of new market development and the internationalization of PSFs, examining the three stages of development.

**GLOBAL CAPABILITIES OF PROFESSIONAL SERVICE FIRMS**

**Early Internationalization**

Just as a growing firm in a domestic context deals with the liability of newness, so does a firm entering a new market have to deal with the liability of foreignness (Hitt, Tihanyi, Miller and Connelly, 2006b; Sherer and Lee, 2002). In their study of experiential knowledge in small internationalizing firms, Michailova and Wilson (2008) remind us that not all founders and managers of internationalizing firms are interested in and engage in learning. They go on to imply that ability and willingness to learn are key success factors for internationalizing small businesses. Human capital and its associated absorptive capacity certainly play a role. Segal-Horn and Dean point out that clients expect a sophisticated and seamless experience across borders, “…the client is saying I want to operate at a level of granularity that makes it the same for me around the world, standardizing things….” (2009: 48).

At this stage we need to distinguish among PSFs that begin in large countries that have multiple business capitals—like Brazil, Germany, India, and the United States—versus those that are born in smaller economies—like most European countries. We use the “multiple business capital” distinction because internationalizing PSFs generally serve governmental and large corporate clients, and these tend to be based in such business capitals. The distinction is relevant because growing PSFs in these large economies generally first build up their growth capabilities domestically, and later internationalize their solid organizational foundations and capabilities. For example, a common pattern among US law firms is first to develop an extensive interstate network of offices
in North America, then to follow established existing clients overseas and/or to cherry-pick lucrative foreign centers of commerce, trade, and governance (Brock, 2006; Rose, 1998). Thus, they are able to commence work immediately for familiar clients and in familiar areas of business operations (such as contracts and trade), allowing them to operate profitability from the start.

PSFs from smaller countries are likely to take their first steps abroad with less experience in geographic (or spatial) diversification in general, with a less critical mass, and thus they are off to a less solid base than their counterparts expanding via the US example provided earlier (Capar and Kotabe, 2003). Therefore, these firms are more likely to find that their initial growth steps are into foreign markets that simultaneously require learning new languages, adapting to foreign law court systems, and managing their offices under localized employment arrangements (Flood, 1999). As Ruigrok and Wagner note, “unlike U.S. firms, German companies have been obligated to pursue culturally unrelated expansion strategies at the outset of foreign expansion” (2003: 78). It is likely that the initial internationalization steps of PSFs from these smaller countries detract from overall firm profitability as the firms must cope with costly investments in what they hope will become a global law firm.

Intermediate internationalization

The fact that that several time zones, cultures, and legal systems may separate existing clients, existing staff, new staff, and prospective clients in the global firm certainly complicates implementation of PSF internationalization strategies. Global integrating mechanisms like a common language can be important (albeit controversial) tools, as illustrated in the following quote about SAP’s struggles to become less German and more global from Dvorak and Abboud:

“… SAP AG hired thousands of programmers in countries such as the U.S. and India. It assigned them to key projects that almost all had been handled from its home base in the small town of Walldorf, Germany. It adopted English for corporate meetings, even in headquarters. SAP recruited hundreds of foreign managers, and non-Germans made up half the company’s top ranks by last year, up from one-third in 2000. The newcomers sought to inject a faster pace and open SAP’s insular culture to more outside influences” (2007: A1).

In general, socialization tactics, like expatriate assignments and exchanges, are effective for the exchange of ideas and the easing of knowledge flows. This is illustrated by the following quote in Segal-Horn and Dean:
“I spent a little while in Italy … but I met all the tax people, I could put names to faces, and if you had a transaction with Italian tax advice, and you’ve got a face in your head, it’s so much easier to pick up the phone and it’s so much easier if you think they’re not quite doing what they should be doing to say to someone if you’ve met them rather than someone you don’t know” (2009: 48).

The importance of having personal contacts and relationships in the host market is underscored here.

Thus, we can identify an intermediate stage of internationalization when the firm has committed substantially to its overseas offices, when about a third of all professionals are based abroad. For those firms that continue to internationalize, we can assume that the initial experience of internationalization was positive and that the firm can now use this experience to continue to expand into attractive markets. Perlmutter (1969) calls this the “polycentric” phase, wherein the firm begins to identify with the foreign markets in which it now operates. On the one hand, advantages of scale and scope—such as reputation, host country support, extension of product life cycles, and overseas know-how—become available and contribute to continued profitability during this phase (Contractor et al., 2003). On the other hand, the polycentric firm obviously cannot rely only on following a constant flow of home country clients, and thus it needs to compete for overseas clients in foreign countries—and this competition generally drives down margins. Some of the capabilities that initially served the firm well in its growth phase may no longer fit. For example, the information systems may no longer be adequate and the organizational capabilities may be strained by greater distances. Additional investment is also likely to be required for offices and other infrastructure.

**Mature internationalization**

The final phase would be when the firm reaches high levels of internationalization, whereby more than half its professionals are outside the home country. The firm has evolved away from its home country orientation to be truly multinational or “geocentric” (Perlmutter, 1969). However, the relatively simple organization structure and infrastructure that served the firm when it was primarily located in its home base, necessarily need to be replaced by more complex systems to cope with the myriad legal, cultural, tax, and geographic contexts in which it operates. At this stage, the firm would have to invest in separate international management, IT, and control infrastructure, often with regional administrative offices overseas as well. Katrishen and Scordis (1998) suggest that diseconomies of scale may plague large service firms. Perlmutter (1969) identifies further costs associated with communication, travel, education, and decision-making time. Contractor et al. suggest that knowledge-intensive
firms can easily over-expand into suboptimal peripheral markets characterized by cultural distance and increasing coordination costs (2003: 16). Together, these three phases of internationalization-performance describe the $\cap$-shaped (or inverted u-shaped) relationship discussed earlier. Support for this inverted u-shaped relationship is provided by Hitt et al. (2006a) in their study of 72 US law firms between 1992 and 1999.

For those (relatively few) small-country firms that survive the initial steps of entering foreign markets, the benefits of internationalization are likely to accrue once they become more polycentric and can capitalize on their hard-earned experience, reputation, organization, information systems, and other capabilities as regional or global law firms, for example. These advantages are more likely to continue in their geocentric phase, as they find that European unity presents opportunities to enter several additional “foreign” markets with minimal additional investment and building of existing managerial capabilities. This is very much the story behind four of the ten largest law firms in the world: Clifford Chance, Freshfields, Linklaters, and Allen & Overy. All four originated in London, but now are in about 20 countries, with some 50 percent of their lawyers outside the UK. In fact, on average, UK law firms are more international than American firms. Support for these ideas comes from Capar and Kotabe (2003) who find a u-shaped internationalization-performance relationship among German service firms; and from Ruigrok and Wagner (2003) who conclude that the internationalization-performance relationship may be U-shaped for German firms and $\cap$-shaped for US firms, as the former tend to diversify early into unrelated markets (which hurt returns), whereas Americans opt for related markets early-on (which helps returns) and later move farther away from home. Analyzing the organizational structural changes needed for effective global PSFs, Aharoni states “firms need to develop capabilities faster than their rivals” (1999: 38) recognizing and absorbing knowledge, perhaps using strategic alliances as opportunities to learn.

**DISCUSSION AND CONCLUSIONS**

We discussed two liabilities associated with growth and internationalization, i.e., the liability of newness and the liability of foreignness. These two liabilities can form the basis for two key dimensions associated with a growing and internationalizing PSF. That is, we can construct a pathway that captures the time dimension of growth and internationalization (see Figure 1).

The size of the home country has been determined to have an impact on the context of the internationalizing PSF and the internationalization-performance results. It seems as though firms residing in small countries face intermediate internationalization prior to facing intermediate growth (or scale) because their home country potential is scant and growth can only be achieved by going global. These firms will face a strong liability of foreignness and their ability to adapt will
influence their ability to grow. Negative profitability following internationalization is associated with such a process. Over time, if the firm succeeds in entering the new market and in addition captures the local knowledge, it is well positioned for growth globally. In contrast, a PSF from a large country does not need to contend with internationalization until it has exhausted the large domestic market potential. This domestic growth enables the firm to devote resources to international expansion and to leverage its domestic market power, brand, and know-how to operate across various locations. PSFs in large countries thus first face a strong liability of newness and if they succeed against the competition, then internationalization will follow. This has been demonstrated for professional service firms utilizing franchising (Alon and McKee, 1999), where the number of outlets is the key determinant of global expansion.

![Figure 1: Paths of Internationalizing PSFs](image)

The resources and capabilities of growing and internationalizing PSFs are key to the development of globally competitive firms. The firm’s ability to learn through experience and to integrate this learning with its know-how repertoire is key to overcoming both the liability of newness and the liability of foreignness. The essence is what needs to be learned. On the one hand, firms with room to develop in the domestic market need to develop capabilities to grow, to develop processes and structures to support this growth, and to invest in intelligence
systems that make them more productive and efficient. On the other hand, if the domestic market is small and internationalization is a necessity, the PSF needs to develop capabilities to manage foreign locations, deal with the cultural distance, take on more political and economic risks, and develop information systems to monitor the environment and respond to changes. International alliances can reduce risks, infuse local know-how, and accelerate growth, but they are laced with misunderstandings and conflicts among partners.

At what point a PSF makes an international expansion decision should it want to accelerate growth depends on the context of the PSF. The size of the home market is only one variable. Certainly, host market factors are also important in attracting PSFs and in creating new competitors/potential partners. Although not discussed in detail in this article, we have alluded to cultural similarities, host country support, product life cycle, and others. Future research should continue to explore the role of the context of the internationalizing PSFs so that we can better understand the internationalization-performance dimension, along with other strategic implications.

Although our model is intended to explain the internationalization of PSFs in general and law firms in particular, it may also have some explanatory power for manufacturing and other service firms. Because of the unique characteristics of PSFs and law firms, as noted in the introduction, and because this model was developed in the context of these unique characteristics, the propositions in our learning and growing globally model need to be tested. In general, further empirical validation is needed to examine differences in the international growth of PSFs and non-PSF service firms, providing insights into how PSF characteristics affect internationalization. Non-linear and categorical techniques may be needed to properly test the relations between internationalization and performance.

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