

Foreign law firms in China: the role of relationships and networks

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Abstract

Despite the growing role of law firms in the economic system and the increasing international scale of their activities, thus far very limited research has been conducted on global law firms' market entry and development process in emerging markets. The main objective of this paper is to contribute to fill this gap providing empirical evidence on the market entry and further development process of global law firms in leading emerging markets. To achieve this goal this paper examines the “embedding process” of main Italian law firms in the Chinese market. In order to frame the empirical analysis this paper adopts the business network model of internationalization processes, as recently proposed as a revision of the Uppsala model. The research methodology is qualitative and is based on the development of five case-studies of leading Italian law firms active in the Chinese market. Preliminary findings highlight, as the business network model underlines, the role of networks in the selection of the foreign market and in the implementation of the presence in China by Italian law firms. In this respect, learning processes play a relevant role in the “embedding process” in terms of accumulation of experience and acquisition of contextual knowledge. Preliminary empirical results show also the relevance of the adoption of ad hoc internal organizational mechanisms to strengthen the commitment to relationships with customers and partners.

Keywords: internationalization process, professional services, relationships, networks, China

INTRODUCTION

Over the last two decades law firms have gained a major role as actors in the business environment, particularly in advanced countries leading towards service-based economic systems (Empson, 2007). Competition in the legal sector is further increased due to the international expansion of major law firms willing to follow their main customers abroad or to tap into new foreign clients. Some law firms have significantly increased their size and established a global presence through the setting up of subsidiaries and offices world-wide, pursuing higher organizational integration of their activities (Spar, 1997; Lowendhal, 2000; Hitt *et al.*, 2007; Segal-Horn, Dean, 2009). This pattern is pushing global law firms to pursue organizational configurations allowing for coordinating a wide network of internal units and external partners. However, despite their growing role in the economic system and the increasing international scale of their activities, thus far very limited research has been conducted on global law firms' market entry and development process in emerging markets (Freeman *et al.*, 2007), which have become the main engines of supply and demand of goods and services, attracting leading multinational companies.

Therefore the main objective of this paper is to contribute to fill this gap providing empirical evidence on the market entry and further development process of global law firms in leading emerging markets. To achieve this goal this paper examines the "embedding process" of main Italian law firms in the Chinese market.

The reason to conduct this study is twofold. Firstly, in the last decade leading Italian law firms have been competing with global law firms in the domestic and international markets, following their customers and setting up subsidiaries and alliances abroad with other major law firms (Visconti, 2009). Therefore they represent an interesting context to be investigated with regard to the behavior of globally-oriented Western law firms. Secondly, China is the leading emerging market and is opening up gradually to foreign companies providing services. However, it is a very complex context in the light of the wide variety of economic, social, cultural and institutional conditions shaping the performance of foreign firms active locally (Child, 2001). Since the starting of economic reform and opening the Chinese legal system have been revised and strengthened to comply with the international requirements, mainly within the World Trade Organization, even though the establishment of new economic rules has been depending on cultural acceptance and enforcement by government authorities (Potter, 2007). Notwithstanding its relevance in terms of business development, thus far no academic analysis has been carried out with respect to the behavior of international law firms in China. Therefore China represents a very challenging – for foreign law firms - and stimulating – for management scholars - context to assess the embedding process of globally-oriented law firms.

In order to frame the empirical analysis this paper adopts the business network model of internationalization processes, as recently proposed as a revision of the Uppsala model (Johanson, Vahlne, 2009; 2011). This theoretical approach is considered appropriate for two reasons. Firstly, in the most recent conceptual development it integrates learning processes about foreign markets with the role of networks and relationships as drivers of entry processes showing different paths and speed. Therefore it appears as an adequate tool to investigate the main patterns and the relevant factors shaping the behavior of global law firms setting up activities in China. Secondly, this theoretical framework places emphasis on variables which are closely linked to the specific nature of professional services as highlighted in the literature: knowledge and learning (Lindsay *et al.*, 2003; Faulconbridge, 2007), organizational

development (Segal-Horn, Dean, 2007), networks and relationships (Chang et al., 1998; Coviello, Martin, 1999).

The research methodology is qualitative and is based on a case studies approach, given the exploratory nature of the research questions. The research process is based on the development of five case-studies of leading Italian law firms active in the Chinese market. The paper is structured as follows. The following section discusses the theoretical background of the study. Then the next section develops the research objectives and methodology. The last section provides the main findings and the fifth section outlines final remarks.

THEORETICAL BACKGROUND

The service industry constitutes an important part of the world economy. The process of globalization of the economic system stimulated a strong debate on the process of internationalization of services firms (Buckley et al., 1992; Edvardsson et al., 2003; Coviello, Martin, 1999). In particular, these studies suggest that the internationalization process of services firms have to be analysed with special lenses that should be substantially different from those used for manufacturing companies. This is particularly true in the context knowledge intensive based firms where the challenges faced in the internationalization process assume specific characters. In this stream of studies, the internationalization development of Professional Services Firms (PSFs), such as legal, consultancy, financial firms has received greater attention in the recent years in the light of complexity in knowledge management and organizational development projects. The difficulties in organizational integration have been highlighted with regard to global law firms, often involved in “follow the customer” pattern of internationalisation processes (Segal-Horn, Dean, 2009).

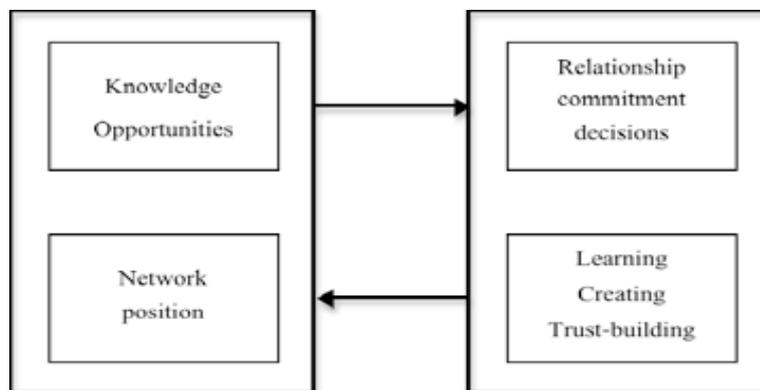
Due to the specific features of the activities carried out by service firms and specifically PSFs, some contributions highlight the main role and importance of relationships in the internationalization process (Lindsay et al., 2003). Other authors argue that classical models of internationalization of the firms - i.e. FDI, stage models of internationalization and network/relationship perspective - are limited in their explanatory power and argue for an integrated approach to the internationalisation of PSFs (Coviello, Martin, 1999; Chetty, Campbell-Hunt, 2004; Freeman et al., 2007).

On the empirical side the process of internationalization of PSFs has been focussed on the Western context, while limited attention has been placed on PSFs expansion in newly emerging markets. Only two studies have been carried out addressing this topic. The first one focuses on the analysis of the way PSFs use existing networks to gain entry into newly emerging markets (Freeman et al., 2007). Three legal, finance and media consulting firms are analysed through their process of entering in the newly emerging markets of Malaysia, Thailand and Vietnam. In this study a main focus is on the role of networks in the foreign market entry strategies of the firms analysed, while less attention is placed on their impact on the process of further internationalization development. The second contribution on PSFs is by Cheung and Leung (2007) on the expansion process in the Chinese market by large international advertising agencies, which in many aspects follows the stage-theory approach proposed by the Uppsala model (Johanson, Vahlne, 1977) of internationalization process. One significant divergence from this theory is that changes in the mode of operating locally have been caused mainly by the behaviour of customer companies rather than by the increasing of market knowledge. Both studies do not adopt an integrated approach to the process of internationalization that effectively addresses the role of relationships and networks in the entry and expansion processes of PSFs in emerging markets.

In our perspective the recent developments of the Uppsala model (Johanson, Vahlne, 2009, 2011) are particularly suited in investigating this almost unexplored area of inquiry. The originally developed Uppsala Model (Johanson, Vahlne, 1977) underlines that internationalization occurs slowly and progressively thanks to the interplay between market knowledge development and commitment. Over the years the model has shown its strength in analysing and explaining internationalization processes of firms in different empirical contexts. However, it has been criticized mostly in the light of changing business contexts and firms' behaviour (Andersen, 1993; Forsgren, 2002).

The point of departure of the recent revision of the Uppsala model is the recognition of such radical change in the sense that *"...Now the business environment is viewed as a web of relationships, a network, rather than as a neoclassical market with many independent suppliers and customers"* (Johanson, Vahlne, 2009; 1). There is a radical change in the perspective adopted that takes into account market-as-relationships and market-as-networks view instead of market-as-geographies in the internationalization process of firms: *"...Internationalization depends on a firm's relationships and network"* (Johanson, Vahlne, 2009; 15). According to Johanson and Vahlne (see Figure 1) firms perceive "opportunities" in foreign markets according to the detained market knowledge and experience. In their perspective relationships and networks with other firms and actors are crucial factors to develop learning and trust-building processes and thus strengthen the knowledge base and the network position while entering and expanding in a foreign market. Therefore the ability of a firm to strengthen its competitive position depends on the degree to which it suffers the "liability of outsidership" with regard to existing relevant networks, which could provide knowledge and market opportunities to those which belong to them or are connected to their actual members.

Figure 1. The business network internationalization process model



Source: Johanson, Vahlne, 2009.

This perspective draws on some assumptions previously elaborated in studies on the importance of relationships in supporting companies in overcoming barriers and obstacles while penetrating foreign markets (Coviello, Munro, 1997), as in the case of suppliers following customers abroad (Majkgård, Sharma, 1998), but with a stronger emphasis on the role of business relationships and networks in the internationalization processes. In this respect the revised Uppsala model comes much closer to the body of literature associated to IMP (Industrial Marketing and Purchasing) group. According to the IMP approach, firms are involved in relationships with suppliers and customers, based on intense interaction processes

involving different types of resources (Håkansson, Snehota, 1995; Ford et al., 2003; Håkansson, Waluszewski, 2007).

In 2011 Johanson and Vahlne strengthen the idea developed in their 2009 paper that markets are better understood as networks. The authors argue that in order to survive in the network and not to suffer from the liability of outsidership, firms need to act in ways favourable to them and their partners. Moreover, the authors explicit call for further research in order to better understand the role of networks and relationships in the internationalization process.

RESEARCH OBJECTIVES AND METHODOLOGY

The main goal of this paper is to provide empirical evidence on the market entry and development process of global law firms in leading emerging markets. Thus this paper sets the following research questions:

- Which is the start-up pattern of foreign law firms in China and which factors have an impact on this process?
- To what extent did foreign law firms undertake the development of their activities in China and which factors had an impact on this process?

The research methodology is qualitative and is based on a case studies approach, given the exploratory nature of the research questions (Eisenhardt, 1989). The research process is based on the development of a selected number of case-studies, whose goal is to show and explain in depth the start-up and development processes in the Chinese market. Therefore the analysis follows a longitudinal multiple case-studies approach that allows to investigate the research questions and the complex nature of the internationalization of the firms under analysis (Aaboen et al., 2012).

Thus the empirical research takes into consideration five law firms based in Italy, which have been selected according to the following criteria:

- size: the five law firms are among the top twenty law firms in the Italian market in terms of number of professionals and total revenues in 2010;
- internationalization experience: all five law firms have been engaged in internationalization processes before starting activities in the Chinese market;
- presence in China: they are active in the Chinese market with a local unit performing activities for customers; the local unit might be a controlled unit or a locally-based partner acting on behalf of the foreign law firm.

The collection of data is in progress. Six interviews have been conducted with lawyers and consultants with deep knowledge of China's legal sector and foreign law firms active in China. Thus far data on selected case studies have been collected through i) desk research on secondary sources, such as press articles, specialized articles from legal press; ii) access to company documents and official web-sites; iii) phone interviews and mail contact with representatives of selected law firms.

EMPIRICAL FINDINGS

This paragraph provides a background of the Italian legal sector and empirical findings concerning the analysis of the start-up and development process of five leading Italian law firms expanding in the Chinese market.

The Italian legal sector

Italian legal sector is characterized by a high number of lawyers and small-size law firms, generating a strong country-wide fragmentation. The level of turnover in 2010 by the main 100 Italian law firms reached 1,906 billion of Euros (Top Legal, 2011). Main 20 law firms represent 57,8% of total turnover and only six law firms have more than 200 lawyers. Italian law firms have been increasingly competing with large global law firms, mainly from US and UK: 11 among top 20 law firms in terms of turnover are subsidiaries of foreign law firms.

Over the last decade the law sector in Italy has been shaped by various factors. Firstly, the Italian government in mid-2000s introduced new regulations with the goal to liberalize this sector and increase competition among law firms. These changes are having an impact on the professional culture in Italian law firms under various dimensions. On the one hand law firms have started to adopt a business/profit profile, thus gradually moving over the traditional way of performing the profession. On the other hand the most dynamic law firms incrementally introduced managerial principles and techniques, pursuing a more strategic approach in the offering of legal services, adopting organizational mechanisms to improve internal coordination and knowledge sharing, and implementing marketing initiatives to promote the image among external stakeholders (Di Tommaso, 2007). This new orientation has been accompanied by the emerging international profile – to various extent – of large, medium and small law firms, targeting Italian and foreign customer companies and investors operating in main financial and political centres (London, Bruxelles, Paris, New York) and in emerging markets, such as Russia, India, China (Visconti, 2009).

The start-up process

All five law firms established activities in China in recent years, between 2007 and 2010 (Table 1). The main driving factor behind the launch of Chinese operations was the willingness to follow existing Italian and European customers exporting in China or taking roots locally through the establishment of production and commercial units. Italian manufacturing and services companies expanded their activities in China only recently and later than their other Western and European competitors (Orlandi, Prodi, 2006), and this could partially explain why Italian law firms only the last few years have established their presence in China. Two law firms – Beta and Delta – set up their activities in China being aware of the market opportunities provided by potential Chinese customers willing to expand their activities in Europe and Italy.

In terms of commitment to Chinese operations in the start-up process four over five law firms started their activities through cooperative relationships with local law firms. In the case of Epsilon the presence in China followed the merger with another major Italian law firm already very active in a partnership with a major Chinese law firm since 2007. The preference for agreements with local partners was due to two main factors. Firstly, Chinese regulations restrict the type of activities which could be performed by foreign-controlled law offices. Chinese law requires a complex approval process to set up an office in China. Moreover, foreign lawyers are allowed to provide only legal consultancy and cannot represent their customers within a judicial procedure; thus they are obliged to rely on local law firms for this type of legal activities. Only in a few exceptional cases foreign law firms have been granted the license to fully operate within the Chinese legal system, after showing long-standing commitment and developing intense relationships with Chinese legal authorities. Secondly, local law firms were perceived as the best providers of technical knowledge and networking capabilities in the various economic and industrial hubs emerging in China's provinces. The

development of trust-based relationships with a local law firms allowed for gaining access to their network of partners based in other main Chinese towns and provinces. Beta instead chose to establish a Representative Office as entry mode to gain a stable and visible foothold in the Chinese market.

Table 1. Start-up process

| | |
|----------------|---|
| Alpha | <ul style="list-style-type: none"> • Following Italian clients • Informal agreements with local law firms • Informal cooperation with Italian consulting and services companies • Wait-and-see approach |
| Beta | <ul style="list-style-type: none"> • Following Italian clients and searching Chinese clients • Set up of a Representative Office (RO) • Hiring of specialized lawyers |
| Gamma | <ul style="list-style-type: none"> • Following Italian clients • Informal agreements with local law firms • Organisational commitment at HQ (China Desk) • Hiring of specialized lawyers |
| Delta | <ul style="list-style-type: none"> • Focus on Italian and Chinese clients • Agreement with a local law firm • Organisational commitment at HQ (coordination) and in China (China desk) • Hiring of specialized lawyers |
| Epsilon | <ul style="list-style-type: none"> • Focus on Italian customers • Merger with a law firm partnering in an agreement with a local firm in China • Organisational commitment at HQ (China Desk) • Hiring of specialized lawyers |

The launch of Chinese operations has been characterized by organizational commitment for four over five law firms. Alpha adopted a wait-and-see approach caused by the effects of the economic and financial crisis started in 2007, while setting up informal cooperation in Italy with other services and consulting firms active in China-related business projects. Beta, Gamma, Delta and Epsilon developed *ad hoc* organizational mechanisms in both Italy and China for the management of existing relationships with clients and local partners in China. A main tool has been the establishment of a “China desk”, a unit in charge of collecting China-related knowledge and of setting up relationships with both customers and relevant business and institutional actors operating in the Chinese market. A common feature among the four law firms has been the focus on hiring of lawyers with extensive experience in China to fill the gap in market-specific competences. These professionals could guarantee highly needed capabilities and networking skills in the Chinese business environment.

The development process

Over time all five law firms shifted from follow sourcing towards market-seeking objectives, thus searching for widening the customer portfolio (Table 2). This is pursued mainly through the establishment of relationships with new Italian and Chinese customers. With regard to the former, Italian law firms aim to provide their services to Italian companies already active in China or willing to expand in this market. However competition has surged in recent years for this type of customers, due to the increasing presence of Italian professionals in China working for Chinese and foreign-invested professional companies. Competition by multinational law firms is very strong in the light of their organizational capabilities and resources allowing them to set up units both in Italy and China.

With regard to Chinese clients, various Italian law firms aimed to play the role of bridge-heads for the Italian and European market, in the light of the growing interest of medium-large Chinese firms in taking roots in Western markets and to acquire valuable technological and organizational knowledge. Thus Chinese firms venturing abroad are considering the involvement of foreign law firms to support their expansion process (Russell, 2010). This option offers a great market potential to Italian law firms. Recently Alpha assisted a Chinese company in the acquisition of a major Italian firm leader in the nautical industry. However this strategy has been difficult to be pursued in the light of the strong competition by global law firms and the propensity of Chinese firms to exploit their own existing business and social networks to expand their activities abroad.

A further strategic goal made explicit by the law firms is the willingness to develop intensive and fast learning processes regarding the Chinese market, business culture and legal system. The availability of local units and dedicated personnel operating in the Chinese business environment is perceived as an opportunity for investing in knowledge assets to be exploited, in order to recognize and catch new business chances in the Chinese market.

Table 2. Development process

| | |
|----------------|--|
| Alpha | <ul style="list-style-type: none"> • Focus on Italian and Chinese clients • Formal agreement with “Best friends” • Organisational coordination at HQ (China Desk) • Hiring of specialized lawyers |
| Beta | <ul style="list-style-type: none"> • Focus on Italian, Chinese and Asian clients abroad • Opening of two new ROs and acquisition of two existing professional services firms • Turnover of personnel and hiring of specialized professionals |
| Gamma | <ul style="list-style-type: none"> • Focus on Italian and Chinese clients • Commitment of internal human resources, hiring of specialized lawyers, secondment in China |
| Delta | <ul style="list-style-type: none"> • Focus on Italian and Chinese clients • Opening of a RO in China and organizational commitment at HQ • Turnover of personnel in Italy, hiring of specialized lawyers in Italy and China |
| Epsilon | <ul style="list-style-type: none"> • Focus on Italian customers • Establishment of a RO in Beijing in 2009 and in Shanghai in 2010 • Informal agreements with local firms and establishment of a Unit in Beijing in 2011 in cooperation with Italian CSR Consulting firm • Turnover of personnel in Italy, hiring of specialized lawyers |

The pursue of these new opportunities has been based on a renewed organizational commitment both in Italy and China. Alpha, Beta, Delta and Epsilon upgraded their activities in China shortly after their start-up phase. Alpha strengthened its indirect presence through the partnerships with its international “best friends” opening their office in main Chinese cities. This allowed its customers to receive assistance from highly skilled teams of international lawyers. In the meanwhile, Alpha developed a partnership in Italy with the main bilateral private-based institution promoting business cooperation between Italy and China.

Beta confirmed its propensity to invest in direct presence integrating the activities of two foreign law firms with longstanding experience in China and Asia and setting up two new representative offices, thus widening its network of units operating locally.

Delta combined a new representative office with the recently signed agreement with a main local law firm. Setting up a local unit and an alliance with a local partner allowed for the involvement in projects of young Italian and Chinese lawyers, which over time could take higher operational responsibility in China or in Italy.

Epsilon set up a RO in Beijing and then in Shanghai in addition to the informal agreements set up with local law firms and to a new collaborative agreement with an Italian consulting firm operating in China. These new steps have been implemented through the involvement of newly appointed Italian lawyers – senior and junior - in its Chinese units.

One relevant factor shaping the behavior of law firms was the requirement of a three years period before opening a new representative office. This might help to explain the slow embeddedness process by Italian law firms in the Chinese market.

Gamma is the only law firm not setting up a controlled unit. It opted for strengthening a partnership with a major Chinese law firm.

All five law firms deemed necessary to further strengthen the organization of China-related operations at their headquarters, in order to improve coordination of business and institutional relationships in Italy and China. This priority has been pursued shifting internal human resources, also among senior lawyers, to China-related projects and involving both experienced and young new lawyers with Chinese market and specific knowledge. All law firms have attempted to tap into lawyers with sound knowledge of China's legal and business environment and with full language proficiency, in order to take responsibility in full autonomy of customer needs. The search for new professionals concerned both Italian and Chinese lawyers, hired for positions both in Italy and China. Four over five law firms involved also leading Italian academic experts with specialized knowledge of Chinese law.

The purpose of such approach has been twofold: to upgrade the level of assistance to Italian firms pursuing business projects in China and to support Chinese companies interested in penetrating the European market. Within this scenario the strengthening of human resources has become a complex task in the light of the upsurge in demand of qualified lawyers and staff with China-related knowledge. Thus increasing human resources turnover and mobility – also among law firms under analysis - have become a main concern for all five law firms.

FINAL REMARKS

The objective of this paper is to provide insights over the expansion process of foreign law firms in China through the analysis of the behavior of main Italian law firms having a stable presence in China. The research effort presented in this paper focused on the analysis of five case-studies of main Italian law firms. This work has many limitations in the light of the preliminary stage of the research process. However, results obtained thus far allow for developing some reflections.

The empirical analysis points out a variety of paths implemented by foreign law firms under examination: some law firms followed an incremental approach, while other law firms implement an “accelerated” process mainly through acquisitions of locally based foreign law firms and hiring of specialized lawyers. This preliminary evidence confirms the argument by Uppsala revised model that internationalization processes vary according to the heterogeneity of firm resources in terms of perceived opportunities, involvement in networks and relationships, commitment and learning processes.

It is apparent that China is becoming for selected law firms a strategic market. Leading Italian-owned law firms in a short period of time established a stable organizational setting to guarantee a position in the market and exploit business opportunities within the Chinese market and along the Italy-China economic and business relations. The most striking aspect is the growing relevance of Chinese customers interested in developing business projects in Europe. Law firms are aware that this opportunity could be exploited by devoting resources to develop effective relationships with Chinese counterparts within their business and institutional environment. Moreover, preliminary evidence seem to underscore the increasing

value of a stable presence in order to speed up learning about the Chinese business system and culture and to further develop of a wide network of collaborative relationship with local partners.

Secondly, Italian law firms displayed their commitment to develop their presence in China through a variety of direct and indirect entry modes. Formal and informal agreements, set up of controlled units are implemented to gain a foothold in the local market. For example, Alpha exploited its existing network resources – global “best friends” - to penetrate further in the Chinese market. Italian law firms’ objective of increasing embeddedness within the Chinese business environment has been achieved placing emphasis on *ad hoc* organizational measures in order to improve their ability to accumulate specialized knowledge, to strengthen the coordination of China-related activities and to enhance the interaction with customers and partners active in China. All selected law firms adopted a multilevel system to coordinate projects and activities in China, establishing positions at the headquarter, country and office level. Four over five law firms set up a China desk within the HQ offices in Italy or in China to coordinate and implement projects concerning customers active in China. A related organizational solution is the secondment of professional staff within the organizational structure of the local partner active in China, allowing to provide legal services through a direct interaction between its professional staff and customers in China and to increase the level of knowledge about the local market, business practices and regulations.

Lastly, Italian law firms development process seems to be shaped by the ability to involve highly qualified professionals with strong competences concerning the Chinese business and legal context. In a few cases the upgrading of China-related activities and business relationships is the immediate outcome of the involvement of experts with a strong international and China-related background and reputation.

Therefore preliminary findings highlight, as the business network model underlines (Johanson, Vahlne, 2009; 2011), the role of networks in the selection of the foreign market – in a “follow the customer” pattern - and in the implementation of the presence in China by Italian law firms, which involve local partners and their network of relationships to gain access to local knowledge and to offer customers specialized and competitive services. In this respect, learning processes play a relevant role in the “embedding process” in terms of accumulation of experience, in combination with the exploitation of specialized knowledge and competences detained by organizations, involved in acquisitions, and by qualified lawyers, hired to cover strategic positions at the HQ in Italy or in China offices.

Preliminary empirical results show the relevance of the adoption of *ad hoc* internal organizational mechanisms to strengthen the commitment to relationships with customers and partners. This calls for a deeper theoretical and empirical effort in the analysis of “relational capabilities” within service firms and specifically in professional services firms. The concept of relational capabilities is increasingly debated and adopted to foster knowledge on the development of collaborative capabilities by firms highly involved in networks of alliances and relationships with other companies and organizations (Heimeriks, 2004; Goerzen, 2005; Pagano, 2009). The examination of the evolution and upgrading of relational capabilities by law firms is considered a valuable research path to be implemented in order to improve the understanding of whether and how law firms are attempting to foster their organizational capabilities, while expanding internationally their network of vertical and horizontal relationships.

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